

REMEMBER TO KEEP YOUR DISTANCE!

The accounting profession is morphing with more and more accountants being called upon to become advisors to their clients. This is being driven by not only the demand for these services but also is seen as an opportunity by accountants to 'value add' to their existing customer base and broaden their revenue pool.

The drive for accountants to ensure that their clients remain loyal to them often means that they will strive for the intangible status of "trusted advisor".



At the end of the day, creditors of a failed company may consider that a potential recovery from an advisor (who likely has PI insurance) is potentially greater than that from the directors.

But when is a relationship too close?

From time to time we see parties associated with a distressed business, with the best intentions, sometimes 'lend' their staff into an organisation in distress to try and help them out. This benevolence can have unfortunate unintended consequences for the good Samaritan or supportive accountant.

Whilst providing advice, offering guidance and giving recommendations to a client is all well and good, becoming an intrinsic part of the client's business or entrenched within their organisation may see the accountant or seconded staff member become a de facto director.

What is a de facto director?

Section 9 of the *Corporations Act 2011* (Cth) (Act), defines a director as:

"a) a person who:

- i. is appointed to the position of a director; or
- ii. is appointed to the position of an alternative director and is acting in that capacity; and

Section 9(b)(ii) of the Act sets out the statutory definition of what has been termed a "de facto" or "shadow" director.

b) unless the contrary intention appears, a person who is not validly appointed is a director if:

- i. they act in the position of a director; or
- ii. the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes."

What does it take to cross the line?

The meaning of a de facto director was considered in the Supreme Court of Queensland case of *International Cat Manufacturing Pty Ltd (In Liquidation) v Rodrick* [2013] QSC 091:

International Cat Manufacturing Pty Ltd (**ICM**) was a company which built boats and it had two formally appointed directors. Raymond Rodrick (**Rodrick**)

entered into an arrangement with ICM to build him a boat (through his company Nu-Log Pty Ltd (**Nu-Log**)). Initially, Rodrick just monitored the progress of the building of his boat. However, he soon became entrenched in the affairs of ICM and involved in ICM's decision making. Rodrick and Nu-Log also started providing working capital finance to ICM.

ICM was subsequently wound up and the Liquidator contended in an insolvent trading action that Rodrick was a de facto director.

His Honour held that Rodrick was a de facto director for a period of time because of the following indicia:

1. ICM records contained "to-do lists" for both Rodrick and the two recorded directors which gave the impression of the three being together in charge of ICM.
2. Rodrick signed a trust account authority on behalf of ICM.
3. Rodrick was authorised to operate ICM's bank account which, given the small size of the business, was significant.
4. Rodrick gave directions to a director regarding ICM product pricing.
5. Rodrick was extensively involved in many aspects of the business, including directing staff, preparing cash flows, calculating costings, dealing with suppliers and generally running ICM.
6. Rodrick attended to office and factory of ICM on a daily basis.

The judge also made the comment that the fact that a company has an active director apart from the alleged de facto director does not preclude a finding that the person in question was a director.

But I'm just an advisor...

Some comfort can be drawn by professional advisers from Section 9 of the Corporations Act as it expressly excludes professional advisers from being deemed a director. Section 9 states:

"Subparagraph (b)(ii) does not apply merely because the directors act on advice given by the person in the proper performance of the functions attaching to the person's professional capacity or to the person's business relationship with the directors or the company, or body."

It is unlikely that a seconded staff member will have such protections as they are unlikely to be viewed by the courts as "Professional Advisors".

At the end of the day, creditors of a failed company may consider that a potential recovery from an advisor (who likely has PI insurance) is potentially greater than that from the directors.

Jumping into the trench with your client when they are in financial distress can sometimes seem like the right thing to do. However, seeking independent advice about the prospects of turning around a distressed client is often the best approach and helps place distance between you and your client's potentially unrecoverable financial position.

In the case of those advisors trying to offer a helping hand, the seconding or "lending" of experienced staff may expose both your organisation and that staff member to attack.



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