

Shadow Directors and De Facto Directors

-Piyush Kumar Jalan*

I Introduction

The affairs of the company are regulated by the Directors. All the transactions of the company are done by the Directors in the name of the company to which the Board of Directors (Every Company shall have a minimum number of three directors in case of public company, two directors in private company and one director in one person company; and a maximum of fifteen directors in its Board of Directors. Only individual can be appointed as Directors. A company may appoint more than fifteen directors after passing a special resolution. Prescribed class or classes of company shall have at least one woman director) are expected to act wisely and honestly while they discharge their duties. The Directors have to act in the dual capacity as he is a director and at the same time the employee of the company as well. This article covers the scope of Shadow directors and De Facto Directors under Companies Act.

Shadow Director is an officer under whose direction or instructions the Board of Directors or any one or more Directors have to act. Whereas De Facto Directors is the person who claims himself to be the Director of the company but actually and legally he is not the Director of the company. The major difference between Shadow Director and De-Facto Director is that Shadow Director are not appointed to the Board. He/she would be liable to the company unless he/ she is giving advice in their professional capacity. Thus Shadow Director is treated as an officer in default. De Facto Directors are liable under the Companies act.

II Legal Provisions

The Companies Act deals with Shadow Directors under the following provisions:

- Meaning of the term “officer in default” which states that in directions of whom, the Board of Directors of the company acts.¹
- Empowers the Inspector to investigate into the affairs of the company, whose Board of Directors is acting on the instructions of the Director.²
- The details of the officer in default to be registered in the Register of the Directors.³
- Details of shares are held by the Director including officer in default is to be maintained.⁴

* Piyush Kumar Jalan is a student at Amity Law School, Kolkata.

¹ Section 2(60) (v) of the Companies Act, 2013.

² Section 219(c) of the Companies Act, 2013.

³ Section 303(1) of Companies Act, 1956.

III Duties of Shadow Directors And De Facto Director

As it is clear that Shadow Directors holds an important position in the company. He has the following duties:

- A shadow director neither has a fiduciary duty towards the company nor does he directly deal with the assets of the company.
- Shadow Directors should at the Board meeting declare his interest in any contract that is or will be entered by the company.
- He also needs to disclose his interest in any of the shares or debentures of the Company.
- There is a restriction by the Company Law on any property related to the financial transactions between the company or shadow directors or to the relatives of the shadow director.

A De Facto Director is also subjected to some duties and liabilities which are as follows:

- He/ she has to accept the responsibility of the company's financial matters.
- He/ she has to act as a sole signatory of the company's bank account.
- On behalf of the board he has to negotiate with the third parties.
- He/ she has to recruit and appoint the post of senior manager.

IV Risk Of Shadow And De Facto Director

A person who is the senior financial member of the company in regards to his qualifications, skills and standing in the organization is at the risk of being the Shadow or De Facto directors. If there are no qualified senior accountant within the organization, whereas the person has his/ her influence in the decision making of the boards may be the directors as mentioned above. Both the directors are at the risk that they may be liable for offences under any other legislation or even be liable for the criminal liability wherever applicable. The reputation risk are associated with this as because they become De Facto or Shadow Directors just to avoid the formalities of appointment or being disclosed on the register of Directors of the Company.⁵

⁴ Section 307(10) (c) of Companies Act, 2013.

⁵ <https://www.icaew.com/technical/business-resources/the-dangers-of-acting-as-a-de-factor-or-shadow-director> [Last accessed May 8, 2020].

V Conclusion

The main motive and logic behind the formers of the Companies Act to put the concept of Shadow Directors and De Facto Directors was to prevent the responsibilities of person who are in shadow or De Jure having the actual control of the company. If the majority of directors follow the instruction of a particular person, ultimately company would be working on the instructions of the person called the “default officer” and such default officer is the Shadow Director. Thus the logic here is that both the directors should be subjected to same duties and liabilities to which the Board of Directors are subjected to.