The Regulation of Shadow Directors

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1 Introduction

There has been increasing concern about the need for effective measures to hold those who exercise a significant degree of actual influence or control over the management of companies accountable for their conduct. The formulation of appropriate mechanisms for doing so is particularly problematic where the influence or control is of an indirect nature.

The concept of a ‘shadow director’ was introduced into English law almost a century ago1 for regulating people who exercise indirect influence or control by giving instructions or directions to a company’s board of directors which the directors are accustomed to obey. Since then several other Commonwealth jurisdictions have also enacted similar specific provisions on shadow directors. South Africa has not followed suit.2 The Companies Act 20083 (‘the 2008 Act’) does, however, introduce the concept of a ‘prescribed officer’. It appears from the draft definition of the term4 and the provisions applicable to it that it may have been intended, at least in part, to address those who act in ways analogous to shadow directors.

I will consider whether there is any need in South African law for introducing express statutory provisions to regulate shadow directors and, if so, the extent to which the new provisions on prescribed officers constitute an appropriate response to that need. English law will be used as a point for reference for a comparative examination of the following more specific issues:

- the ways in which other jurisdictions have defined the concept of a ‘shadow director’ and interpreted and applied that definition;
- the civil duties, liabilities and other consequences that attach to shadow directors, their theoretical basis and their location within the broader legal framework; and
- the extent to which existing rules and principles of South African law

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1 By s 3 of the Companies (Particulars as to Directors) Act 1917 (7&8 Geo 5 c 28).
2 There has also been very little South African commentary on the concept apart from JS McLennan ‘Directors’ Duties and Misapplications of Company Funds’ (1982) 99 SALJ 394; N Locke ‘Shadow Directors: Lessons from Abroad’ (2002) 14 SA Merc LJ 420.
3 The Companies Act 71 of 2008.
4 Section 1 of the 2008 Act defines a ‘prescribed officer’ as ‘the holder of an office, within a company, that has been designated by the Minister in terms of s 66’. A draft definition is contained in reg 45 of the Draft Companies Regulations Pursuant to the Companies Act, 2008 Notice 1664 Government Gazette No 328832 of 22 December 2009. For the full draft definition, see note 108 below.
already provide satisfactory equivalent accountability despite the absence of any express or specific recognition of shadow directors.

I will then argue that in certain respects South African law already provides regulation and accountability equivalent to that provided by English law. There are currently only two types of English statutory provisions that are not present in South African legislation: provisions that require the disclosure of certain information relating to shadow directors in annual financial statements and those that regulate company transactions in which shadow directors have an interest. If the final definition of a ‘prescribed officer’ includes a shadow director, then those statutory ‘gaps’ will be filled once the 2008 Act is in force, and South African statutory regulation of shadow directors will be substantially the same as that in English law. The inclusion of shadow directors within the definition of a ‘prescribed officer’ would, however, also go further than the English statutory regulation by imposing certain statutory fiduciary and other duties on shadow directors. Finally, I will conclude that the issue of whether shadow directors are or should be subject to any fiduciary duties other than those that may be applicable under the 2008 Act is best left to the courts to determine.

2 The Concept of a Shadow Director

2.1 The Definition of a ‘Shadow Director’

The first formal reference to a ‘shadow director’ in English law was in the Companies (Particulars as to Directors) Act 1917, which extended the term ‘director’ to include ‘any person in accordance with whose directions or instructions the directors of a company are accustomed to act’.5 A similar definition was included in subsequent Companies Acts6 and in various other statutes relating to companies.

Section 251(1) of the Companies Act 2006 defines a ‘shadow director’ as ‘a person in accordance with whose directions or instructions the directors of the company are accustomed to act’. There are two express exclusions from the general definition. First, ‘[a] person is not to be regarded as a shadow director by reason only that the directors act on advice given by him a professional capacity’.7 Secondly, a corporate entity is not to be regarded as a shadow director of any of its subsidiary companies for the purposes of certain of the Act’s shadow director provisions8 ‘by reason only that the

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5 Section 3 of the Companies (Particulars as to Directors) Act 1917.
6 For example, s 741(2) of the Companies Act 1985 (c 6) which, unlike the 1917 Act, defined a ‘shadow director’ separately and not as part of the general definition of a ‘director’.
7 Section 251(2) of the Companies Act 2006 (c 46).
8 Section 251(3) of the Companies Act 2006. The shadow director provisions referred to in the exclusion are those contained in Chapter 2 (the general duties of directors); Chapter 4 (transactions requiring members’ approval); and Chapter 6 (contracts with a sole member who is also a director).
directors of the subsidiary are accustomed to act in accordance with its directions or instructions’.9

Other Commonwealth jurisdictions that refer to shadow directors have defined the concept in substantially the same terms as those used in the English Companies Act, although they have incorporated it into their laws in different ways. Whilst English law adopts what may be termed a ‘separatist’ definitional approach by defining a ‘shadow director’ separately from its definition of a ‘director’, Australia and New Zealand have taken an ‘integrated’ approach by including a description of a shadow director within their general definition of a ‘director’.10 As will be suggested later, the difference between these separatist and integrated formulations is significant in the determination of the nature and extent of the legal consequences that flow from a shadow directorship.

2.2 The Interpretation and Application of the Shadow Director Concept

The ‘shadow director’ definition, its constituent elements and its application within particular factual scenarios have been the subject of extensive commentary and an increasing number of high-profile cases before the English courts.11

Earlier judgments interpreted the term relatively narrowly.12 More recent cases have, however, moved towards a wider construction and a more flexible and practical approach.13 This culminated in the judgment of Morritt LJ in

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9 Section 251(3) of the Companies Act 2006.
10 Sections 60(1) and 60(2) of the Australian Corporations Law 2001; s 126 of the New Zealand Companies Act 1993. Section 351(2), as read with s 2, of the Hong Kong Companies Ordinance L.N. 139 of 2008 adopts a similarly separatist, although more indirect or circuitous, approach. Section 351(2) provides:

‘For the purpose of any provision of this Ordinance which provides that an officer of a company who is in default shall be liable to a fine or penalty, “officer who is in default” means any officer of the company, or any person in accordance with whose directions or instructions the directors of the company are accustomed to act, who knowingly and wilfully authorizes or permits the default. . . .’

Shadow directors are thus included within the wider definition of ‘an officer in default’ but not in the definitions of either ‘director’ or ‘officer’. For further discussion of the Hong Kong shadow director provisions, see F Horsey & G Forrai ‘Hong Kong Shadow Directors: Patchwork Provisions or Blanket Protection?’ (1999) Journal of Business Law 84, which describes them as a ‘backdoor approach’.

11 Leading cases include Re Tasbian Ltd (No 3) [1993] BCLC 297 (CA); Re Unisoft Group Ltd (No 3) [1994] 1 BCLC 608; Re Hydrodan (Corby) Ltd [1994] 2 BCLC 180 (ChD); Re PFTZM Ltd (in liquidation) [1995] 2 BCLC 354 (ChD); Re Kaytech International plc; Secretary of State for Trade and Industry v Kaczer & Others [1999] 2 BCLC 351 (CA); Secretary of State for Trade and Industry v Deverell [2001] Ch 340 (CA; Civ Div); Secretary of State for Trade and Industry v Becker [2003] 1 BCLC 555; Ultraframe (UK) Ltd v Fielding [2005] EWHC 1638 (Ch).
12 For example, in Re PFTZM Ltd supra note 11 it was held that a person would not be a shadow director if the directors had any choice as to whether to follow his or her directions or instructions. Other earlier cases that adopted a restrictive approach include Re Unisoft Group Ltd (No 3) supra note 11 at 620, which required evidence that the alleged shadow director had influenced a majority of the board and had been ‘the master controlling a puppet board’.
13 The leading example of this broader construction of the shadow director definition is the Deverell case supra note 11.
Secretary of State for Trade and Industry v Deverell,¹⁴ which laid down the following general principles:¹⁵

- The definition must be construed so as to give effect to the legislative aim of public protection and should not be interpreted strictly merely because it may have quasi-penal consequences.

- Whether any particular communication, whether by words or conduct, should be classed as a direction or instruction must be determined objectively in the light of all the evidence. Advice given in a purely professional capacity is clearly excluded. Other advice given regularly may constitute a direction or instruction in so far as it amounts to an act of guidance. The subjective states of mind, intention and motives of the parties in giving or following the directions or instructions are not conclusive,¹⁶ although evidence of an understanding or expectation of compliance on the part of either the giver or the receiver may be a relevant factor.¹⁷

- It is not necessary for the directions or instructions to cover every matter on which the directors act or the whole ambit of the company’s corporate activities or affairs.¹⁸

- The directors must have been ‘accustomed to act in accordance with the directions and instructions’. This does not mean that they must have been given frequently or over any extended period but only that when they were given, the directors were accustomed to act in accordance with them.¹⁹ There may thus be a period during which instructions or directions are given but the directors are not yet ‘accustomed’ to acting on them.²⁰ The emphasis is on the outcome of the communications and a ‘pattern of compliance’ beyond one occasion.²¹

- It is possible to have a shadow director in relation to a single director company.²² Where the company has more than one director, all or at least a consistent governing majority of them must have been accustomed to following the directions or instructions.²³

- It is not necessary to show that the directors adopted a subservient role, surrendered their discretion, acted as mere puppets, or were under any compulsion²⁴ to obey the directions or instructions, although a relation-
ship of dominance and subservience may be evidence of a shadow directorship.25 A person can be a shadow director even if the board had the capacity to exercise some degree of independent judgment.26

- Despite the use of the term ‘shadow director’, it is not necessary to characterise the person as ‘lurking in the shadows’ or for the latter’s influence to be hidden; a shadow director can operate quite openly.

The essence of the enquiry is thus whether, judged objectively, the directions or instructions concerned were relied and acted upon by the board and carried ‘real influence’27 in relation to the business activities of the company, irrespective of whether there was any expectation that they would be followed. If all the necessary elements are present, any natural or corporate person could be a shadow director, including a company’s holding company28 or other controlling shareholder, a bank29 or a major creditor of a company.30

3 The Consequences of a Shadow Directorship

Most of the provisions in the English Companies Act31 that refer to shadow directors relate to directors’ duties; impose obligations for the disclosure of certain information by or in relation to them;32 or refer to them in the types of transactions that require members’ approval (such as service contracts, substantial property transactions, loans and guarantees for their benefit, and payments for loss of office).33 There are also references to ‘shadow directors’ in the provisions of the Insolvency Act relating to the imposition of wrongful

25 The Deverell case supra note 11 at 376C and 375J.
26 The Supreme Court of South Australia in Harris v S (1976) 2 ACLR 51 at 71 (quoted with approval in Emanuel Management Pty Ltd v Foster’s Brewing Group Ltd [2003] QSC 205 at 259) took a different approach and held that: ‘for any person to be a [shadow] director . . . by virtue of his control of the directors it must be shown . . . that it was his will, and not the independent will of the appointed directors, which determined the resolutions of the board of directors’.
27 See also Re Kaytech, Secretary of State for Trade and Industry v Kaczer supra note 11.
28 Subject to the previously mentioned proviso in s 251(3) of the Companies Act 2006.
29 See, eg, Re Hydrodan (Corby) Ltd supra note 11; Re MC Bacon Ltd (No 1) [1990] BCLC 324 at 325.
30 Re PTZFM Ltd supra note 11; Ex parte Copp [1989] BCLC 13 (ChD) at 21A-C.
31 The provisions in the Companies Act 2006 that refer to shadow directors are: s 156(6), which includes shadow directors as officers for the purposes of the offence of non-compliance with the Act’s s 154 and s 155 requirements regarding the minimum number and nature of directors; s 162(6), which includes shadow directors as officers for the purposes of the offence of non-compliance with the requirements for the keeping of registers of directors; s 170(5), which renders the general duties of directors applicable to shadow directors to the extent to that the corresponding common-law rules and equitable principles on which the duties were based would apply; s 187, which renders the ss 182 duty to declare interests in existing transactions or arrangements applicable to directors, subject to some adaptations; s 223(1), which treats a shadow director as a director for the purposes of the following transactions requiring members’ approval (subject to a proviso in s 223(2) that references in these sections to loss of office as a director do not apply to loss of a person’s status as a shadow director) – ss 188 and 189 on director’s service contracts, ss 190-196 on property transactions, ss 197-214 on loans etc and ss 215-222 on payments for loss of office; s 239 on ratification of directors’ negligence, default, breach of duty or breach of trust; s 260(5), which treats shadow directors as directors for the purposes of Chapter 1 of Part 11 on derivative claims; and s 859.
32 Section 859 as read with the annual return provisions in Part 24 of the Companies Act 2006, which treats shadow directors as directors for the purposes of the Part 24 annual return disclosure requirements.
33 Section 223(1) as read with ss 182 and 187-222 of the Companies Act 2006.
trading liability, the Company Directors’ Disqualification Act 1986 and various other company-related statutes.

Section 170(5) of the Companies Act is particularly relevant. This section is a new addition to the English Companies Act and provides that the general duties of directors set out in ss 171 to 177 (which are the directors’ fiduciary duties and their duty to exercise reasonable care, skill and diligence) ‘apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply’. The effect of this provision is that the English courts have been left with the task of determining the duties and potential liability of shadow directors in terms of the English common law and equity.

3.1 The Theoretical Basis, Nature and Classification of Shadow Directors’ Duties and Liability

There has been relatively little express judicial or academic analysis of the principles governing the duties and liability of shadow directors, their theoretical basis and their classification within the broader framework of the English common law and equity. But it is possible to identify some emerging general principles.

In general, civil liability in English law is classified as either primary or secondary. Primary liability is that imposed on a person in relation to an act or omission that the latter has committed (or that is attributable to that person) that fulfils the relevant requirements for liability for a particular wrong at common law or in equity.

‘Secondary’ liability is imposed on a ‘secondary party’ in relation to a wrong committed by another ‘primary wrongdoer’ against a third-party.
‘claimant’.38 This liability is based on either some relationship between the secondary party and the primary wrongdoer or some participation by the secondary party in the primary wrongdoer’s wrong, or, as Baughen terms them, some ‘relationship or participation link’.39 Once the primary wrongdoer commits a wrong and the requisite relationship or participation link is present, the primary wrongdoer’s liability is attributed to the secondary party, who is then jointly and severally liable for the claimant’s loss. Depending on the type of secondary liability concerned, the attribution will be of either the primary wrongdoer’s actus reus or of the liability to compensate the claimant that flows from it. In either case, the liability is parasitic in that it arises out of, and depends upon, the commission of a wrong by another person.40 It follows that if the primary wrongdoer incurs no liability to the claimant, neither will the secondary party. The difference between secondary and primary liability lies not in the degree of wrongfulness but in the difference in the character or kind of wrong concerned and the nature of the legal obligation owed by each of the wrongdoers to the claimant.41

3.2 The Application of Primary Duties and Liability to Shadow Directors

Several of the cases on the duties and liability of shadow directors have focused on whether shadow directors are fiduciaries and owe primary fiduciary duties to the companies whose directors they influence or control.

Unfortunately, the law governing the recognition of fiduciary relationships and duties generally is, as the court in *Ultraframe (UK) Ltd v Fielding* put it, ‘depressingly unclear’,42 and there are few discernible principles.

There is some Australian authority43 in favour of treating shadow directors as fiduciaries, but it was based on the fact that the Australian Corporations Act 2001 includes shadow directors in its definition of a ‘director’. The application of primary fiduciary duties and liability within the context of separate definitions of shadow directors as in the English legislation is more problematic. The only express description of a shadow director as a fiduciary in an English case44 was in relation to a person who would more accurately be classified as a de facto director, and it can thus be dismissed as laying down any binding general principle.45 There is also one

38 In the shadow director scenario, the primary wrongdoers would be the directors who have become accustomed to act in accordance with the shadow director’s directions or instructions, the shadow director would be the secondary party, and the company would be the third-party claimant.


40 Idem at 546.

41 *Builders Supply Co v McCabe* 366 Pa 322, 326, 77 A 2d 368, 370 (1951); *Mentzer & Rhey, Inc v Ferrari* 532 A 2d 484 (Pa Super 1987).

42 The *Ultraframe* case supra note 11 in par 1285.


44 In *Yukong Line Ltd of Korea v Rendsburg Investments Corporation of Liberia and Others (No 2)* [1998] 1 WLR 294.

45 The *Ultraframe* case supra note 11 in par 1284.
case in which the Court assumed that a person who complies with the statutory definition of a shadow director is one on whom equity will impose the duties of a company director; but it is far outweighed by authority to the contrary.

The general approach of the courts is rather that shadow directors are not in themselves fiduciaries and owe no fiduciary duties to the company whose directors they influence. There appear to be only two exceptions. The first is where the shadow director’s activities ‘go beyond the mere exertion of indirect influence’ and extend to a voluntary assumption of direct control of a company asset. In such cases they, like directors, may be treated as trustees of the asset and as being under a duty to use it only for the benefit of the company, but they would not be subject to any of the other directors’ fiduciary duties. The second exception is where the shadow director exercises so much control over a fiduciary and the latter acts with so little autonomy that the shadow director can be said to have effectively taken it upon himself or herself to act as a fiduciary.

Various reasons have been advanced as justification for the general refusal to apply fiduciary duties to shadow directors. One is that a separatist definitional approach clearly indicates that the legislature did not intend to equate shadow directors to directors for any purpose other than as expressly indicated. If the legislature intended shadow directors to be treated in the same way as directors for fiduciary purposes, it would either follow the Australian integrated approach or expressly state that the directors’ fiduciary duties are equally applicable to shadow directors. Where, however, shadow directors are expressly referred to in only certain provisions, the implication is that they were intended to be subject to those provisions only.

There are also a number of theoretical objections to the recognition of shadow directors as fiduciaries. These are based on various versions of the ‘reliance and vulnerability’ and the ‘voluntary assumption or contractual’ theories of fiduciary relationships. In terms of the ‘reliance and vulnerability’ theory, the essential elements of a fiduciary relationship are the respose of confidence and reliance by the beneficiary in the fiduciary and a...
corresponding vulnerability on the part of the beneficiary that gives rise to a real risk of abuse, exploitation and the taking of improper advantage by the fiduciary. According to the ‘voluntary assumption or contractual’ theory, a fiduciary relationship arises only where a person willingly undertakes or assumes a position of trust, confidence and loyalty in relation to a vulnerable beneficiary who legitimately expects and relies on the maintenance of that trust, confidence and loyalty.

The voluntary assumption and legitimate expectation criteria have found particular favour with the English courts, and there is

‘growing judicial support for the view that a fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relation of trust and confidence. The concept encapsulates a situation where one person is in a relationship with another which gives rise to a legitimate expectation, which equity will recognise, that the fiduciary will not utilise his or her position in such a way which is adverse to the interests of the principal’.55

These criteria are, however, not fulfilled in the shadow director context because the company does not trust, confide in or rely on the shadow director to act in anyone’s interests except his or her own; and the shadow director undertakes no duties or responsibility in consequence of any reliance placed in him or her.56

Another argument against recognising shadow directors as fiduciaries relates to the underlying rationale and purpose of fiduciary obligations. The general function of the fiduciary principle is to ensure that the interests of the beneficiary remain paramount, and to do so prophylactically57 by imposing strict liability and deterring opportunistic breaches by the fiduciary.58 Shadow director liability is different. It does not seek to ensure that the company’s interests remain paramount, but rather to mediate and achieve a balance between the competing interests of the company and the shadow director.

Shadow director liability thus has a rationale different from and more limited than fiduciary liability. It arises from the nature and effects


56 PL Loughlan ‘Liability for Assistance in a Breach of Fiduciary Duty’ (1989) 9 Oxford Journal of Legal Studies 260 at 263. And as stated in the Ultraframe case supra note 11 in par 1280, a shadow director:

‘directs or instructs those who themselves owe a fiduciary duty to the company. . . . He does not thereby assume any obligation of loyalty to the company, and the company does not look to him to promote its interests. Instead, the company continues to look, at all times, to the de facto or de jure directors it has in place. It is against those persons that the company may have a complaint for breach of a fiduciary duty. If the company has a complaint in equity against the “shadow director” this can only be based upon an allegation of dishonest assistance by procuring a breach of fiduciary duty or for knowing receipt of trust property’ (original emphasis).

57 PD Finn ‘The Fiduciary Principle’, paper presented to the International Symposium on Trusts, Equity and Fiduciary Relationships, Faculty of Law, University of Victoria, British Columbia, Canada, Feb 14-17, 1988 at 36, quoted in Loughlan op cit note 56 at 265.

58 If damages were the general award, fiduciaries might be prepared to commit opportunistic breaches in circumstances where their benefits might outweigh their liability for damages.
of the initial fiduciary relationship, namely, the beneficiary’s vulnerability to loss and the third person’s increased opportunities to exploit that vulnerability and bring about the loss. Equity guards that vulnerability and restricts the third person’s ability to exploit those opportunities by its imposition of liability, but it does so, or only ought to do so, only in circumstances where the beneficiary has in fact suffered a loss and the third person has been at fault.59

The argument is thus that the prophylactic purpose and justification that underlie primary fiduciary liability should not dictate the ambit of shadow director liability. Shadow director liability should not be based on strict fiduciary standards of conduct but rather on those that can appropriately be required of secondary parties.60

Similar arguments have been advanced in relation to the different treatment of de facto and shadow directors. The English courts have accepted that, unlike shadow directors, de facto directors are subject to the same fiduciary duties as de jure directors, at least in relation to the functions they perform as directors.61 This raises the question of whether there are, apart from the express reference to de facto directors in the general definition of ‘director’, any reasons for differentiating between de facto and shadow directors. Noonan and Watson argue that there are and that the most significant one is that de facto directors willingly assume the position, functions and appearance of properly appointed de jure directors. Treating them in the same way as de jure directors gives effect to substantive reality and brings form into line with function.62 There is, they argue, no justification for treating shadow directors similarly.

It is debatable, though, whether the indirect nature of a shadow director’s influence and absence of an overt assumption of a relative position or relationship of trust, loyalty and confidence with the company should be afforded such crucial importance as to preclude the recognition of fiduciary duties. Arguably, the ‘substance over form’ principle employed to recognise de facto directors as bound by the duties of directors is also relevant to shadow directors. Although their influence or control may be indirect, it is voluntarily assumed and it is real. As they are by definition required to have influence over the majority of the board, their control over the company is likely to be more extensive than that of a single de facto director. The factual existence of this influence or control implies a corresponding vulnerability on the part of the company. There is also an intuitive sense of unfairness about allowing shadow directors to escape the full range of duties and liability applicable to de jure and de facto directors.63 On the other hand, mere power or control and corresponding vulnerability in themselves have never been recognised as sufficient for the existence of fiduciary relationships or duties.

59 Loughlan op cit note 56 at 261 (original emphasis).
60 Idem at 260-1.
61 The Ultraframe case supra note 11 in par 1255; Secretary of State for Trade and Industry v Tjolle [1998] 1 BCLC 333 at 343; Re Canadian Land Reclaiming and Colonizing Co (1880) LR 14 ChD 660 (CA) at 670.
63 JS McLennan op cit note 2 at 402.
3.3 The Secondary Liability of Shadow Directors

The general refusal by the English courts to classify shadow directors as fiduciaries and as subject to fiduciary duties has focused attention on the common law and equitable grounds for secondary liability.

The English common law recognises secondary liability in tort for ‘joint tortfeasance’ in the form of inducing, procuring or authorising, or acting pursuant to a common design in relation to, a primary wrongdoer’s commission of a tort,64 and for inducing a primary wrongdoer’s breach of contract.65 In equity, secondary liability is imposed for ‘dishonest assistance’66 in a primary wrongdoer’s breach of trust or fiduciary duty and for ‘knowing receipt’67 of property received pursuant to such a breach by a primary wrongdoer.

It is within this secondary liability framework that the courts and commentators have generally sought to locate and confine the potential non-statutory liability of shadow directors. Given the appropriate factual matrix, each of these forms of secondary liability could be applicable.

However, the one most likely to be relevant in shadow director scenarios is equitable secondary liability for dishonest assistance. This liability is imposed on a secondary party who ‘dishonestly assists’68 a primary wrongdoer in committing a breach of trust or fiduciary duty owed by the latter to a third party. It arises regardless of the quality of the primary wrongdoer’s breach, which may be dishonest, negligent or innocent.69 It does, however, require proof of fault on the part of the secondary party. The exact nature of the fault required has been subject to some debate. In Selangor United Rubber Estates Ltd v Craddock70 it was accepted that mere negligent assistance in, or notice of, the primary wrongdoer’s breach would suffice. However, it now appears settled that what is required is some form of dishonesty, and that the test for that dishonesty is primarily an objective one of whether a reasonable person in the same circumstances as the secondary party would have thought the

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67 Barnes v Adly (1873-74) LR 9 Ch App 244; El Ajou v Dollar Land Holdings Plc [1994] BCC 143 at 154; Brown v Bennett [1999] BCC 525 at 530; the Ultraframe case supra note 11 in par 1485.
68 Liability for dishonest assistance is often referred to as ‘constructive trust liability’, although it is not actually constructive trust liability because it does not involve any receipt by the secondary party of trust property belonging to the claimant. Although the confusing and anomalous use of constructive trust terminology in relation to dishonest assistance has been noted by various commentators, it appears to persist. Another term suggested by Thomas J in Markwell Bros Pty Ltd v CPN Diesels Queensland Pty Ltd [1983] QJR 308 at 325 is ‘constructive fiduciary’, although that is also misleading in so far as it suggests that dishonest assistance makes the secondary party a trustee or fiduciary when all it does is make them liable as if they were one.
69 Regal (Hastings) Ltd v Gulliver [1967] 2 AC 134 at 144-5; Boardman v Phipps [1967] 2 AC 46.
70 Selangor United Rubber Estates Ltd v Craddock (No 3) supra note 66 at 1555.
transaction or arrangement concerned to be dishonest. Secondary parties should therefore be recognised as acting with the requisite fault if they either had actual knowledge that they were assisting in a breach of trust or fiduciary duty, or reasonably ought to have known that they were.

The participation link that underpins this liability is the dishonest rendering of assistance in the facilitation or realisation of a primary wrongdoer’s breach of trust or fiduciary duty. It therefore also requires proof that the primary wrongdoer’s breach caused the claimant’s loss and that the secondary party ‘assisted’ that breach, although it is not necessary to show a causal nexus between the secondary party’s fault and the claimant’s loss. ‘Assistance’ requires that the secondary party’s conduct must have facilitated or made the primary wrongdoer’s breach easier in some way. If that conduct had no effect on the implementation or realisation of the primary wrongdoer’s breach, there is no basis on which to hold the secondary party liable. The extent of causative facilitation of the breach that is required is unclear.

Once the two requirements of dishonesty and assistance are met, the secondary party is jointly and severally or ‘co-extensively’ liable with the primary wrongdoer for loss suffered by the claimant in consequence of the primary wrongdoer’s breach as though the secondary party were also a fiduciary. It is not joint liability for the actual breach of trust or fiduciary duty (and cannot be, for the secondary party is not personally bound by any such duty to the claimant) but rather liability for the loss caused by the breach.

In the shadow director context, the directors who obey the shadow director’s directions or instructions would, in doing so, breach the fiduciary duty that they owe to the company to exercise an independent and unfettered discretion. The shadow director, in giving the directions or instructions, may be taken to have assisted in that breach.

\[\text{71 Royal Brunei Airlines Sdn Bhd v Tan supra note 66; Barlow Clowes v Eurotrust International [2006] 1 Lloyd’s Rep 225. Of the more subjective test applied in Twinsectra Ltd v Yardley supra note 66 that required that the transaction or arrangement concerned be dishonest according to reasonable standards of dishonesty and that the secondary party must subjectively have appreciated that fact.}\]

\[\text{72 Loughlan op cit note 56 at 266.}\]

\[\text{73 Brinks Ltd v Abu Saleh (No 3) [1996] CLC 133.}\]

\[\text{74 According to Mance LJ in Grupo Torras SA v Al-Sabah (No 5) [1999] CLC 1469 at 1667: ‘In this context, as in conspiracy, it is inappropriate to become involved in attempts to assess the precise causative significance of the dishonest assistance in respect of either the breach of trust or fiduciary duty or the resulting loss.’}\]

\[\text{A similar approach was taken by Laddie J in Balfron Trustees Ltd v Peterson [2002] Lloyd’s Rep PN 1 at 21 that the secondary party’s liability ‘arises from the fact of the assistance to the primary wrongdoers . . . . It is no answer, either to say that he participated in part of a chain of events all of which led to the breach . . . . or to assert that the breach . . . would probably have occurred without his assistance’.}\]

\[\text{75 Timber Engineering Co v Anderson [1980] 2 NSWLR 488 at 504.}\]

\[\text{76 The Ultraframe case supra note 11 in par 2005.}\]

\[\text{77 The secondary liability does not convert the secondary party into a trustee or fiduciary or subject him or her to the duties of a trustee or fiduciary; it merely renders him or her liable as if he or she were one.}\]

\[\text{78 Boulting v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606 (CA) at 626; Kuwait Asia Bank EC v National Mutual Life Nominees supra note 23; Re Westmid Packing Services Ltd, Secretary of State for Trade and Industry v Griffiths [1998] 2 All ER 124 at 130-1.}\]
3.4 Arguments for and against a Secondary Liability Classification

There are various arguments in favour of classifying shadow director liability as secondary, apart from those based on the theoretical difficulties associated with a primary fiduciary-based classification.

Noonan and Watson, for example, argue that it is important formally to acknowledge the purpose of imposing shadow director liability. That purpose is to deter improper participation in company management and, in doing so, it reflects, reinforces and supports at least two fundamental principles of company law. The first of these is the ‘proper division of powers’ principle that a company’s affairs should be managed by, and only by, its board of directors; and the second is that the directors, when exercising those management powers, should do so independently and without fettering their discretion. It is thus the non-constitutional exercise of corporate control through a usurpation of the management powers and discretion of the board that constitutes the wrong and rationalises the imposition of liability on the shadow director. The formal classification of shadow director liability, and as a form of secondary liability, reflects its true rationale and elevates it from a mere ad hoc statutory intervention to a core principle of company law.

Classifying shadow director liability as secondary liability, and restricting it to that classification, is however also problematic.

Secondary liability only attaches to a secondary party who acts ‘dishonestly’. But fault is not a pre-requisite for recognition of a shadow directorship, and it is thus possible for a person to be classified as a shadow director without proof of any actual fault on their part. The fault requirement for secondary liability will therefore either have to be proved as a separate requirement for liability or deemed to be met in the case of every person who falls within the definition of a shadow director. The more widely the concept of dishonesty is framed, the less problematic it will be. If dishonesty includes situations in which the shadow director ought reasonably to have realised that they were participating in a breach by the directors, it is likely to be relatively easy to prove in most cases. Alternatively, it has been suggested that it can be presumed from the pattern of influence over the directors and need not be specifically proved in any particular instance.

Another difficulty with secondary liability, at least for dishonest assistance, is that it requires ‘assistance’ by the secondary party in the primary wrongdoer’s breach. This implies the need for some causal link between the shadow director’s conduct and the directors’ breach of duty. Whatever the required nature and extent of the link is, it may be difficult to prove in relation to any particular breach by the directors. Again, Noonan and Watson suggest that there

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79 Noonan & Watson op cit note 62.
80 Boulting v Association of Cinematograph, Television and Allied Technicians supra note 78 at 626; Kuwait Asia Bank EC v National Mutual Life Nominees supra note 23 at 187.
81 Noonan & Watson op cit note 62 at 797.
82 Idem at 796.
is (as with the fault requirement) no need to prove the shadow director’s actual participation in any specific breach by the directors, because the requisite participation can be presumed from the history and pattern of influencing the board.83 The broader the range of corporate activities covered by the directions or instructions, the more likely it is that they will have related to at least the general area in which the director breached the duty and the easier it will be to justify such a presumption. But this does not address its potential unfairness in cases where a director acted independently in breaching a fiduciary duty and was not in fact influenced by the shadow director. To require shadow directors to protect themselves against that possibility by acting as watchdogs over the directors may place too onerous a burden on them.

More significantly, a rationalisation of secondary liability only on the basis of a ‘wrongful’ usurpation of the board of directors’ management powers and assistance in their breach of fiduciary duty is too narrow and unduly limits its potential application. If the purpose of the shadow director concept is to identify those who exercise ‘real influence’84 over corporate management and ensure ‘no power without responsibility’,85 then liability should also be recognised as flowing simply from their de facto control or influence, without the need for any link with a director’s breach of duty. A further difficulty is that secondary liability, being remedial in nature, is of relatively limited application. Although it may have some deterrence value, it does not operate prophylactically in the same way as fiduciary duties, which require the fiduciary to act only in the interests of the beneficiary.

4 South African Law

4.1 The Position prior to the Companies Act 2008

Although there have been some suggestions of it,86 there has been no formal or specific recognition of the shadow director concept in South African law. It has been suggested that since shadow directors engage in management (albeit indirectly), they ‘occupy the position of a director’ and therefore fall within the definition of a director as a type of de facto director.87 This rests in an overly strained construction of the ordinary meaning of the definition’s wording and is unlikely to be accepted by the courts.88

83 Idem at 794.
84 The Deveryrell case supra note 11 at 353G.
85 JS McLennan op cit note 2 at 403.
86 There was a description of a shadow director in s 70nov(10) of the Companies Act 46 of 1926 which provided that for the purposes of that section, ‘any person in accordance with whose directions or instructions any director of a company is accustomed to act’ was deemed to be a director of the company. The only current statutory provision that may include a shadow director (if the term ‘control’ is sufficiently widely construed) is s 332(10) of the Criminal Procedure Act 51 of 1977, which provides, in relation to prosecutions of corporations and members of associations, that ‘the word “director” in relation to a corporate body means any person who controls or governs that corporate body.’
87 JS McLennan op cit note 2 at 401-3.
88 Section 1 of the Companies Act 61 of 1973 defines a ‘director’ as including ‘any person occupying the position of director or alternate director of a company, by whatever name he may be designated’. A substantively similar definition is contained in s 1 of the Companies Act 2008. To include a shadow
Despite this absence of express recognition of shadow directors, there are several statutory provisions in relation to wrongful trading and director disqualification that provide protection substantially equivalent to the English provisions.

Thus the reckless or fraudulent trading liability provisions of s 424 of the Companies Act 61 of 1973 apply to ‘any person who is knowingly a party to the carrying on of a company’s business’ either recklessly or fraudulently. The courts have interpreted the section widely and stressed that its liability can attach to any natural or juristic person, even one not a member, director or officer of the company. Being ‘a party to the carrying on of a company’s business’ means to take part in or concur in the carrying on of a company’s business, and is sufficiently wide to include the activities of a shadow director.

In addition, the provisions of the Companies Act 1973 relating to the disqualification of directors allow the courts to disqualify ‘any person’ from being a director and from being concerned or taking part in the management of any company. These provisions are also sufficiently wide to allow for the disqualification of a shadow director. The Companies Act 1973 does not, however, contain provisions equivalent to those in the English Companies Act that require the disclosure of certain information relating to shadow directors in companies’ annual financial statements and those that require members’ approval for transactions in which shadow directors have an interest.

Although South African law does not formally classify liability as being either primary or secondary, its general common-law principles do provide for some liability equivalent to the secondary liability that can be imposed on a shadow director in English law. Whilst our law of delict does not recognise a separate delict of conspiracy, there is some authority for liability for aiding, instigating or authorising a delict and for liability for common design. Liability for interference with a contractual relationship is well established. It is thus arguable that Aquilian liability has developed sufficiently to allow

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[89] Philotex (Pty) Ltd & Others v Snyman & Others; Braitex (Pty) Ltd & Others v Snyman & Others 1998 (2) SA 138 (SCA) at 142; Gordon NO and Rennie NO v Standard Merchant Bank Ltd & Others 1984 (2) SA 519 (C) at 527.

[90] Cooper & Others NNO v SA Mutual Life Assurance Society & Others 2001 (1) SA 967 (SCA); S v Hepker 1973 (1) SA 472 (W) at 484G.


[94] For example, Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Gifwano (Pty) Ltd & Others 1981 (2) SA 173 (T) at 202; Genwest Batteries (Pty) Ltd v Van der Heyden & Others 1991 (1) SA 727 (T) at 729; Aetiology Today CC t/a Somerset Schools v Van Aswegen & Another 1992 (1) SA 807 (W) at 820; Dun and Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau (Cape) (Pty) Ltd 1968 (1) SA 209 (C).
generally for the imposition of liability comparable to that provided by the English law of tort. The equitable principles relating to liability for dishonest receipt of property have been recognised under our common law. The extent to which liability for dishonest assistance in another’s breach of fiduciary duty is also part of our law is less clear. McLennan refers to Rectifier and Communications Systems (Pty) Ltd v Harrison as authority that conspiring in another’s breach of fiduciary duty can give rise to delictual liability. The claim in that case was for the profits that had been made by the second and third defendants through participation in a breach of a fiduciary duty owed by the first defendant to the claimant. The claim was classified by the claimants as delictual. One of the main arguments for this classification was that the claim had to be delictual because it could not be a fiduciary claim. The reason why it could not be a fiduciary claim was that the second and third defendants had no fiduciary relationship with the claimant. That approach misconstrued the real issue, which was whether the second and third defendants should be liable for the claimant’s loss as if (not because) they were fiduciaries. Unfortunately, the Court did not address that issue and thus missed an opportunity to clarify whether our law recognises any equivalent to the English equitable liability for dishonest assistance.

The common-law position on the application of fiduciary duties and liability to those who act as shadow directors is not clear. The South African courts may well adopt an approach similar to that of the English courts in this regard. Like the English courts, ours appear to have accepted that there are exceptional cases where fiduciary duties can be imposed on a non-director who exercises near-absolute control over a company. As stated in Robinson v Randfontein Estates Gold Mining Co Ltd:

‘A man, who procures the election of a board of directors under circumstances which make it impossible for them to exercise an independent judgment, must . . . observe the utmost good faith in his dealings with the company, which he has, of set purpose, deprived of independent advice.’

The approach likely in cases of less-extensive control is difficult to predict. As in English law, there are few clear principles for determining whether particular relationships (such as those between shadow directors and the company whose directors they influence) are fiduciary ones.

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96 Generally, Dun and Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau (Cape) (Pty) Ltd supra; Union Government (Minister of Railways and Harbours) v Warneke 1911 AD 657 at 664-5; Latham & Another v Sher & Another 1974 (4) SA 687 (W) at 694; Zimnat Insurance Co Ltd v Chawanda 1991 (2) SA 825 (ZS) at 829-3.

97 Robinson v Randfontein Estates Gold Mining Co Ltd supra note 52; Liquidators of Cape of Good Hope Bank v De Beers Mines and Danckelsbuhler (1894) 11 SC 441 at 449-50; African Claim and Land Co Ltd v WJ Langermann 1905 TS 494 at 518-22; Davies v Donald 1923 CPD 295; Philipps v Fieldstone Africa (Pty) Ltd & Another [2004] 1 All SA 150 (SCA); Volvo (Southern Africa) (Pty) Ltd v Yssel 2009 (6) SA 531 (SCA).

98 JS McLennan op cit note 2 at 411; Rectifier and Communications Systems (Pty) Ltd v Harrison & Others 1981 (2) SA 283 (C).

99 Robinson v Randfontein Estates Gold Mining Co Ltd supra note 52 at 197.
A broad review of the case law reveals some support for identifying features such as trust, confidence and reliance\(^{100}\) and unequal power and corresponding vulnerability.\(^{101}\) Although fulfilment of the criteria of the voluntary assumption or contractual theory would give rise to fiduciary duties, they are not a necessary pre-requisite for the recognition of a fiduciary relationship in South African law.\(^{102}\) The Supreme Court of Appeal in Volvo (Southern Africa) (Pty) Ltd v Yssel\(^{103}\) recently also referred to a need for 'justified reliance' by the beneficiary on the fiduciary and stated that the essential enquiry is whether, having regard to all the facts, there is a state of affairs 'which impels or induces one party “to relax the care and vigilance it would and should have ordinarily exercised in dealing with a stranger” and to justifiably trust and rely on the other.\(^{104}\) Despite the flexibility of this justified reliance test, it is not clear that it, or any of the other recognised criteria for the identification of fiduciary relationships, will necessarily be fulfilled as between a company and a shadow director.

4.2 The Position under the Companies Act 2008

The provisions of the Companies Act 2008 relating to fraudulent and wrongful trading and director disqualification are substantially the same as those in the Companies Act 1973 and, once enacted, will continue to provide protection comparable with those in the English Companies Act.

The 2008 Act has also introduced the concept of a ‘prescribed officer’ and includes references to it in almost all its provisions relating to directors.\(^{105}\) These include the sections dealing with directors’ duties and liability; the disclosure of directors’ personal interests in company transactions; the need for shareholder consent for certain transactions involving directors; and the information required to be disclosed in annual financial statements.

The 2008 Act left the definition of a ‘prescribed officer’ to be determined by

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100 For example, ibid.
101 For example, Phillips v Fieldstone Africa (Pty) Ltd supra note 97.
102 For example, Volvo (Southern Africa) (Pty) Ltd v Yssel supra note 97 at 537.
103 Volvo (Southern Africa) (Pty) Ltd v Yssel supra note 97.
104 Idem at 537.
105 The sections in the Companies Act 2008 that contain references to ‘prescribed officers’ are s 1 (definition); s 15(6) (obligation to adhere to the company’s constitution); s 20(1)(b) (acts contrary to the company’s constitution or internal procedures); s 30(5)(a) (disclosure of remuneration and benefits in the annual financial statements); s 41 (shareholder approval for share issues to); s 43(5) (ineligibility as trustee of debt instrument trust); s 45 (financial assistance); s 66 (management of the company’s business and affairs); s 69 (ineligibility and disqualification of directors); s 75 (disclosure of personal financial interests); s 76 (standards of directors’ conduct and duties); s 77 (liability for breach of duty); s 78 (indemnification and insurance); s 81 (shareholder applications for a winding-up); s 90 (ineligibility as auditor); s 93 (auditor’s right to require information); s 94(4) (disqualification from audit committee membership); s 96 (exclusions from ‘offers to the public’); s 108 (liability in relation to allotments); s 155 (information in relation to proposed compromises with creditors); s 162 (right to apply for a person to be declared delinquent or on probation); s 163 (oppressive or unfairly prejudicial conduct); s 165 (right to bring a derivative action); and s 169 (investigations). Schedule 3 also amends the definition of an ‘officer’ in s 1 of the Close Corporations Act 69 of 1984 so as to include a ‘prescribed officer’. 
the Minister by regulation. The Draft Companies Regulations, 2010 define the term as including various categories of person who have general or significant direct or indirect executive or managerial authority, influence or control over all or part of a company’s business or activities. Paragraph (e) of the draft definition includes any person who

‘otherwise directly or indirectly exercises, or significantly influences the exercise of control over the general management and administration of the whole or a significant portion of the business and activities of the company, irrespective of any title assigned by the company to an office held by that person, or function performed by that person’.

This definition appears to have been intended to cover those who act as shadow directors.

The draft definition raises various problems. It is framed far too widely and loosely. With regard to paragraph (e) in particular, there is no attempt to define the notion of ‘significant influence’ or qualify the kind of influence required with reference to its regularity, duration, nature, the extent to which it is realised, or in the other ways in which the English definition of a shadow director has been qualified. There are also no exceptions in relation to professional advisors or holding companies, and no indication of whether the definition extends to juristic persons.

Much will depend on the final wording of this definition and how it is subsequently interpreted and applied by the courts. If it does include shadow directors, it will fill the current gap in relation to disclosure of information relating to shadow directors in annual financial statements and the regulation of company transactions in which shadow directors have an interest. It would also have significant implications for the duties and liability of shadow directors.

Section 76 of the 2008 Act lists a number of duties and renders them applicable to all directors, members of board and audit committees and all

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106 Section 1 of the Act defines a ‘prescribed officer’ as ‘the holder of an office, within a company, that has been designated by the Minister in terms of section 66’.
108 The full definition in reg 45 of the Draft Companies Regulations Pursuant to the Companies Act, 2008 provides that:

‘For all purposes of the Act a person is a “prescribed officer” of a company if, despite not being a director of the company, that person—

(a) has general executive authority over the company, (such as a President, Chief Executive Officer, Managing Director, Executive Director or similar office holder) by whatever title the office is designated;

(b) has general responsibility for the financial management of the company (such as a Treasurer, Chief Financial Officer, Chief Accounting Officer, or similar office holder) by whatever title the office is designated;

(c) has general responsibility for the management of the legal affairs of the company (such as a General Secretary, General Counsel or similar office holder) by whatever title the office is designated; or

(d) has general managerial authority over the operations of the company, (such as a Chief Operating Officer or similar office holder) by whatever title the office is designated; or

(e) otherwise directly or indirectly exercises, or significantly influences the exercise of control over the general management and administration of the whole or a significant portion of the business and activities of the company, irrespective of any title assigned by the company to an office held by that person, or function performed by that person.’
prescribed officers. Included in the list are a duty not to gain an unauthorised advantage; a duty to act in good faith and for a proper purpose; a duty to act in the best interests of the company; and a duty to exercise reasonable care, skill and diligence. A person who breaches any of these duties can be held liable ‘in accordance with the principles of the common law’ for any loss, damages or costs sustained by the company as a consequence of the breach.\textsuperscript{109}

If the definition of a prescribed officer does include shadow directors, then the s 76 duties will clearly apply to them. But those duties are not a complete statement of all the common-law fiduciary duties. The question then is whether the common-law fiduciary duties that have no equivalent in s 76 would apply. If shadow directors are not ‘prescribed officers’, the same question applies with regard to all the common-law fiduciary duties. As previously suggested, the courts are likely to follow the approach of the English courts in this regard and generally refuse to recognise shadow directors as being subject to any primary fiduciary duties or liability.\textsuperscript{110}

5. Conclusions

The extent to which shadow director responsibility and accountability is desirable is ultimately a question of policy. There are a number of arguments in its favour. The imposition of liability on those who exercise real control over corporate management responds to current international calls for better corporate governance practices, and does so in a way that correlates legal responsibility and accountability with sufficiently significant actual influence or control. It may also have economic benefits in the form of improved corporate management, and in providing claimants who suffer loss as the result of a shadow director’s influence with an additional defendant to pursue, especially if that additional defendant is one with greater financial resources. Perhaps more compelling is the sense of unfairness about allowing shadow directors to exercise real power and control over companies and yet avoid directors’ duties and responsibilities simply by acting through a number of intermediaries.

Despite the absence of any express or specific reference to ‘shadow directors’, South African law does in many respects already provide satisfactory regulation and accountability comparable to that provided for in English law.

There are already equivalent provisions in relation to fraudulent or wrongful trading and director disqualification under the Companies Act 1973, and these will continue under the 2008 Act. If a prescribed officer includes a shadow director, the 2008 Act will also introduce similar provisions with regard to disclosure of information relating to shadow directors in annual

\textsuperscript{109} Section 77(2) of the Companies Act 2008.

\textsuperscript{110} Apart from the previously discussed exceptional circumstances of actual control over company assets or near absolute control over the company’s board.
financial statements and the regulation of company transactions in which shadow directors are interested.

There is also some scope within existing common-law principles for the imposition of certain kinds of comparable secondary-type liability, although the position in relation to the crucial liability for ‘dishonest assistance’ is limited, unclear and problematic in various respects.

The most difficult issue is whether and to what extent shadow directors are, or may be, subject to fiduciary duties and liability. If a ‘prescribed officer’ does not include a shadow director, the question is whether all or any of the common-law fiduciary duties are or should be applicable. If shadow directors are prescribed officers, the enquiry is limited to those common-law duties that do not have an equivalent in the list of duties set out in s 76 of the 2008 Act.

Subject to s 76 and the extent to which it applies to shadow directors (by virtue of the definition of a ‘prescribed officer’), the courts may well construe the typical shadow director scenario as lacking the characteristics generally accepted as essential for the recognition of a relationship as a fiduciary one at common law. It is arguably not desirable for this to be altered by way of statutory intervention. The common-law fiduciary principles are already unclear and lack a cohesive theoretical basis. The need for a consistent and principled approach to their application and development suggests that it may be preferable to follow the approach of the English Companies Act and leave the issue of their application to shadow directors to the courts.