

Insolvent trading and liability for shadow / de facto directors

Overview

In the recent case of *Featherstone v D J Hambleton as liquidator of Ashala Pty Ltd* (Featherstone Case), the Queensland Court of Appeal considered the circumstances in which a shadow/de facto director may be caught under the insolvent trading provisions of the Corporations Act 2001. Section 588G of the Act deals with the liability of directors for insolvent trading by their company, which not only applies to directors, but also to any employee determined to be a 'director' of a company when the company incurs the debt.

The Featherstone Case serves as an important reminder that the insolvent trading liabilities applicable to directors are equally relevant to employees acting in the capacity of a director, even if they have not been formally appointed as such (ie. shadow/de facto director). The Featherstone Case confirmed that in order to determine whether an employee can be classified as a shadow/de facto director, the Court will look beyond an employee's title and consider factors such as:

- the conduct of the employee;
- the functions performed by the employee and whether these were at a level expected of a director; and
- the influence and control the employee exercised over the other directors of the company.

Featherstone Case

Darrell Featherstone was the former director of Ashala and two related companies. He was a director of Ashala between March 2004 and October 2005 and again between November 2005 and December 2005. In October 2005, it was agreed that Mr Featherstone would transfer his shares in Ashala and the related companies to Kristy Marks, and that Ms Marks would replace him as the sole director in each of the three companies. This agreement was recorded in a letter and the Australian Securities and Investments Commission (ASIC) was notified that Ms Marks had replaced Mr Featherstone as the director in October 2005. Ms Marks was recorded as a director of Ashala up to August 2010. In March 2010, Mr Malcom Marshall was recorded as a director of Ashala.

In July 2007 Mr Featherstone was employed by Ashala as the training and events co-ordinator. The terms of his employment specified that Mr Featherstone would have '*no responsibility or rights or powers as a director, secretary, officer or manager of the company*' and that he would not '*be involved in any decisions that substantially affect the operation of Ashala*'. It is relevant to also note that it was recorded in the agreement that Ms Marks may seek advice from Mr Featherstone from time to time.

During the period of June 2008 to September 2010, Ashala incurred debts which were primarily tax debts, totalling approximately \$200,000. At no time during this period was Mr Featherstone formally recorded as a director. The debt resulted in the appointment of the respondent, Mr David Hambleton, as administrator of Ashala in September 2010 and then as liquidator in October 2010.

District Court Proceedings

Proceedings were initially commenced by Mr Hambleton against Mr Featherstone in the District Court. Mr Hambleton sought orders that Mr Featherstone be required to pay the debt pursuant to the insolvent trading provisions of the Act. The District Court ruled in favour of Mr Hambleton finding that despite the fact Mr Featherstone was not recorded as a director on the company register, he acted in the capacity of a director and as such was a shadow/de facto director at the time the debt was incurred. The primary judge found that the employment letter and the agreement letter *'were nothing more than attempts to create self-serving evidence in the event that the respondent was sued as a consequence of his involvement'* with Ashala and the related companies. The District Court ruled that Mr Featherstone was therefore liable to pay the debt.

Court of Appeal proceedings

Mr Featherstone unsuccessfully appealed the judgment of the District Court. The Court of Appeal upheld the ruling of the District Court, finding that Mr Featherstone was acting in the capacity of a shadow/de facto director during the time in which the Debt was incurred and as such was liable under the insolvent trading provisions of the Act.

The Court of Appeal relied on the following facts in its judgment:

- evidence was put forward by Mr Marshall that Mr Featherstone had the ultimate say over the operation of Ashala and that all actions and decisions in respect of the business required his consent;
- during the course of his examination before the primary Judge, Mr Featherstone admitted that he virtually ran Ashala, being involved in any decisions relating to Ashala, overseeing the day to day affairs of Ashala and attending Ashala's premises on any day he was in Brisbane;
- evidence submitted by Mr Featherstone, that it was agreed between him and Ms Marks that the shares in Ashala (and the related companies) would be transferred to her on the basis that she would only hold them on trust for him;
- evidence submitted by Mr Featherstone, that in relation to one of Ashala's related companies, it was understood between Ms Marks and Mr Featherstone that Ms Marks would operate subject to Mr Featherstone's direction. The Court of Appeal was of the view that there was no reason to think that he held a different view in relation to Ashala and it was likely that Ms Marks was acting subject to Mr Featherstone's direction in relation to Ashala;
- evidence submitted by Mr Marshall which suggested that Mr Featherstone had significant control in relation to one of the related companies. Specifically, that Mr Featherstone had vetoed Mr Marshall (who had also become the sole director of the related company) from being the sole signatory on the related company's bank account.

Conclusion

The decision of the Court of Appeal confirms that when considering whether an employee is a shadow/de facto director for the purposes of s588G of the Act, the Courts will not simply look at the structure of a company on paper. Rather, the Courts will consider the overall responsibilities of the employee. Importantly, written agreements and ASIC records will not exonerate an employee from being found liable under the insolvent trading provisions of the Act.

If you have further questions on directors' duties, or for further information, please contact:

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