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Our ref:

Dear Colleagues,

5 February 2015

SMALL BUSINESS, ENTERPRISE AND EMPLOYMENT BILL: SHADOW DIRECTOR DUTIES

I would like to thank you for your contributions during Committee on the application of directors' general duties to shadow directors. I promised to consider the points you made during the debate and write to you setting out my conclusions. I have now had the opportunity to reflect on the debate, and I appreciate your patience in awaiting my response.

Application of directors' general duties to shadow directors

You helpfully set out your concerns with the wording in Clause 86 of the Bill which states:

'The general duties apply to a shadow director of a company where and to the extent that they are capable of so applying.'

I understand that you are concerned that the 'capable' test in this definition will not give courts any flexibility as to which duties apply to shadow directors. This is not the Government's intention.

In light of your concerns, I asked my officials to ask expert stakeholders about their views on this approach, in order to consider this issue anew. These stakeholders do not share your concern. They conclude that the courts will have flexibility to determine whether a duty is 'capable' of applying to an individual shadow director, and if so, whether the duty should be applied as if they were a duly appointed director.

Duty to avoid conflicts of interest

Lord Leigh also raised a concern around the duty to avoid a conflict of interest with regards to bank lending to businesses. I have considered this issue carefully and would like to reassure you that the Bill already has the effect you are seeking.

We consider it unlikely that a court would conclude that a bank exercising control under a contractual lending agreement would be considered a shadow director. Although we

cannot be certain that this will never happen in the future, we are not aware of any reported English cases in which a lender has been found to be a shadow director. The New South Wales Appeal Court did, however, consider this issue in the case of *Buzzle Operations vs Apple* in 2011¹. The Australian definition of shadow director is very similar to the definition in the Companies Act 2006. Here the court found that the restructuring lender was not a shadow director. Being in a position of control was not found to be sufficient to be a shadow director. It is exercising that control that will determine shadow directorship and this will be determined on a case by case basis. Whilst Australian judgments do not bind the courts here, they can be persuasive authorities.

Further, even if we are wrong and the court concluded that a lender acted as a shadow director, the arrangement between the lender and the company the conflict of interest would be permissible through s175(3) of the Companies Act. This states:

'This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company'

This description would cover the arrangement of a lender exercising influence or control under their lending agreement.

Conclusion

The purpose of this clause is to make it clear to potential shadow directors that the same standards of behaviour are expected of duly appointed directors and shadow directors alike. The Government intends to keep a close eye on how the courts interpret this wording. We will consider exercising the powers included in Clause 86(3) to adapt the duties if needed, in light of developments. I therefore do not consider it necessary to amend the Bill or to exercise the powers under Clause 86(3) of the Bill at this time.

I agree that it is important to get this change right, and so I am grateful to you for the time and consideration you have put in to scrutinise this area of the Bill. I hope I have reassured you that the Bill currently achieves the outcomes that we all want. I recognise that this area of Company Law is complicated and rests largely on the facts of each individual case. My officials would therefore be happy to meet with you or other interested parties to discuss this issue in more detail.

I am placing a copy of this letter in the Libraries of both Houses.

Warm regards

Lucy

BARONESS NEVILLE-ROLFE DBE CMG

¹ *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd [2011] NSWCA 109*