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Shadow Directors in the UK

Tatsuya SAKAMOTO

This report shows studies on shadow director framework in the United Kingdom in relation to protection of creditors of controlled companies.

In the United Kingdom, the corporate law has tendency to see executive organs of companies flexibly in order to reach realistic solutions, whether issues are those concerning controlling and controlled companies or not. The shadow director provision is such an example. The UK law takes an approach to achieve intention of regulations by including those who fall within the shadow director provision in the executive organs. But there is room for study as to whether the shadow director framework, as it is, can be applied to solve issues concerning corporate groups or protection of creditors of controlled companies.

The shadow director provision was adopted to the then principal Companies Act, which was the Companies Act, 1908, by the Companies (Particulars as to Directors) Act, 1917, with an intention of putting real controllers of companies in an ambit of regulations. The Companies Act, 1917 added registration and disclosure regulations of directors to those of the Companies Act, 1908, with a shadow director provision. Historically, the shadow director provision was applied limitedly to such registration and disclosure regulations at the time of the Companies Act 1917. But the provision is applied to more areas today. For example, the article 214 of the wrongful trading provision in the Insolvency Act 1986 is famous in that shadow directors will come into its regulation, and also, controlling companies can be deemed shadow directors of controlled companies.

This report chiefly presents studies on, firstly, underlying factors for liability as shadow directors, secondly, underlying factors for liability as shadow directors in terms of controlling companies, thirdly, relation between shadow directors and fiduciary duties or general duties of directors, and lastly, as suggestion to the Japanese law, proposals of regulations in relation to protection of creditors of controlled companies.

According to studies of the author of this report, as to the first and the second points, the underlying grounds arise from a factor of control such as control over decisions of the board of directors. In terms of the second point, there is an issue as to whether courts have actually found controlling companies as shadow directors of controlled companies. The third point is currently left unresolved as a difficult problem in the UK. As to the fourth point, in the UK which does not have an established framework of regulation for corporate groups, the shadow director framework is expected to operate as a substitution for the former framework. However, an essential problem, namely to what extent the executive organ is extended, arises from taking
the shadow director framework for corporate group regulations. This problem relates to an issue that controlling companies are deemed to be shadow directors of controlled companies, and an issue as to relation between controlling companies, which are deemed shadow directors, and their duties of directors towards controlled companies. This report offers brief studies on the four points mentioned above.

Directors' Disqualification in England and Wales

History and Evolution

Yasue NAKAMURA

When a limited company's assets are insufficient to pay its debts and other liabilities, it is said to 'become insolvent'. Insolvency constitutes grounds for the commencement of bankruptcy proceedings.

In Japan, if the directors of an insolvent company are with knowledge or are grossly negligent in performing their duties, they are liable to a third party, such as a creditor of the company, for damages arising from the insolvency. In England and Wales, if in the course of insolvent liquidation of a company it appears that a person who is or has been a director of the company has been negligent, the court, on the application of the liquidator, may declare that person liable to contribute to the company's assets as the court thinks proper.

Furthermore, the court shall issue a disqualification order against a person who is or has been a director of the insolvent company if his or her conduct as a director makes him or her unfit to be involved in managing the company. The disqualification of an 'unfit' director is established under the Company Directors Disqualification Act of 1986 (CDDA). CDDA states that other reasons to disqualify a person as a director include conviction of an indictable offence in connection with the promotion, formation, or management of a company. About 1,000 directors are disqualified each year; the total since 1986 is more than 20,000.

Disqualification provisions relating to bankruptcy and fraudulent trading were first enacted in the Companies Act of 1928. Since then, there has been a sporadic process of consolidation that has culminated in CDDA. In 1982, the Cork committee in its review of insolvency law and practice primarily argued for more energetic application of disqualification legislation. In particular, they proposed a radical reform of the rules relating to the disqualification of directors of insolvent companies on grounds of 'unfitness'. The disqualification provisions were then consolidated in CDDA.

CDDA provides that if the directors of insolvent companies are deemed by the court to be unfit, the court shall issue disqualification orders to them. Broadly speaking, a disqualification order prohibits the disqualified person from being a company director or from engaging generally in the promotion, formation, or management of companies, in each case without the permission of the court. Such an order absolutely prohibits the disqualified person from acting as an insolvency practitioner.

In addition, the Insolvency Act of 2000 added a new provision about