Corporate Directors in the United Kingdom

Stephen M. Bainbridge

Repository Citation
CORPORATE DIRECTORS IN THE UNITED KINGDOM

STEPHEN M. BAINBRIDGE*

ABSTRACT

In the United States, state corporation law uniformly provides that only natural persons may serve as directors of corporations. Corporations, limited liability companies, and other entities otherwise recognized in the law as legal persons are prohibited from so serving. In contrast, the United Kingdom allowed legal entities to serve as directors of a company. In 2015, however, legislation came into force adopting a general prohibition of these so-called corporate directors, albeit while contemplating some exemptions. This Article argues that there are legitimate reasons companies may wish to appoint corporate directors. It also argues that the transparency and accountability concerns that motivated the legislation are overstated. The requisite enhancement of transparency and accountability can be achieved without a sweeping ban. Accordingly, this Article proposes that Parliament either repeal the ban or, at least, authorize liberal exemptions.

* William D. Warren Distinguished Professor of Law, UCLA School of Law.
# Table of Contents

**INTRODUCTION** ................................................................. 67  
I. CORPORATE DIRECTORS UNDER U.K. LAW ......................... 69  
II. WHY DO COMPANIES USE CORPORATE DIRECTORS? .............. 71  
III. THE CASE AGAINST CORPORATE DIRECTORS ..................... 75  
IV. ASSESSING THE CASE AGAINST CORPORATE DIRECTORS ......... 77  
   A. Disclosure ................................................................. 78  
   B. Liability Constraints ................................................... 79  
CONCLUSION ................................................................. 83
INTRODUCTION

Since the U.S. Supreme Court handed down its controversial Citizens United decision, the concept of corporate personhood has been highly controversial in the United States.¹ Yet, despite the ongoing controversy, it has long been settled law that corporations have most—but not all—of the rights and powers of natural persons.² One exception to that general rule, however, is that only natural persons may serve as directors of a corporation.³ The same is true in most other major capitalist economies.⁴

² See, e.g., Consol. Edison Co. of N.Y. v. Pataki, 292 F.3d 338, 346-47 (2d Cir. 2002) (“[A] wide variety of constitutional rights may be asserted by corporations.”); Ehlinger v. Hauser, 785 N.W.2d 328, 365 (Wis. 2010) (“A corporation ... has the same powers as a natural person to do all things necessary or convenient to carry out its business and affairs.” (quoting Wis. Stat. § 180.0302 (2010))).
³ Section 141(b) of the Delaware General Corporation Law (DGCL), for example, provides that a director “shall be a natural person.” DEL. CODE ANN. tit. 8, § 141(b) (West 2016). The Model Business Corporation Act (MBCA) accomplishes the same result in a two-step process. First, section 8.03(a) provides that a board of directors “shall consist of one or more individuals.” MODEL BUS. CORP. ACT § 8.03(a) (AM. BAR ASS’N 2016). Second, section 1.40 defines individual as “a natural person.” Id. § 1.40. Accordingly, under both statutes, non-natural legal persons—such as corporations and other forms of business organizations—cannot serve as members of a board of directors.
⁴ The law is the same in other states. See, e.g., Ute Indian Tribe of the Uintah & Ouray Reservation v. Ute Distrib. Corp., No. 2:06-cv-557 CW, 2010 WL 956905, at *5 (D. Utah Mar. 12, 2010) (“Utah statute specifies that a director must be a natural person who is at least eighteen-years-old.”); aff’d, 455 F. App’x 856 (10th Cir. 2012); NFL Props., Inc. v. Superior Court of Santa Clara Cnty., 75 Cal. Rptr. 2d 893, 899 n.5 (Ct. App. 1998) (“A director of a corporation must be a natural person, pursuant to [California] Corporations Code section 164.”); Michael A. Budin, Prepare LLC Documents with Care—Issues to Consider to Achieve the Desired Results for Your Client, 74 PA. B. ASSN Q. 27, 36 n.30 (2003) (“Section 1722(a) of the Pennsylvania Business Corporation Law requires each director of a business corporation to be a natural person.”); see also Shawn J. Bayern, The Implications of Modern Business-Entity Law for the Regulation of Autonomous Systems, 19 STAN. TECH. L. REV. 93, 98 (2015) (“This restriction is standard across American law.”)).
Until recently, however, the United Kingdom stood as a glaring exception to the general rule. For over a century, U.K. company law allowed a corporation or other legal entity to serve on the board of directors of another company. In 2015, however, Parliament approved legislation containing a ban—albeit allowing some yet to be defined exemptions—of corporate directors. As of this writing (fall 2017), the ban has not been implemented, but it was expected to come into force soon.

This Article argues that there are legitimate reasons for companies to use corporate directors. In work done elsewhere with University of Chicago Professor of Law Todd Henderson, I propose that U.S. law be modified to permit legal entities to serve as corporate directors. That proposal is intended to permit the rise of service companies—so-called Board Service Providers (BSPs)—that would serve on or, preferably, as a company’s board of directors. This is not an appropriate forum in which to rehash those arguments. For present purposes, suffice it to say that if the U.K. ban goes forward, the U.K. would be foreclosing the opportunity for its companies to experiment with the BSP model. In addition,
even where the corporate director is not a specialist BSP, but rather
a normal business company, there are still advantages to allowing
corporations to serve as corporate directors.\footnote{11}

This Article also evaluates the reasons offered for restricting
corporate directors to natural persons and finds them wanting. It
therefore proposes that the U.K. government either repeal the
relevant legislation or, at least, be liberal in granting exemptions to
the natural person restriction. Part I briefly traces the history of
corporate directors under U.K. law. Part II argues that there are
several legitimate reasons for companies to use corporate directors.
Part III summarizes the arguments advanced in favor of the
legislation restricting the use of corporate directors. Finally, Part IV
critiques those arguments.

I. CORPORATE DIRECTORS UNDER U.K. LAW

Prior to 2006, the U.K. had no restrictions on the appointment of
a corporation as a director of another company.\footnote{12} As a widely cited
1907 Chancery Division decision explained, for example, under the
Companies Act of 1862 there was “nothing ... which in any way
ma[de] it incumbent on a company ... to have directors who shall be
individual persons and responsible as individuals to the shareholders.”\footnote{13} This remained the rule for the next century.\footnote{14}

The corporate director option apparently was rarely used, al-
though the exact numbers are difficult to find. A 2013 survey of U.K.
companies found that approximately 38,000 companies (1.2 percent
of all U.K. companies) had one or more corporate directors.\footnote{15} In

\footnotesize

\footnote{11. \textit{See infra notes} 42-55 and accompanying text (discussing advantages).}
\footnote{12. \textit{See} Jason Ellis, \textit{The Continued Appointment of Corporate Directors: An Examination
of the Effect of S.87 of the Small Business, Enterprise and Employment Act 2015, 37 COMPANY
LAW. 203, 203 (2016) (“Prior to the Companies Act 2006, any legal person (either a company or
a limited liability partnership) could assume the office of a director.”).}
\footnote{13. \textit{In re Bulawayo Mkt. & Offs. Co.} [1907] 2 Ch 458 at 463 (UK).}
\footnote{14. \textit{See} Len Sealy, \textit{Paycheck Services 3 Ltd: The Supreme Court Reviews the Concept of the
De Facto Director, 287 COMPANY L. NEWSL. 1, 3 (2011) (“English company law has, for over
a century, recognised that a company may be a director of another company.”).}
\footnote{15. \textit{DEPT FOR BUS., INNOVATION & SKILLS, CORPORATE DIRECTORS: SCOPE OF EXCEPTIONS
TO THE PROHIBITION OF CORPORATE DIRECTORS 4 & n.2 (2014) [hereinafter Exceptions
PAPER], https://www.icsa.org.uk/assets/files/pdf/guidance/Consultations%202014/bis-14-1017-
contrast, however, a 2014 government report found 67,000 companies with corporate directors (2.1 percent of all companies). In either case, the majority of companies with one or more corporate directors were nonpublic and small in size, presumably because stock exchange listing standards effectively require directors to be natural persons.

Recent changes in U.K. company law likely will result in a substantial decline in the number of corporate directors, if not their complete abolition. Since the adoption of the Companies Act of 2006, U.K. law has required that a company “have at least one director who is a natural person.” This provision was understood to permit corporate directors to continue serving on company boards, but only so long as at least one board member was a natural person.

The status of corporate directors underwent a further restriction in 2015 with passage of the Small Business, Enterprise and Employment Act (SBEEA), which amended the Companies Act to provide that “[a] person may not be appointed a director of a company unless the person is a natural person.” Existing non-natural person directors of U.K. companies originally were to be phased out by October 2017, but in September 2016 the U.K. government indefinitely postponed implementation of the ban. It did so for the


17. See id. at 228 (“[O]ver 85% of the 67,000 companies with corporate directors file accounts as if they were small companies.”).

18. Jillian Gauntlett, Update on Corporate Directorships, NORTON ROSE FULBRIGHT (Dec. 2010), http://www.nortonrosefulbright.com/knowledge/publications/32739/update-on-corporate-directorships [https://perma.cc/FRJ5-GNSG] (“The corporate governance requirements for directors of UK listed companies to have the appropriate skills to undertake the duties of directors, effectively rule out the use of corporate directors in the context of public listed companies.”).


20. See Ellis, supra note 12, at 205 (stating that under the Companies Act “all companies are required to have at least one director who is a natural person”).


government to consider permitting exceptions in limited circumstances, as authorized by the statute.23 As of this writing (fall 2017), the government had not yet defined the scope of such exceptions or the situations in which they will be granted, but action was expected in the near future.

II. WHY DO COMPANIES USE CORPORATE DIRECTORS?

Interestingly, a survey of fifty-five companies having at least one corporate director reported that “31% saw no advantage to having one, and 11% responded that they did not know what the advantages of having one were.”24 While the small size of the sample relative to the tens of thousands of U.K. companies with corporate directors makes it difficult to draw firm conclusions from the survey, it is interesting that so many of the surveyed firms were unable to offer a legitimate reason for using entities as directors. As disclosed below, perhaps they were unable to do so because corporate directors are often used for purposes at or over the edge of the law.25

Nevertheless, there are legitimate reasons for companies to use corporate directors. In general, boards have three major functions. First, although day-to-day operational decision making is properly delegated to management, the board does have certain managerial

23. Small Business, Enterprise and Employment Act 2015, c. 26 § 87(4) (“The Secretary of State may make provision by regulations for cases in which a person who is not a natural person may be appointed a director of a company.”); see also EXCEPTIONS PAPER, supra note 15, at 4 (“[W]e seek views on circumstances where the use of corporate directors could continue, under exceptions to the prohibition.”).

24. EXCEPTIONS PAPER, supra note 15, at 8.

25. See infra note 61 and accompanying text (observing the disproportionate incidence of corporate directors in cases of serious fraud). This inference is perhaps further supported by the survey’s further finding that only 42 percent of surveyed companies would replace a corporate director with a natural person if the former were banned. See IMPACT ASSESSMENTS PAPER, supra note 16, at 180.
functions. The Companies Act, for example, requires that the board of directors approve the terms on which the company will merge with another. More generally, the Corporate Governance Code provides that all companies should have “a formal schedule of matters specifically reserved” to the board. It further requires an annual report stating, inter alia, “which types of decisions are to be taken by the board and which are to be delegated to management.”

A major study of U.K. boards found some variance in how this aspect of the board’s role was operationalized, but concluded that “boards remain controllers of the strategic agenda.” The board serves as the “ultimate arbiter of what constitutes the focus of the company.” It sets the parameters within which management conducts the day-to-day operations.

Second, boards have a service function. Both individually and collectively, board members provide advice and guidance to top managers. This is an especially valuable and important role of the nonexecutive directors. A diverse board can expand the company’s network by providing interlocks with potential suppliers, customers, sources of finance, and other potential suppliers of key organizational needs. Research suggests that nonexecutive directors, in particular, play a valuable role in “opening doors for firms through

26. See Companies Act 2006, c. 46 § 905(1) (“A draft of the proposed terms of the scheme must be drawn up and adopted by the directors of the merging companies.”).


28. Id.


30. Id.

31. Id. at 51.

32. See Remus Valsan, Board Gender Diversity and the Enlightened Shareholder Value Principle, 37 COMPANY LAW. 171, 175 (2016) (identifying the advisory role as one of three main board functions).

33. See Colin Law & Patricia Wong, Corporate Governance: A Comparative Analysis Between the UK and China, 16 INT’L COMPANY & COM. L. REV. 350, 356 (2005) (“A nonexecutive director usually performs an advisory role and is not involved in the day-to-day management of the company.”).

34. See Valsan, supra note 32, at 175 (noting “the role of directors in providing and maintaining resource networks that are essential for the company’s survival and success”).
use of contacts.” Finally, directors have an important institutional role in liaising with shareholders and other key company stakeholders.

Third, the board—especially its nonexecutive members—monitors the performance of management. Indeed, as is also the case in the United States, monitoring is the chief function of U.K. company directors. U.K. boards do so by setting the broad policies and strategic framework within which management conducts the firm’s business, reviewing and approving plans and budgets put forward by management, setting management compensation, and wielding the ultimate power to hire and fire managers.

All of these functions were cited by U.K. companies surveyed as advantages of corporate directors. To be sure, as noted above, 31 percent of the surveyed companies could not state any advantage provided by corporate directors, but 24 percent stated that corporate directors broadened the skill sets and knowledge possessed by the board. Nine percent of the surveyed respondents stated corporate directors provided greater continuity; 5 percent cited improved efficiency; and 2 percent cited access to a wider network, access to finance, and better decision making.

These claims are far from fatuous. To the contrary, a corporate director in fact has many potential advantages over individual natural persons. As to the board’s managerial function, a corporate director likely will make better decisions than a single individual. Most of what boards do involves exercising critical evaluative judgment,

35. STILES & TAYLOR, supra note 29, at 53.
36. See id. at 100-01 (describing the board’s institutional role).
37. See CORPORATE GOVERNANCE CODE, supra note 27, at 9 (“Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance.”).
38. See Valsan, supra note 32, at 175 (“The Anglo-American corporate governance literature traditionally places a great emphasis on the monitoring role of the board.”).
39. See STILES & TAYLOR, supra note 29, at 78-80 (reviewing the board’s control function).
40. IMPACT ASSESSMENTS PAPER, supra note 16, at 183.
41. Id.
42. This Section draws on work I have done elsewhere with Professor Todd Henderson of the University of Chicago Law School. See generally Bainbridge & Henderson, supra note 8.
43. See id. at 1097 (arguing that corporate directors that specialize in board service “would make better decisions than current boards” because they “would have better information, access to specialists with fewer conflicted interests, more person-hours available for exercising judgment, better incentives, and so on”).
assessing proposals put forward by management, rather than original thinking. A considerable body of evidence demonstrates that groups are superior to individuals at making such judgments. Assuming most of the companies that serve as corporate directors themselves have multiple employees and directors, a corporate director brings to bear the combined knowledge and expertise of multiple individuals. Having multiple individuals serving collectively as a corporate director also increases the number of man hours devoted by each slot in the board.

In the exercise of its service role, the board’s function is to “enhance a firm’s ability to raise funds, to add to the reputation of the company through recognition of their name in the community, and to deal with threats in the external environment.” By interlocking multiple boards of directors, the board facilitates access to mission-critical resources by providing introductions, formal and informal communication channels, and helping coordinate ongoing relationships. A corporate director with multiple employees and directors, each of whom has their own network of clients and associates, should be far better at building a network of resources on which the firm can draw than individual directors.

Finally, as to the board’s monitoring function, a corporate director again has advantages over natural persons. In addition to the time and knowledge advantages already cited, which are of significant value in making informed assessments of management performance, corporate directors may often have better incentives than natural persons. At the very least, corporate directors should be no worse than natural persons whose incentives to effectively monitor


45. See id. at 12-19 (reviewing the empirical evidence on group decision making).

46. See Bainbridge & Henderson, supra note 8, at 1098 (arguing that a specialist corporate director “combines the advantages of group decisionmaking with a group composition likely to be better informed and motivated”).

47. See id. at 1077 (discussing time advantages of a specialized corporate director).


50. See generally Bainbridge & Henderson, supra note 8, at 1081-96 (reviewing the incentives a specialized corporate director has to be an effective monitor of management).
management “are fairly limited since they capture so little of any gains and suffer so little of any losses from the decisions they make.”

In addition to these considerations, there are several practical ways in which corporate directors can be useful. For example, in Hong Kong, where corporate directors are also permitted, foreign investors outside Hong Kong use corporate directors—typically corporate service providers or financial institutions—as local nominee directors of Hong Kong companies so as to facilitate prompt handling of business matters such as signing documents. Where directors travel frequently, using a corporate director helps ensure that at least someone representing that director remains in town to deal with business matters as they arise. Finally, in the corporate group context, a parent corporation may appoint itself to the board of directors of a subsidiary to exercise direct control.

III. The Case Against Corporate Directors

The stated rationale for restricting the use of corporate directors was that they “bring about a lack of transparency and accountability with respect to the individuals influencing the company.” At a

51. Id. at 1081.
52. See Ji Lian Yap, De Facto Directors and Corporate Directorships, 7 J. BUS. L. 579, 581 (2012) (noting that under Hong Kong law, public companies may not have corporate directors but private companies—other than private companies that form a part of a corporate group that includes a public company—may do so).
53. See E-mail from Hui Huang, Professor of Law & Exec. Dir., Ctr. for Fin. Regulation & Econ. Dev., Faculty of Law, Chinese Univ. of H.K., to author (Feb. 10, 2017, 23:34 PST) [hereinafter Huang email] (on file with author) (offering this example).
54. See id.
55. See id; see also Yap, supra note 52, at 582 (“[C]orporate directorships might be used for legitimate reasons, for instance, a parent company being the corporate director of its subsidiary to facilitate group cohesion.”).
56. DEP’T FOR BUS., INNOVATION & SKILLS, TRANSPARENCY AND TRUST: ENHANCING THE TRANSPARENCY OF UK COMPANY OWNERSHIP AND INCREASING TRUST IN UK BUSINESS—GOVERNMENT RESPONSE 44 (2014) [hereinafter GOVERNMENT RESPONSE].

Similar concerns have been advanced in other countries in connection with rejecting proposals to permit the use of corporate directors. See, e.g., Conway & Kavanagh, supra note 4, at 151 & n.30 (noting that Ireland’s Company Law Review Group’s 2000 report argued that changing the law to permit corporate directors would reduce director accountability); Yap, supra note 52, at 581 (noting that the June 2011 report of Singapore’s Steering Committee
2013 G7 summit, U.K. Prime Minister David Cameron called for global action against corruption, which he proposed accomplishing through “greater transparency, fair tax systems and freer trade.”

In July 2013, the U.K. Department for Business, Innovation and Skills responded by promulgating a discussion paper advancing numerous proposals to increase the transparency of company ownership. The paper acknowledged that corporate directors can serve legitimate purposes, but objected that they could also be used “to conceal beneficial owners in a complex corporate structure and across multiple jurisdictions to facilitate illegal activity.” Accordingly, the paper requested comments on a proposal to prohibit corporate directors.

Concern about the use of corporate directors to conceal fraud and other misconduct is legitimate. Despite the low frequency at which U.K. companies use corporate directors, the Serious Fraud Office estimated that corporate directors figured in a quarter of the cases it investigated. A 2014 assessment of the need for reform concluded that:

Corporate directors—one company (or legal person) as the director of another—are inherently opaque with respect to the natural person in fact controlling a company. Where someone controls an appointed director—who might be acting irresponsibly as a “front” for them—there is also scope for opacity and a lack of accountability.

for Review of the Companies Act “took the view ... that there was no need to amend the law to allow corporate directorships” because of concerns “about difficulties in ascertaining who in fact controlled the company’s affairs, and the consequent lack of accountability”).


59. Id. at 50.
60. Id. at 52.
The use of irresponsible “front” directors who allow themselves to be controlled by another can similarly introduce opacity with respect to that control and lead to reduced effectiveness of corporate oversight.

Since all appointed directors have the same status under the law, there is no means of identifying how many appointed directors are acting irresponsibly as a front for another, nor how many people are seeking to control them. But we do know that international organisations and UK law enforcement consider such arrangements high risk in terms of facilitating crime such as money laundering.\(^6^2\)

Not surprisingly, the 2013 discussion paper elicited considerable support for a broad prohibition of corporate directors from law enforcement agencies, as well as numerous nongovernmental organizations (NGOs).\(^6^3\)

Nevertheless, the paper also elicited comments from business representative organizations arguing that a complete prohibition of corporate directors was unwarranted considering the potential benefits offered by corporate directors.\(^6^4\) At the same time, however, support for a change in the law increased if it were framed as a partial prohibition permitting exceptions for situations in which the risk of misuse is low.\(^6^5\) As we have seen, that is the approach the government eventually adopted.\(^6^6\)

IV. ASSESSING THE CASE AGAINST CORPORATE DIRECTORS

Concerns about transparency and accountability could be addressed through disclosure and substantive regulation without sacrificing the benefits corporate directors provide. Indeed, much of the regulatory structure necessary is already in place.

---

62. **IMPACT ASSESSMENTS PAPER, supra** note 16, at 152, 155 (bullet points omitted).
63. **GOVERNMENT RESPONSE, supra** note 56, at 44.
64. **Id.** at 45.
65. **See id.** (citing “group structures involving large (and listed) companies, pension funds, charities, and Open-Ended Investment Companies (OEICs)” as examples of such situations).
66. **See supra** notes 21-23 and accompanying text (discussing the legislation).
A. Disclosure

As U.S. Supreme Court Justice Louis Brandeis famously observed, “Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.” The U.K. has already taken steps to enhance corporate disclosures, which easily can be adapted to provide adequate information about the ownership structure of corporate directors.

In April 2016, the U.K. government implemented enhanced disclosure requirements with respect to most companies’ beneficial owners. All persons with significant control (PSCs)—defined as an individual who owns or controls more than 25 percent of the company’s stock or holds the right to appoint or remove a majority of the board of directors, among other criteria—who are known to the company must be placed on a PSC register that includes the PSC’s identity, date of birth, address, and other pertinent information.

In addition, and more pertinent to present purposes, the PSC register must also include “relevant legal entities” (RLEs), which are defined, inter alia, as companies that are listed on an exchange or are required to maintain their own PSC register. The register need not contain information about the RLEs’ ownership structures because the RLEs typically will have to maintain their own registers or otherwise provide such disclosures. As with the ban on

---

67. LOUIS D. BRANDEIS, OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT 92 (1914).
69. See id. (listing the five criteria imposed by the law).
70. See Small Business, Enterprise and Employment Act 2015, c. 26 § 790K (listing required disclosures).
71. Taylor & Elphinstone, supra note 68.
72. Id. The new legislation further provides that companies have a “positive duty to take ‘reasonable steps’ to identify PSCs.” Michael Roach, An Analysis of the UK’s New Register of Beneficial Owners, LEXOLOGY (Apr. 13, 2016), http://www.lexology.com/library/detail.aspx?g=d9de907f-6997-4d7a-bb95-4afa89c5a2d3[https://perma.cc/5T54-UXUP]. What constitutes reasonable steps will vary from case to case, “but the Government guidance makes it clear that a company will have to demonstrate significant efforts in this regard.” Id. If a company is unable to obtain the required disclosures from a suspected PSC, it “must ‘seriously consider’ whether it is appropriate to impose restrictions on any shares or rights they hold in the company.” Id.
corporate directors, the new requirements were justified as necessary to improve corporate transparency and accountability.\footnote{73}{See \textit{Roach}, supra note 72 (noting that the requirement “should be viewed in the wider context of the UK Government’s commitment to promote greater corporate transparency”).}

Similar disclosure requirements could be imposed on corporate directors so that regulators and, if desired, the public, would know the identities of the corporate director’s own directors, officers, and major beneficial owners of its shares. To further promote accountability and transparency, such requirements could include a similar positive duty on the part of both the company appointing the corporate director and the company serving as the corporate director to ensure that all relevant information is fully disclosed.

To ensure full transparency, moreover, the full ownership structure of the corporate director should be part of the required disclosure. Unlike RLEs, some corporate directors may be small companies that are not required to maintain a PSC register or they may be foreign companies. Accordingly, the disclosure should include the ultimate beneficial owner of the corporate director as well as any intermediary corporations or other legal entities in the chain of ownership.

There are several analogous requirements in U.S. law. The SEC “requires disclosure of all twenty-five percent owners of direct owners” of a registered broker-dealer, “their twenty-five percent owners, and each successive twenty-five percent owner of a twenty-five percent owner, continuing up the chain of ownership until a reporting company is reached.”\footnote{74}{Form BD Amendments, 60 Fed. Reg. 4040, 4042 n.19 (proposed Jan. 19, 1995) (to be codified at 17 C.F.R. pt. 249).} U.S. banking law likewise “mandates disclosure of extensive information about entities in the chain of ownership.”\footnote{75}{David L. Glass, \textit{So You Think You Want to Buy a Bank?}, 73 \textit{ALB. L. REV.} 447, 461 (2010).} As these analogies suggest, it is possible to condition regulatory privileges—such as using a corporate director—on complete chain of ownership and control disclosure.

\textbf{B. Liability Constraints}

When a corporate director is involved in criminal or civil misconduct, the entity may be held liable. The more serious question is
whether the ultimate beneficial owners of the corporate director can
be held liable. Being able to reach those individuals and hold them
liable will often be desirable from both a compensatory and deter-
rence perspective.

The principal means by which such individuals may be held re-
sponsible under U.K. law for the acts of a corporate director is the
de facto director doctrine.76 “A person will be deemed to have acted
in the capacity of a de facto director where that person performs
management functions of a type and in a manner consistent with
management functions ordinarily performed and associated with a
formally appointed director (a de jure director).”77 In the leading
case of Revenue and Customs Commissioners v. Holland, the U.K.
Supreme Court identified several factors relevant to determining
whether someone is a de facto director, such as

whether they were part of the company’s “governing structure”;

whether they were “truly in a position to exercise the powers
and discharge the functions of a director” of the company;

whether they had “assumed the status and functions of a com-
pany director” or “assumed to act as a director of the company.”78

The Hollands were a husband and wife who were shareholders and
directors of a trading company called Paycheck Services.79 “Pay-
check Services was the parent company of ‘Paycheck Directors,’”

76. See Stephen Griffin, Establishing the Liability of a Director of a Corporate Director:
Issues Relevant to Disturbing Corporate Personality, 34 COMPANY LAW. 135, 135 (2013)
(“Liability may be imposed against a de jure director, a de facto director ... and in circum-
stances where a statutory provision provides specifically, a shadow director of the company.”
(footnote omitted)).

77. Griffin, supra, at 143.

78. Sealy, supra note 14, at 3; see Revenue & Customs Comm’rs v. Holland [2010] UKSC
51, [26]-[40] (appeal taken from Eng. & Wales).

79. Sealy, supra note 14, at 1.
which served as a corporate director for a number of affiliated companies.\textsuperscript{80} Even though “Holland was the directing mind and will be behind it all,” a majority of the court held that Holland was not a de facto director.\textsuperscript{81} The majority “placed a great deal of emphasis on the importance of the principle of separate legal personality” and worried that the de facto director doctrine could swallow that principle.\textsuperscript{82}

As illustrated by \textit{Holland}, U.K. company law has a strong tradition of respecting the separate legal personalities of incorporated entities and their shareholders, directors, and officers.\textsuperscript{83} Indeed, while the U.K. recognizes a doctrine of piercing the corporate veil similar to that under U.S. law, U.K. courts are far less likely to do so than their American counterparts.\textsuperscript{84}

Strong policy reasons justify respecting the separate legal personality of an incorporated entity and its controlling person.\textsuperscript{85} Those reasons in fact are sufficiently compelling that I have elsewhere proposed that U.S. courts abolish the veil piercing doctrine.\textsuperscript{86} Limited liability encourages risk taking by allowing shareholders to insulate themselves from liability, for example, which encourages investment and resulting economic growth.\textsuperscript{87} While it is true that limited liability allows shareholders to externalize some of the costs of risk taking, the evidence shows that the introduction of limited liability spurred economic growth.\textsuperscript{88}

Conversely, as the \textit{Holland} case illustrates, doctrines such as de facto directorships and veil piercing are difficult to apply. In

\begin{footnotesize}
\begin{itemize}
    \item \textsuperscript{80} Id. at 1-2.
    \item \textsuperscript{81} Id. at 3.
    \item \textsuperscript{82} \textsc{Slaughter} \& \textsc{May}, \textsc{Corporate Directors and De Facto Directorship—The Supreme Court Requires “Something More”} 3 (2011), \url{https://www.slaughterandmay.com/media/1626034/corporate-directors-and-de-facto-directorship-the-supreme-court-requires-something-more.pdf} [https://perma.cc/XN5Q-5WW5].
    \item \textsuperscript{83} See \textsc{Stephen M. Bainbridge} \& \textsc{M. Todd Henderson}, \textsc{Limited Liability: A Legal and Economic Analysis} 235 (2016) (“[T]he UK has a rich tradition of limited liability for corporate entities.”).
    \item \textsuperscript{84} Id. at 241 (“British courts are more reluctant to pierce the veil or combine a corporate group than American courts.”).
    \item \textsuperscript{85} See, e.g., id. at 46-47, 50, 52 (reviewing policy arguments in favor of limited liability).
    \item \textsuperscript{86} See generally \textsc{Stephen M. Bainbridge}, \textsc{Abolishing Veil Piercing}, 26 \textsc{J. Corp. L.} 479 (2001).
    \item \textsuperscript{87} See \textsc{Bainbridge} \& \textsc{Henderson}, \textsc{supra} note 83, at 47.
    \item \textsuperscript{88} See id. at 49-52.
\end{itemize}
\end{footnotesize}
Holland, “it is difficult to differentiate between those of his acts done as director of Paycheck and whatever other acts he carried out in the business wearing other hats.” The doctrinal tests courts use to make such distinctions, moreover, are inherently ambiguous. As Judge (later Justice) Benjamin Cardozo observed of the U.S. version of veil piercing, for example, it is “an enigmatic doctrine caught ‘in the mists of metaphor.’” Accordingly, as Judge Frank Easterbrook and Professor Daniel Fischel rightly argue, veil piercing “seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled.”

Accordingly, I have argued that “the appropriate question is not whether the shareholder used the corporation as his or her alter ego, but whether the shareholder personally engaged in conduct for which he or she ought to be held directly liable.” Additionally,


Interestingly, this approach to the problem would be consistent with the trend of U.K. law with respect to veil piercing. U.K. law increasingly focuses on whether the corporation’s controlling person has committed a wrong for which direct individual liability may be imposed. As a U.S. court applying U.K. law explained,

89. Sealy, supra note 14, at 3.
92. Bainbridge, supra note 86, at 516.
93. Id. (footnotes omitted).
94. See Bainbridge & Henderson, supra note 83, at 241 n.32 (“Indeed, it appears that British law may be trending in the direction we urge ... namely, substituting direct
[W]here an individual (“B”) has, by making fraudulent misrepresentations, procured a contract between the plaintiff (“A”) and a third party (“C”), and C subsequently breaches that contract, any claim that A possesses against B sounds in tort rather than in contract, “even where C is the creature of B.” Thus, where “[t]he Claimants have their remedy ... in the form of an action for fraudulent misrepresentation,” “[t]here is simply no need ... to lift the veil at all.”

British courts and regulators should take the same approach to beneficial owners—and other controlling persons—of corporate directors. When the individual commits fraud or other serious violations, the fact that he did so while acting through a corporation should not bar imposition of direct personal liability. This approach would be directly responsive to the accountability concerns motivating the ban on corporate directors. It is generally accepted that one should not be held liable for harms one did not cause. Conversely, however, where the controlling persons of a corporate director are active participants in the harm-causing activity, they are properly held responsible.

CONCLUSION

Although the U.K.’s century-old tradition of allowing corporate directors raised legitimate transparency and accountability concerns, those concerns could have been addressed without the sweeping shareholder liability for veil piercing.”.


96. See, e.g., Restatement (Third) of Torts: Apportionment Liability § 26 cmt. a (Am. Law Inst. 2000) (“No party should be liable for harm it did not cause.”); Restatement (Second) of Torts § 5 cmt. b (Am. Law Inst. 1965) (“The defendant may be subject to liability but may escape it [if] ... his conduct may not have been the legal cause of the plaintiff’s harm.”); Jonathan T. Molot, How U.S. Procedure Skews Tort Law Incentives, 73 Ind. L.J. 59, 108 (1997) (“[T]he ethical justification for tort liability requires proof of causation, and that it is not only inefficient, but also unfair, to require a defendant to devote resources to defending and settling lawsuits for injuries that it did not cause”); John A. Robertson, Causative vs. Beneficial Complicity in the Embryonic Stem Cell Debate, 36 Conn. L. Rev. 1099, 1104 (2004) (“Moral responsibility for a wrong requires both causation and complicity. One is not morally responsible for an event unless one has caused that event with the intention, knowledge, recklessness, or negligence necessary for moral culpability.”).
prohibition imposed by the SBEEA. Given the legitimate uses of corporate directors, as well as the potential for them to evolve into BSPs, the U.K. should consider replacing that prohibition with a regime allowing corporate directors but requiring extensive disclosures of the director’s ownership structure and imposing personal liability on the ultimate beneficial owner in appropriate cases. If that proves politically impractical, the relevant authorities should be willing to craft broad exemptions in situations where the risk of misconduct is modest.97

97. As the U.K. government acknowledges, companies that use corporate directors “to increase efficiency” are often subject to “extensive regulation” and have “high standards of corporate governance,” IMPACT ASSESSMENTS PAPER, supra note 16, at 228. For example, large companies might reasonably be thought to pose a lower risk of being used as a shell company for illicit activity (since larger companies might be more likely to be employing staff and producing goods, while those seeking to use a company as a vehicle for illicit ends need only establish a small one to do so). Id. (emphasis omitted).