

High Court Provides Clarity on Application of Directors' Duties to a Financial Institution Acting as a Shadow Director of Its Borrower Customer

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On 19 November 2019, the High Court provided guidance in the case of [Standish v The Royal Bank of Scotland \[2019\] EWHC 3116 \(Ch\)](#) on the application of directors' duties to shadow directors. This is a particularly important decision for financial institutions that are considering exercising their management or other control rights available to them upon a customer's default of their facility agreement.

Brief facts of the case were that the financial institution appointed an observer to the board of one of its borrower customers undergoing a turnaround and through the acts of the observer, which included the giving of instructions that the directors felt obliged to follow, it was assumed that the financial institution / observer qualified as a shadow director. Through the implementation of a restructuring, the claimants alleged that steps were taken by the observer / financial institution to undermine the company's financial position to enable the financial institution to acquire 80% of the company's equity, being the "**Unconscionable Purpose**". It was alleged that the shadow director was influenced by the Unconscionable Purpose, and had therefore breached its fiduciary duty.

One question that the court considered was whether the Companies Act 2006 imposed a full range of fiduciary duties on the shadow director (as are owed by *de jure* directors) or a more limited range of duties. The court concluded the latter. It was held that the Companies Act 2006 does not impose a full range of fiduciary duties on a shadow director merely because they have acquired the status of shadow director but instead, a limited range of duties will be owed that reflect the directions and instructions being given. A breach of such duties may then occur if a link can be established between the shadow director's instruction or direction and a breach of those limited fiduciary duties.

Financial institutions should therefore be cautious in exercising their management or other control rights over customers that are in default under their facility agreement, particularly in insolvency, turnaround or distressed situation where the financial institution's and the borrower's interests may not align, as in exercising such rights, the financial institution could qualify as a shadow director and thereby expose itself to potential liability.

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