The butterfly effect

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The butterfly effect: Theoretical implications of an apparently minor corporate transparency proposal

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Abstract

The UK government has proposed a seemingly minor change to the UK corporate transparency regime, being to require Companies House to verify the identity of new directors of companies, persons of significant control and those incorporating companies, to help in the fight against corporate crime. These proposals seem sensible and innocuous. However, there are a number of theoretical implications which flow from this seemingly minor change. First, it starts the process of making the UK corporate register an effective gatekeeper. Second, it involves the state more in the establishment and operation of the company, strengthening the argument that the corporate form somehow exists as a gift from the state. Third, shareholders are ignored, which challenges argumentation structures for those who believe in shareholder primacy. This illustrates how dependent ostensibly universal company law theory is on a particular doctrinal structure, and thus how exposed particular calibrations of arguments are to being undermined. Every time the UK government proposes a minor change to company law doctrine, the butterfly flaps her wings and those advancing existing company law argumentation structures must brace themselves.

Keywords

company law, corporate transparency, corporate law

Introduction

The 'Butterfly Effect' is the observation that tiny changes in the atmosphere (the eponymous butterfly flapping her wings) can have major implications for global weather systems.[1] The effect became

1. EN Lorenz, 'Deterministic Nonperiodic Flow' (1963) 20(2) Journal of Atmospheric Sciences 131; EN Lorenz, 'Atmospheric Predictability As Revealed by Naturally Occurring Analogues' (1969) 26(4) Journal of the Atmospheric Sciences 636.

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subsumed into the wider chaos theory of physics – that small changes can have large, often unpredictable, effects elsewhere.[2] This trope has been previously applied to laws – to illustrate how an interpretation of minor boilerplate in a contract can cause serious repercussions to a large number of contracts,[3] the finance of litigation,[4] international law[5] and the development of the efficient capital market hypothesis.[6] The key point running through this literature is that small doctrinal changes in law can have large, sometimes unintended, effects on law and theories derived from that law.

This article argues that a recent apparently minor UK government proposal in the sphere of corporate transparency could potentially have large, knock-on effects for company law theory in the UK. This apparently minor proposal is the introduction of a requirement for the Registrar of Companies[7] to conduct anti-money laundering and identity checks on those incorporating a company, directors and persons of significant control (PSC)[8] in the company, in order to better tackle fraudulent use of the corporate form.[9] This has been followed by three subsequent proposals, which are complementary to the overall themes of the first proposal.[10] There are clearly legitimate policy goals advanced in respect of this measure. Its introduction, however, has a series of effects on theoretical UK company law. First, by expanding the role of the Registrar of Companies from a passive entity which checks basic details on forms and files whatever passes this cursory test, towards a more constitutive register, it will expand the state's role in providing gatekeeping services[11] to those interacting with companies. Second, it interposes more of the UK state into the creation and running of a company. This boosts arguments that companies derive, ultimately, as a gift from the

2. For example, see SA Kauffman, 'Antichaos and Adaption' (1991) 265 Scientific American 78; EJ Heller and S Tomsovic, 'Postmodern Quantum Mechanics' (1993) 46 Physics Today 38.
3. JF Coyle, 'The Butterfly Effect in Boilerplate Contract Interpretation' (2019) 82 Law and Contemporary Problems i.
4. M Rodak, 'It's about Time: A System Thinking Analysis of the Litigation Finance Industry and its Effect on Settlement' (2006) 155 The University of Pennsylvania Law Review 503.
5. MJ Glennon, 'How International Rules Die' (2005) 93 Georgetown Law Journal 939.
6. LA Cunningham 'From Random Walks to Chaotic Crashes: The Linear Genealogy of the Efficient Capital Market Hypothesis' (1994) 62 The George Washington Law Review 546.
7. Companies Act 2006, Part 35. The Registrar operates from Companies House, where the central registry of companies is located. The terms 'Registrar' and 'Companies House' are, therefore synonymous.
8. K Murray, 'The veiled threat of organised crime – how organised crime does its business' (2020) 41 The Company Lawyer 385; P German, 'Unlocking the secrets of ownership' (2020) 41 The Company Lawyer 245.
9. Department for Business, Energy & Industrial Strategy, 'Corporate Transparency and Register Reform' 18 September 2020 – available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/925059/corporate-transparency-register-reform-government-response.pdf.
10. These are all by the Department for Business, Energy & Industrial Strategy, and were all published on 9 December 2020. They are, respectively, proposals for increased powers for the registrar 'Corporate transparency and register reform: powers of the registrar' – available at https://www.gov.uk/government/consultations/corporate-transparency-and-register-reform-powers-of-the-registrar; updates on the proposed ban of corporate directors – 'Corporate transparency and register reform: implementing the ban on corporate directors' – available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/942194/Corporate_Directors_Consultation.pdf.; and changes to improve the quality of financial information registered – 'Corporate transparency and register reform: improving the quality and value of financial information on the UK companies register' – available at https://www.gov.uk/government/consultations/corporate-transparency-and-register-reform-improving-the-quality-and-value-of-financial-information-on-the-uk-companies-register.
11. RH Kraakman, 'Corporate Liability Strategies and the Costs of Legal Controls' (1984) 93 Yale Law Journal 857; RH Kraakman, 'Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy' (1986) 2 Journal of Law, Economics and Organization 53.

state[12] rather than by private contract.[13] The decision to verify the identity of PSCs in the company, and not shareholders, also tacitly creates (or evidences) a marginal decline of the importance of shareholders in the UK company, which would provide a boost for those who argue against[14] shareholder primacy.[15]

Thus by taking a series of small steps, these proposals influence major aspects of company law theory. Company law theory is important when arguing what the law should be in any given situation. Further, each of these aspects of company law theory has major practical implications.[16] The UK government's proposals are the butterfly, with the changes to company law theory the chaos theory erupting therefrom. Company law is especially at risk from this type of change, as a number of ostensibly normative statements are based on a particular embedded description of a company.[17] In other words, statements that appear to be purely theoretical tend to be linked to a particular set of characteristics that may not apply to all companies. As such, statements of apparent universality are often based on a particular type of company.[18] Therefore, company law lacks a truly neutral normative framework, and instead any normative statements of company law inherently flow purely from a description of the legislative framework (or company law practice[19]) in place at any given time. If these apparently small changes to this legislative framework are enacted, they will have the potential for major changes to how we conceptualise company law in the UK.

The rest of this article proceeds as follows. The section 'Corporate transparency' reviews corporate transparency. The section 'Registry as gatekeeper' argues these proposals enhance the role of the Registrar of Companies as a corporate gatekeeper. The section 'State gift?' reviews the impact of these proposals on theories of the origin of the company and the section 'Shareholder primacy?' reviews their impact on the shareholder primacy debate. The section 'Implications' proposes implications of this analysis, and the last section concludes the paper.

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12. SM Watson, 'The Corporate Legal Person' (2019) 19 (1) Journal of Corporate Law Studies 137.
13. FH Easterbrook and DRR Fischel, 'The Corporate Contract' (1989) 89 Columbia Law Review 1416.
14. E.g. EM Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 Harvard Law Review 1145.
15. E.g. DG Smith, 'The Shareholder Primacy Norm' (1998) 23 The Journal of Corporation Law 277. See Shareholder primacy? for further details.
16. For example, good gatekeepers reduce the cost of interacting with the firm (SM Bainbridge, *Corporate Governance after the Financial Crisis* (OUP, Oxford, 2012) 200); state gift gives the state has more locus to intervene in the company (A Wolfe, 'The Modern Corporation: Private Agent or Public Actor?' (1993) 50 Washington & Lee Law Review 1673); and in whose interest the company should be run dictates the activities a company should undertake (AA Berle, 'For Whom Corporate Managers are Trustees: A Note' (1932) 45 Harvard Law Review 1365).
17. G Kelly and J Parkinson, 'The Conceptual Foundations of the Company' in J. Parkinson, A. Gamble and G. Kelly (eds) *The Political of Economy of the Company* (Hart Publishing, Oxford, 2000); MT Moore, 'Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism' (2014) 34 Oxford Journal of Legal Studies 693.
18. E.g. reliance upon a public market – see the market for corporate control (HG Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110) and market forces disciplining directors (EF Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 Journal of Political Economy 288).
19. E.g. statements about the directors managing the company (BR Cheffins, *Company Law Theory, Structure and Operation* (reprint, OUP, Oxford, 2007), 603) are predicated on practice – the division between directors and shareholders is for the articles (SM Watson, 'The significance of the source of the powers of boards of directors in UK company law' [2011] Journal of Business Law 597).

Corporate transparency

Corporate transparency has been rising in importance in recent years.[20] One of its key purposes is to increase transparency to shareholders and potential investors[21] to create as perfect a market in the shares of the company as possible.[22] Thus, transparency to achieve this purpose should be seen as a function of capital markets law rather than a matter of company law: not all UK shares are publicly listed, and not all of those listed on the London Stock Exchange are UK companies.[23] This focus on informing shareholders fits neatly into corporate law's 'master problem of research',[24] the separation of control between shareholders and managers.[25] In turn, transparency helps lower agency costs which arise between managers and shareholders,[26] and which are generally seen as something to be minimised.[27] Transparency into the affairs of the company has long been seen as a way to help lower these agency costs.[28] It does so by reducing information asymmetries,[29] which improves capital markets.[30] As such, increased corporate transparency tends to produce a higher share price for the company.[31]

Advantages attract to other corporate constituencies (i.e. parties that are not current, future or potential shareholders) too – disclosure safeguards creditors,[32] perhaps by making shareholders (through the price mechanism) act as representatives of other stakeholders.[33] Transparency helps tackle corporate crime: by shining a light on the activities of companies, illegal activity

20. See IH-Y Chiu, 'Reviving Shareholder Stewardship: Critically Examining the Impact of Corporate Transparency Reforms in the UK' (2014) 38 Delaware Journal of Corporate Law 983.
21. E.g. TA Paredes, 'Blinded by the Light: Information Overload and Its Consequences for Securities Regulation' (2003) 91 Washington University Law Quarterly 417.
22. See, for example, IH-Y Chiu, 'Taking stock of securities and fund-raising in the EU and UK' (2020) 41 The Company Lawyer 201; Z Goshen and G Parchomovsky, 'The Essential Role of Securities Regulation' (2006) 55 Duke Law Journal 711.
23. I MacNeil and A Lau, 'International Corporate Regulation: Listing Rules and Overseas Companies' (2001) 50 International and Comparative Law Quarterly 787; BR Cheffins, 'The Undermining of UK Corporate Governance(?)' (2013) 33 Oxford Journal of Legal Studies 503.
24. R Romano, 'Metapolitics and Corporate Law Reform' (1984) 36 Stanford Law Review 923, 923.
25. AA Berle and G Means, *The Modern Corporation and Private Property* (rev edn, Harcourt, New York, 1967); BR Cheffins, *The Trajectory of (Corporate Law) Scholarship* (CUP, Cambridge 2004), 38-43.
26. MC Jensen and WH Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305.
27. E.g. R Aguilera and others, 'Regulation and Comparative Corporate Governance' in M Wright and others (eds), *The Oxford Handbook of Corporate Governance* (OUP, Oxford, 2014), 25; LA Bebchuk and S Hirst, 'Private Ordering and the Proxy Access Debate' (2019) 65 The Business Lawyer 329, 335–336; LA Bebchuk, R Kraakman and GG Triantis, 'Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights' in in RK Morck (ed), *Concentrated Corporate Ownership* (The University of Chicago Press, London, 2000), 310–311.
28. PG Mahoney, 'Mandatory Disclosure as a Solution to Agency Problems' (1995) 62 University of Chicago Law Review 1047; C Villiers, *Corporate Reporting and Company Law* (CUP, Cambridge, 2006), Ch 1.
29. P Ormrod and KC Cleaver, 'Financial Reporting and Corporate Accountability' (1993) 23 Accounting and Business Research 431; Villiers, n 28 above, 21.
30. JC Coffee, 'Market Failure and the Economic Case for a Mandatory Disclosure System' (1984) 70 Virginia Law Review 717.
31. A Durnev and EH Kim, 'To Steal or Not Steal: Firm Attributes, Legal Environment and Valuation' (2005) 60 The Journal of Finance 1461; M Lang, KV Kins and M Maffett, 'Transparency, Liquidity and Valuation: International Evidence on When Transparency Matters Most' (2012) 50 Journal of Accounting Research 729.
32. L Sealy, 'The Disclosure Philosophy and Company Law Reform' (1981) 2 The Company Lawyer 51, 51.
33. G Hertig, 'Governance by Institutional Investors in a Stakeholder World' in JN Gordon and W-G Ringe, *The Oxford Handbook of Corporate Law and Governance* (OUP, Oxford, 2018).

is less likely to happen.[34] Transparency's other main purpose, therefore, is the public policy purpose of reducing another agency cost that exists in corporate law[35] – that arising between the company and outsiders interacting with it.[36] Rather than a positive externality[37] (an additional, external benefit rather than the core purpose), mitigating this agency cost has been embraced by the UK government as its sole aim in proposing changes to corporate transparency.[38] Here, the UK government is focusing on identify verification,[39] which is deployed in anti-money laundering regulations.[40] Three corporate constituents will need to verify their identity: those who present companies for incorporation, PSC in the company and directors.[41] This list reflects some realities of corporate life. First, the majority of companies by number are private companies,[42] which means that the disciplinary effects of the capital market[43] (and related rules[44]) do not apply to them. In addition, the majority of private vehicles are established by professional presenters,[45] and their style constitutional documents tend to be followed slavishly and rarely subsequently varied.[46] Second, directors are those who are most likely to direct the activities of the company. Third, identification of shareholders is not sufficient, it is instead necessary to look beyond this formalistic understanding to see who, in practice, exerts significant control over the company. Under the new regime, a director will not be appointed legally until his or her identity has been verified by Companies House.[47] The identity of those exerting significant control is a matter of fact, and so there will be a requirement to verify the identity of such PSCs ex post.[48] To incorporate a company, the person or entity submitting the form will

34. RL Knauss, 'A Reappraisal of the Role of Disclosure' (1964) 62 Michigan Law Review 607; J Hardman, 'Reconceptualising Scottish Limited Partnership Law' (2021) 21 Journal of Corporate Law Studies 179; A Vaccaro, 'To pay or not to pay? Dynamic Transparency and the Fight against the Mafia's Extortionists' (2012) 106 Journal of Business Ethics 23.
35. R Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd ed, OUP, Oxford, 2017), Ch 1.
36. This is often phrased in that limited liability encourages externalisation of risk to third parties – see H Hansmann and R Kraakman, 'Towards Unlimited Shareholder Liability for Corporate Torts' (1991) 100 Yale Law Journal 1879.
37. R Romano, 'Empowering Investors: A Market Approach to Securities Regulation' (1998) 107 Yale Law Journal 2359; MA Lemley and D McGowan, 'Legal Implications of Network Economic Effects' (1998) 86 California Law Review 479.
38. DBEIS, n 9 above.
39. DBEIS, n 9 above, Ch 2.
40. See discussion in J Lowry, 'Relieving the trustee-solicitor: a modern perspective on section 61 of the Trustee Act 1925?' (2017) 133 Law Quarterly Review 223; P Matthews, 'Registered land, fraud, and human rights' (2008) 124 Law Quarterly Review 351.
41. DBEIS, n 9 above, Ch 3.
42. See J Hardman, 'Articles of Association in UK Private Companies: An Empirical Leximetric Study' (2021) European Business Organization Law Review, DOI: 10.1007/s40804-021-00213-3.
43. For the disciplinary effect, see those sources referenced in n 18 above. For their inapplicability to private companies, see JAC Hetherington and MP Dooley, 'Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem' (1977) 63 Virginia Law Review 1.
44. E.g. the UK Corporate Governance Code, (https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf) required under the listing rules (https://www.handbook.fca.org.uk/handbook/LR.pdf, rule 9.8.6).
45. A Cosh and A Hughes, 'Size, financial structure and profitability: UK companies in the 1980s' in A Hughes and DJ Story (eds) *Finance and the Small Firm* (Routledge, London, 1994); Hardman n 42 above.
46. See Watson, n 19 above; Hardman, n 42 above.
47. DBEIS, n 9 above, paras 106–114
48. DBEIS, n 9 above, para 119. The PSC regime was introduced in the UK to make companies identify not just the legal entity who holds their shares, but also those individuals who, on a look-through basis, actually control the

have to have their identity verified by Companies House.[49] The UK Government considered requiring further information in respect of shareholders and verifying their identities, but decided against it.[50]

Registry as gatekeeper

These reforms strengthen the role of Companies House in the activities of the company. As such, it makes Companies House a stronger gatekeeper for UK corporate law. Gatekeepers have a strong theoretical role in corporate law.[51] Gatekeepers are external parties who verify information to potential investors in the company,[52] often as a result of their reputation.[53] This role can be especially effectively undertaken by corporate lawyers[54] and by auditors.[55] A state's corporate registry, such as Companies House, can also act as a gatekeeper.[56] However, Companies House does not currently fulfil such a role adequately for two reasons.

First, the current legal regime undermines Companies House, through its public registers,[57] being an effective gatekeeper. A company does not exist, and cannot contract, until it is incorporated by Companies House.[58] However, after it is created, matters in a company's life are only notified to the registry ex post. Three changes are not effective until actually processed by Companies House: a change of name,[59] a change of registered office[60] and a change of the company's objects.[61] For these purposes, therefore, the public register is constitutive – the change is not legally made until and unless the relevant forms are processed by the public registry. Other event-driven filings, though, are ex post notifications to the registry.[62] For these other filings, the change is legally made and then notified after the fact to the registry.

company – see discussion in J Hardman, 'Scottish share pledges and recent legislative developments: lessons for the Great Repeal Bill' [2018] Juridical Review 64.

49. DBEIS, n 9 above, para 129.
50. DBEIS, n 9 above, Ch 10.
51. E.g. sources cited n 11 above.
52. Bainbridge, n 16 above, Ch 6.
53. JC Coffee, 'Understanding Enron: It's About the Gatekeepers, Stupid' (2002) 57 Business Lawyer 1403.
54. D Langevoort 'Where were the Lawyers? A Behavioural Inquiry into Lawyers' Responsibility for Client's Fraud' (1993) 46 Vanderbilt Law Review 75; JC Coffee 'The Attorney as Gatekeeper: an Agenda for the SEC' (2003) 103 Columbia Law Review 1293; J Loughrey, *Corporate Lawyers and Corporate Governance* (CUP, Cambridge, 2011), Chs 3 and 7.
55. C Flores, 'New Trends in Auditor Liability' (2011) 12 European Business Organization Law Review 415; A Mennicken and M Power, 'Auditing and Corporate Governance' in Wright et al (eds) n 27 above; WF Ebke, 'Corporate Governance and Auditor Independence' in G Ferrarini et al (eds) *Reforming Company and Takeover Law in Europe*, (OUP, Oxford, 2004), 508.
56. Villiers, n 28 above, 115–116.
57. https://www.gov.uk/get-information-about-a-company; Hardman n 42 above; J Hardman, 'The Slow Death of the Scottish plc Listed in London' Journal of Business Law, forthcoming.
58. Companies Act 2006, s16; Dodd, n 14 above, 1160; MM Blair and LA Stout, 'A Team Production Theory of Corporate Law' (1999) 85 Virginia Law Review 247, 250; WT Allen, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14(2) Cardozo Law Review 261.
59. Companies Act 2006, s81.
60. Companies Act 2006, s87.
61. Companies Act 2006 s31(2)(c); J Hardman, 'The Companies Act 2006: It's Time to Complete the Transition' (2020) 41 The Company Lawyer 93.
62. E.g. upon changes to share capital (Companies Act 2006, ss619, 621, 625, 627 and 689), changes to directors (Companies Act 2006, s167).

A number of key provisions in the Companies Act make reference to a company's own internal records being constitutive[63] – meaning that these internal records are determinative of the relevant issue, such as whether someone is a shareholder or not. This regime was clearly sensible in a world without modern technology, as there were delays in public filings and checking public registers was cumbersome. Now that filings can be made instantaneously,[64] and checked by anyone online,[65] constitutive internal registers seem anachronistic. Indeed, the reliance on internal registers undermines public registers (or, more accurately, their operators) being effective gatekeepers: public information will not be accurate, as such information may have changed but not yet been notified, and even if not then any information listed is not determinative. The move to delay the legal date of appointment of directors until Companies House has verified their identity can, then, only strengthen the gatekeeper function of Companies House. Those transacting with the company will know that any person purporting to be a director who is not listed as such at Companies House cannot be duly appointed.[66] When this is added to the name of the company, any limitations on its capacity[67] and its registered office, it creates a clear picture to those considering investing in, or interacting with, the company.

This measure alone does not transform Companies House into a perfect gatekeeper. So long as any change to the company remains to be notified ex post, the register will not be perfect.[68] Charges granted by UK companies have a 21 day period in which to be registered,[69] which effectively translates to a 21 day blind period for those interacting with the company: they cannot know whether a currently unregistered charge was granted 20 days ago. Similarly, the filing of financial information is inherently historic,[70] filed up to 6 or 9 months after the date of the information,[71] and can be manipulated.[72] When we move to registered partnerships, the issues become even greater. In addition to the same issues as above, limited liability partnerships suffer from the fact that indication of membership status on the register is not determinative – it is legally impossible to be an employee and a partner,[73] and courts have held that a member of an

63. E.g. members – Companies Act 2006, s112 & s113, and debenture holders – Companies Act 2006, s743.
64. E.g. https://find-and-update.company-information.service.gov.uk/accounts/guidance.
65. See n 57 above.
66. Currently, director appointment is governed by articles of association, with the model articles stating that appointment takes effect upon resolution – The Companies (Model Articles) Regulations 2008 (SI 2008/3229), Sch 1 Art 17. The position for de facto and shadow directors is unclear, but these are usually considered as ex post liability attribution mechanics – S Witney, 'Duties owed by shadow directors: closing down the puppet masters?' [2016] Journal of Business Law 311; C Noonan and SM Watson, 'Examining company directors through the lens of de facto directorship' [2008] Journal of Business Law 587.
67. Which are effectively irrelevant to third parties under Companies Act 2006 ss39–40; L Talbot, 'A Contextual Analysis of the Demise of the Doctrine of Ultra Vires in English Company Law and the Rhetoric and Reality of Enlightened Shareholders' (2009) 30 The Company Lawyer 323; C Nyombi, 'The gradual erosion of the ultra vires doctrine in English company law' (2014) 56(5) International Journal of Law and Management 347.
68. As noted, some elements (like PSC appointment) can only be registered ex post.
69. Companies Act 2006, s859Aff. See ADJ MacPherson, 'Registration of Company Charges Revisited: New and Familiar Problems' (2019) 23 Edinburgh Law Review 153.
70. Companies Act 2006, Part 15 Ch 4; E Walker-Arnott, 'A true and fair view: the difficulties for company directors and the case for reform' [2017] Journal of Business Law 499.
71. Companies Act 2006, s442.
72. E.g. JE Hill, 'Regulating executive remuneration: international developments in the post-scandal era' (2006) 3 European Company Law 64.
73. *Ellis v Joseph Ellis & Co* (1905) 1 KB 324 (CA) 329. This is a partnership case, but to ascertain whether a member of an LLP is employed by that LLP, partnership rules are applied – see Limited Liability Partnerships Act 2000

limited liability partnership (LLP) can still be its worker, but true (equity) members of an LLP cannot be employees, and if a purported member is in fact an employee then they cannot be a true member.[74] Even less information is published for limited partnerships (LPs)[75] and defunct LPs cannot be registered as being dissolved, meaning no LP is ultimately ever removed from the register.[76] However, the measure proposed will undoubtedly strengthen the role of the Registrar of Companies as a corporate gatekeeper, and should be welcomed accordingly.

Second, the current practice of Companies House hinders its gatekeeper function. When the Registrar accidently filed a winding up order against a wrong company, causing its collapse,[77] the registrar explained that they only check the form of documents filed with them and not the substance.[78]

This shows Companies House was not a strong corporate gatekeeper as it was not verifying any information it entered onto the public register. The requirement that Companies House verify the identity of key constituencies will strengthen this role, and mean that third parties can be more certain about the contents of the public register. It is therefore to be welcomed that Companies House practice will have to change, and so strengthen the gatekeeper function of the public register.

Thus, a simple proposal begins the transformation of the public register from an entirely passive, form-based ex post register, to a constitutive register which third parties can rely on. This is not sufficient, in and of itself, to create a robust gatekeeper overnight, but will necessitate a change of approach which, if harnessed correctly, will create a strong gatekeeper. Thus by a small change in law and practice, steps are taken towards a key change in UK company law.

State gift?

The proposed reform will alter the balance in a very historical debate in corporate law – the source of the company's separate legal personality.[79] Some argued that this arose as a fiction allowed by law,[80] and others claimed that the company was a real entity.[81] This debate skewed over time,[82] with descendants of the 'fictional' commentators arguing that this fiction

s4(4), and *Reinhard v Ondra LLP* [2015] EWHC 26 (Ch), so someone cannot be simultaneously a true member of an LLP and an employee of it.

74. See *Bates van Winkelhof v Clyde & Co LLP* [2014] UKSC 32; E Berry, 'When is a partner/LLP member not a partner/LLP member? The interface with employment and worker status' (2017) 46 Industrial Law Journal 309; J Prassl, 'Members, partners, employees, workers? Partnership law and employment status revisited. Clyde & Co LLP, Bates van Winkelhof' (2014) 43 Industrial Law Journal 495.
75. E Berry, 'Limited partnership law and private equity: an instance of legislative capture?' (2019) 19 Journal of Corporate Law Studies 105.
76. See Hardman, n 34 above.
77. *Sebry v Companies House* [2015] EWHC 115 (QB), [37]; 'Court finds Companies House liable for mistake which caused firm's collapse' (2015) 36 The Company Lawyer 181.
78. *Sebry,* [59].
79. For a historical overview of the debate, see R Harris, 'The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Business' (2006) 63 Washington and Lee Law Review 1421; Watson, n 12 above.
80. See J Dewey, 'The Historic Background of Corporate Legal Personality' (1926) 35 Yale Law Journal 655, 665.
81. FW Maitland, 'The Corporation Sole' (1900) 16 Law Quarterly Review 335; FW Maitland, 'The Crown as Corporation' (1901) Law Quarterly Review 131; F Pollock, 'Has the Common Law Received the Fiction Theory of Corporations' (1911) 27 Law Quarterly Review 219.
82. A 1926 article highlighted that commentators from were ascribing attributes to their position which were neither inherent nor exclusive to that position (Dewey, n 80 above, 669) – see Cheffins, n 25 above, 39.

was effectively allowed by the state, and as such separate legal personality was a gift from the state.[83] Conversely, descendants of the 'real entity' commentators argued that if the company is truly a 'nexus of contracts' then it is formed naturally, by agreement, and therefore no state action creates its separate legal personality.[84] This debate dictates the locus that the state has to intervene into the activities of the company: if separate legal personality is a gift from the state, then that locus is high, whereas if the company exists merely by private contract then state intervention requires more justification – causing practical differences at the margin.[85] It is linked to a debate as to whether the company should be considered as a public or private entity.[86]

This debate remains of modern relevance. Watson has argued that the process of incorporation, relying so heavily on state officials, provides evidence for the state gift theory in English law.[87] In counter to that, the Scottish example has been used[88] to highlight that Scots law enables the creation of separate legal personality by private bargain.[89] Each can point to elements of doctrinal company law to justify their position.[90] There are a number of potential ways to reconcile these two views within a singular legal system.[91] The important aspect, though, is that if such arguments are predicated upon the applicable doctrinal framework, then any changes to that framework can impact the balance of arguments. For our purposes, the balance of arguments as to the theoretical origin of the separate legal personality of a company within UK jurisdictions is changed by the UK government's proposal. This is because Watson's argument is predicated upon the state being important in the incorporation of the company and its ongoing administration, and the new proposals increase the state's role in the life of UK companies. The state's role is increased by adding control over incorporation and control over directors.

83. MH Hager, 'Bodies Politic: The Progressive History of Organizational "Real Entity" Theory' (1989) 50 University of Pittsburgh Law Review 575, 580; WW Bratton, 'Berle and Means Reconsidered at the Century's Turn' (2001) 26 Journal of Corporate Law 737, 742.
84. Jensen and Meckling, n 26 above; Easterbrook and Fischel, n 13 above; M Eisenberg, 'The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm' (1998) 24 Journal of Corporate Law 819.
85. PG Mahoney, 'Contract or Concession? An Essay on the History of Corporate Law' (2000) 34 Georgia Law Review 873; JE Friedlander, 'Corporations and Kulturkampf: Time Culture as Illegal Fiction' (1996) 31 Connecticut Law Review 31; Moore, n 17 above, 706.
86. Contrast Moore, n 17 above (arguing mandatory rules in corporate law provide a challenge to contractarianism) with E Lim, 'Corporate Law, Private Law and Instrumentalism' (2015) Lloyds Maritime and Commercial Law Quarterly 541.
87. Watson, n 12 above.
88. L Macgregor, 'Partnerships and Legal Personality: Cautionary Tales from Scotland' (2020) 20 Journal of Corporate Law Studies 237.
89. Hardman, n 34 above.
90. E.g. state gift commentators can identify Sir Edward Coke in 1612 holding that 'incorporation cannot be created without the King' (*Sutton's Hospital* (1612) 77 E.R. 960), whereas contractarians can look to historic maritime law, which recognised a form of separate legal personality – Mahoney, n 85 above. Currently, state gift theorists can point to the process of creation of a company (Watson, n 12 above), and contractarians can look to the treatment of the articles of association as a contract (Companies Act 2006, s33).
91. E.g. state-created and privately created personality could be differentiated. I am grateful to Professor Susan Watson for highlighting this potential. Indeed, precedent for this argument would seem to exist under Roman law – see F De Vischer *Nourvelle studes de droit romain et priv* (Multa Paucis, Milan, 1949) 122ff; L Caporgrossi Colognesi, 'Peregrini and slaves in the Roman empire' (1996) 2 Fundamina 236. I am grateful to Jonathan Brown for identifying this Roman law link.

First, control over incorporation. Since incorporation by registration was introduced in 1844,[92] anybody has been able to incorporate a company.[93] Thus, limiting those entitled to incorporate companies to those who have been blessed by the state is a dramatic move. The proposal is limited to the seemingly innocuous requirement to verify identity prior to incorporation, without any corresponding limitation on who can establish a UK company. In other words, the proposals are merely that identity must be verified, not that certain individuals cannot set up a UK company. However, we have moved from a position in which the state provided no limitations on who can establish a UK company to one in which only those who have passed the state's verification processes can. This signals a clear move towards the state controlling who can incorporate companies. Elsewhere, it is proposed that a new body be established to consider whether to approve the transfer of shares in companies important to national security.[94] It seems incongruous that control over sales of shares be so implemented, but that someone who had been rejected by such process should be able to incorporate a company to perform the same function of national importance. Should 'incorporating companies' be aligned to 'buying shares', then state control would further extend from a formalistic process of identity verification to a more substantial analysis of establishing whether the state agrees with the incorporation of the company. Those industries which are of national importance are not expressly stated in statute – instead, transactions which automatically fall into this regime will be those listed in secondary legislation.[95]

The tendency for such important details to be left to secondary legislation has been criticised for providing a lack of accountability and scrutiny.[96] The same principles apply to the decision to leave the mandatory list of 'notifiable transactions'[97] to secondary legislation. A proposed list of those industries which will fall under this purview has been published,[98] but this can of course change. Thus, all we know for certain is that it is proposed that the UK legislature pass to the UK government the power to dictate which industries are of importance to national security, that the UK government is likely to have control over transactions in such situations, and that the UK government is likely to have control over who incorporates a company. At the

92. Joint Stock Companies Act 1844; JJ du Plessis 'Corporate law and corporate governance lessons from the past: Ebbs and flows, but far from the "end of history": Part 1' (2009) 30 The Company Lawyer 43; L de Koker, 'The Limited Liability Act of 1855' (2005) 26 The Company Lawyer 130.
93. This was only verified in the seminal case of *Salomon v A Salomon & Co Ltd* [1897] AC 22. See R Grantham and C Rickett, 'The Bootmaker's Legacy to Corporate Law Doctrine' in R Grantham and C Rickett (eds) *Corporate Personality in the 20th Century* (Hart, Oxford, 1998); R Harris, 'The Private Origins of the Private Company: Britain 1862-1907' (2013) 33 Oxford Journal of Legal Studies 339.
94. National Security and Investment Act 2021. The act received Royal Assent on 29 April 2021. Some parts have been implemented, but some (e.g. s1 and s2) are not yet in force.
95. National Security and Investment Act 2021, s63.
96. K Ewing, 'Covid-19: Government by Decree' (2020) 31 King's Law Journal 1.
97. See National Security and Investment Act 2021, s6(1). Any acquisitions important to national security can be 'called in' (National Security and Investment Act 2021, s1), but the requirement to make a mandatory notification will, of course, make it more likely that this power is exercised.
98. Department for Business, Energy & Industrial Strategy, 'National Security and Investment: Sectors in Scope of the Mandatory Regime: Consultation on secondary legislation to define the sectors subject to mandatory notification in the National Security and Investment Bill 2020' November 2020 – https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935774/nsi-consultation.pdf, 5. At the time of proof of this article, draft regulations have also been promulgated – https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1003506/Draft_National_Security_and_Investment_Act_2021__Notifiable_Acquisition__Specification_of_Entities__Regulations_2021.pdf.

moment, it is proposed that the UK government have limited control over each of these steps. However, even under these limited controls, setting up a company will increasingly rely on prior approval from the UK state in a way that has not been seen for 175 years. This is currently proposed to be merely procedural, but it seems logical to, in due course, extend the proposals to be substantive as well. The current proposals alone place the state as being even more key in the process of incorporating a company – providing a boost to those arguing that corporate separate legal personality is a gift of the state.[99]

Second, the proposals transcend incorporation, and provide that directors will not be validly appointed at any stage of the company's life until their identity has been verified.[100] This continues a trajectory of governmental interference in the identity of directors. Until the Companies Act 2006 was introduced, there were minimal mandatory rules as to the identity of directors.[101] With the implementation of the 2006 Act came a requirement that at least one director of each company must be a natural person,[102] and law has been passed (but not yet implemented) to state that all directors must be natural persons.[103] This proposal continues the existing trajectory of corporate law[104] – mandatory restrictions as to the identity of directors have slowly been increased.[105] This most recent proposal, however, provides an ultimate right of veto for the state when it comes to the identity of directors of companies. As with the restriction on incorporation, it is currently proposed to be a limited verification exercise. However, practical considerations abound – what will qualify as adequate evidence of identity? Depending on the precise equivalent required for non-UK documentation, this could disproportionately affect non-UK nationals (either by setting non-UK documentary requirements too low, and thus reduce transparency for non-UK nationals, or by setting the requirements too high, making it harder for non-UK nationals to meet technical requirements).

It may well be coherent with the new approach proposed for corporate acquisitions[106] to argue that non-UK nationals should somehow be treated differently to UK nationals in their access to being a director of a UK company. However, this argument has not been advanced. As such, we risk indirect effect from an ostensibly neutral provision. In addition, verification can only be valuable if it matters who the person is. In other words, the process of verification of identity implies either that Companies House are checking that you fall within a category, or that you fall outside a certain category. This implication holds that verification is not an end in and of itself, but a means to an end. By way of illustration, under the current proposals, it is

99. E.g. Watson, n 12 above.
100. DBEIS, n 9 above, p29.
101. See PL Davies and S Worthington, *Gower's Modern Company Law* (London: Sweet & Maxwell, 2016, 11th edn) para 14-24.
102. Companies Act 2006, s155. At the same time a requirement was introduced that stipulated that directors who are natural persons must be at least 16 – Companies Act 2006, s157.
103. Companies Act 2006, s156A. It is now proposed that this provision be altered so that companies can still be directors if all of their directors are natural persons, and have had their identities verified – see DBEIS, Ban on Corporate Directors, n 10 above.
104. See Cheffins, n 25 above.
105. Removal is a different matter – the Joint Stock Companies Act 1844 contained a provision by which directors automatically vacated office if such director became bankrupt, be declared a 'lunatic' or cease to retain any shareholding requirement (s29). This provision did not expressly exclude the appointment of any director who had such characteristic.
106. National Security and Investment Act 2021.

unknown what would happen if a proposed director verified their identity as someone who was convicted of major fraud but had absconded prior to their incarceration. Here, the hopeful director's identity would be verified, but as someone who, one assumes, should be prevented from becoming a corporate director. In scenario A, Companies House verifies the identity and completes the director's appointment. Here, law enforcement would be able to track the businesses that the fraudster would be involved in.[107] However, it is unclear why this is achieved by changes to company law: the same end could have been achieved by providing the same amount of resources to law enforcement combatting fraud.[108] Thus, it would be unclear why any of the theoretical implications outlined in this article are being set in motion: company law theory may change when matters would be best left to criminal law investigations.[109] In scenario B, Companies House refuses to complete the appointment. This would explain why this is a matter for company law rather than criminal law. However, it would reinforce that the state is not merely verifying the identity of the director, they are vetting the director to establish whether they consider them (in some way) suitable to become a director of a UK company. Once again, this is providing enhanced state control in company activities – strengthening the argument that the separate legal personality of the company arises from a gift from the state, rather than as a result of private ordering.

Thus, once again, from a small change in company law doctrine, large implications may arise. This is because the arguments in favour of and against the 'state gift' theory are predicated upon a description of a certain doctrinal landscape. It is not, therefore, surprising that amendments to that doctrinal landscape have implications for more theoretical approaches to company law.

Shareholder primacy?

A third element of corporate law theory which may be affected by this proposal is commonly called the purpose of the company, that is in whose interests the company should be run.[110] The traditional common law perspective[111] on this issue is that the company should exist for the benefit of its shareholders.[112] The normative argument in favour of this is that shareholders

107. For discussion of how this is unhelpful from the perspective of reforms of business entities, see Hardman n 34 above.
108. For academic criminal law discussion of the misuse of the corporate form, see L Campbell, 'Dirty Cash (Money Talks): 4AMLD and the Money Laundering Regulations 2017' (2018) Criminal Law Review 102; N Lord, K Van Wingerde and L Campbell, 'Organising the Monies of Corporate Financial Crimes via Organisational Structures: Ostensible Legitimacy, Effective Anonymity, and Third-Party Facilitation' (2018) 8 Administrative Sciences 17; NJ Lord, LJ Campbell and K Van Wingerde, 'Other People's Dirty Money: Professional Intermediaries, Market Dynamics and the Finances of White-Collar, Corporate and Organized Crimes' (2019) 59 British Journal of Criminology 1217.
109. For discussion as to the balance between misuse of partnership law and criminality, see E Berry, 'Partnership Law: Used, Misused or Abused?' (2021) 32 European Business Organization Law Review, 207.
110. D Attenborough, 'Giving purpose to the corporate purpose debate: an equitable maximisation and viability principle' (2012) 32 Legal Studies 4; A Keay and R Adamopoulou, 'Shareholder value and UK companies: a positivist inquiry' (2012) 13 European Business Organization Law Review 1; D Kershaw, 'Corporate law's fiduciary personas' (2020) 136 Law Quarterly Review 454.
111. See Berle & Means, n 25 above.
112. E.g. Easterbrook & Fischel, n 13 above.

receive the 'residual claim' in the company, that is any surplus on a winding up.[113] The logic is that every other constituent is only interested in receiving their fixed claim, whereas because the shareholders will receive any surplus, they are the only constituency who care whether the company makes £1 surplus or £5,000,000. This argument is used to, amongst other things, justify shareholder voting[114] and argue that shareholders should be the ultimate beneficiaries of fiduciary duties owed to the company.[115] This approach is, as would be expected, hotly contested by some.[116] Once again, it is based on a particular factual matrix – this particular argument is contingent upon the shareholders actually enjoying the residual claim to the company.

Within the debate we can identify a spectrum. Most believe in shareholder wealth maximisation, that is the idea that the company should be run to return maximum profit to the shareholders in the longer term.[117] Shareholder primacists believe not only in shareholder wealth maximisation, but also that shareholders are the correct constituency to make key corporate decisions.[118] Director primacists believe in shareholder wealth maximisation, but argue that this is achieved by providing maximum power to directors, therefore shareholders may have less of a say.[119] Team productionists believe that directors do have considerable power, but to coordinate all factors of production for the benefit of all rather than merely for the shareholders.[120] Stakeholder theorists consider the directors to be only one of a range of stakeholders who are concerned with the company, therefore consider directors to be less important than team productionists do.[121]

All commentators provide a normative quality to their arguments: they apply to how companies should operate.[122] There are, however, two key areas which cause a lack of clarity in why certain commentators disagree.[123] First, they do not always argue in respect of the same subject matter: some analysis concerns how companies should be run[124] whilst other analysis concerns what company law should mandate.[125] It is therefore not always clear the nature of disagreement: one (of many) potential resolution to the debate is to argue that law should

113. Insolvency Act 1986 s107. The articles of association can stipulate that the residual claim will be paid elsewhere – e.g. *Liverpool and District Hospital for Diseases of the Heart v Attorney General* [1981] 1 All ER 994; *Re Merchant Navy Supply Association Ltd* [1947] 1 All E.R. 894.
114. FH Easterbrook and DRR Fischel, 'Voting in Corporate Law' (1983) 26 Journal of Law and Economics 395.
115. JR Macey, 'An economic analysis of the various rationales for making shareholders the exclusive beneficiaries of corporate fiduciary duties' (1991) 21 Stetson Law Review 23.
116. E.g. Dodd, n 14 above.
117. For critical approaches, see I Lynch-Fannon, 'Employees as corporate stakeholders: theory and reality in a transatlantic context' (2004) 4 Journal of Corporate law Studies 155; CM Bruner, 'Power and Purpose in the Anglo-American Corporation' (2010) 50 Virginia Journal of International Law 579.
118. See Smith, n 15 above.
119. E.g. SM Bainbridge, *The New Corporate Governance in Theory and Practice* (OUP, Oxford 2008).
120. E.g. Blair and Stout, n 58 above. This is based on the economic approach to the firm advanced in AA Alchian and H Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62 The American Economic Review 777.
121. See Kelly and Parkinson, n 17 above; R Phillips, RE Freeman, and A Wicks, 'What Stakeholder Theory Is Not' (2003) 13 Business Ethics Quarterly 479.
122. E.g. E Sternberg, 'The Defects of Stakeholder Theory' (1997) 5 Corporate Governance: An International Review 3.
123. This is redolent of the issue with the debate over the origin of separate legal personality – see Dewey, n 80 above.
124. E.g. Philips, Freeman and Wicks, n 121 above; Alchian and Demsetz, n 120 above.
125. E.g. Kelly and Parkinson, n 17 above.

mandate shareholder wealth maximisation, and that a stakeholder approach is the best way to maximise the value of the company for the benefit of the shareholders. It is unclear whether this is the optimal resolution, or indeed if it would satisfy all commentators, but this lack of clarity arises from a lack of clarity as to what, exactly, certain commentators are disagreeing about. Second, despite being ostensibly normative, all theories are rooted in descriptions of a particular doctrinal framework. Thus, underpinning director primacy arguments are provisions of the Delaware code providing maximum discretion to directors,[126] and underpinning shareholder primacy and shareholder wealth maximisation arguments are that the shareholders will, in fact, enjoy the residual claim.[127] If law provided a residual claim elsewhere[128] then these arguments would be undermined. Thus such normative statements are, ultimately, extrapolated from descriptions of the legal system that the commentator identifies.[129] This means that any change to the doctrinal framework will necessitate a change to normative arguments flowing therefrom. For our purposes, it means that, again, minor changes to corporate transparency can cause large effects for company law theory: the butterfly flaps its wings once more.

New controls are focused on those incorporating companies (presenters), those running companies (directors) and those who exert significant control over the company (PSCs). There are no controls over identities of shareholders. The UK government's rationale for this omission is that shareholders who are PSCs will have to verify their identities under the new regime anyway, and so this would only capture shareholders without significant control, which would be a waste of resources.[130] This is slightly flawed logic: the PSC regime operates on a 'pass-through' basis to identify those who actually have control.[131] An intermediary holding vehicle, be it a company or a trust, would be a shareholder but not a PSC.[132] Thus, there is not an inevitable overlap between the identity of shareholders and PSCs. Accordingly, the decision to require verification of identity of PSCs and not shareholders provides an argument that the UK government do not see shareholders are being key under the existing regime. Whilst the decision to introduce the PSC regime merely added an additional corporate constituency to examine, this decision to verify the identity of PSCs and not shareholders indicates a clear policy choice that the former are more important for these purposes than the latter. There is, of course, a difference between ensuring transparency in the name of the public interest, and a focus on how the company is run, but nonetheless a focus on PSCs and not shareholders highlights that the government consider the former to be of greater importance than the latter.

This argument seems inherently counterintuitive, the UK has deliberately[133] chosen 'enlightened shareholder value' as the statutory basis for its basis for corporate purpose.[134] This provides lip service to non-shareholder constituencies, whilst actually setting the

126. Bainbridge, n 119 above, 12.
127. As without a residual claim, the normative force behind, e.g., Macey, n 115 above, is weakened.
128. See cases cited n 113 above.
129. Or specific characteristics of a company they have in mind – see Moore n 17 above.
130. DBEIS, n 9 above, para 151.
131. Companies Act 2006, Sch 1A, part 1.
132. Companies Act 2006, Sch 1A, para 9.
133. Company Law Review, 'Modern Company Law for a Competitive Economy: The Strategic Framework' URN 99/654 (London, DTI, 1999), paras 5.1.1.–5.1.12.
134. A Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the UK's Enlightened Shareholder Value Approach' [2007] 29 Sydney Law Review 577.

corporate purpose as being solely shareholder friendly.[135] However, it is worth noting the means by which this end is achieved – it is through duties placed on directors rather than any other general statement about company law. Thus, arguments can be constructed as to whether the UK follows shareholder primacy or director primacy. The UK government's emphasis on directors provides a boost to those who wish to argue the latter, as does the emphasis on PSCs rather than shareholders. It could be argued that this is the functional equivalent – those arguing in favour of shareholder primacy do not mean a strict legal interpretation of the shareholder, but instead concentrate on the ultimate economic owner on a similar pass-through basis as the PSC. If this line of analysis is followed, then shareholder primacy is not undermined. However, various other strands of corporate law theory are. In particular, company law adopts a very legalistic entity approach, always holding that a parent company and its wholly owned subsidiary company are, legally, two separate legal entities – each with their own assets and liabilities.[136] In other words, it does not operate on a pass-through basis, but instead pays heed to legal formalities such as the use of intermediaries.[137] It thus rigidly protects the independent liability of each company in a group.[138] There are some exceptions to this general principle, but it is always noted that these should be considered as rarities.[139] This general principle is normally noted as being directly descended from the economic literature based on the theory of the firm. However, such literature does not provide for such personal subjective determination – all notions are based on an objective analysis of where the boundaries of the firm are.[140] These boundaries are clearly set by corporate participants, however this is undertaken by operational decision: once participants have decided what will be inside or outside their putative firm, economic literature does not allow for this firm to then be artificially bifurcated by the imposition of the legal construct of two separate companies.[141]

This 'entity' approach to company law has undesirable results,[142] in that it encourages structuring to increase risk to third parties whilst increasing reward to the ultimate shareholders.[143] Some theorists posit that it is best instead to focus on an objectively-determined enterprise rather

135. Companies Act 2006, s172 merely provides that directors must 'have regard' to non-shareholder constituencies – see Keay, n 134 above.
136. Thus assets cannot be freely transferred between related companies without obeying formal distribution rules – *Averling Barford Ltd v Perion Ltd* [1989] 4 WLUK 159; and courts are reluctant to attribute liabilities of one company to another in its group – see G. Allan, 'To pierce or not to pierce? A doctrinal reappraisal of judicial responses to improper exploitation of the corporate form' [2018] Journal of Business Law 559.
137. E.g. to deny the application of the Duomatic principle – *Demite Ltd v Protec Health Ltd & Ors,* [1998] B.C.C. 638.
138. E.g. *Petrodel Resources Ltd v Prest* [2013] UKSC 34; Allan, n 136 above; A Dignam and P Oh, 'Rationalising corporate disregard' (2020) 40 Legal Studies 187; EC Mujih, 'Piercing the corporate veil: where is the reverse gear?' (2017) 133 Law Quarterly Review 322.
139. See E Lim, 'Salomon reigns' (2013) 129 Law Quarterly Review 480.
140. Economists focus on objective establishment of what participants have decided to be the 'firm' e.g. R Coase, 'The Nature of the Firm' (1937) 4 Economica 386 (argues that the firm internalises market risk to avoid transaction costs); JK Galbraith, *The New Industrial State* (Harmondsworth, Penguin, 1972), 140 (argues that coordination is the defining characteristic of the firm).
141. Even Berle and Means, n 25 above, focus on the gap between ultimate shareholders and the firm, and so treat the firm as all legal entities from whom shareholders are separated – see C Cezanne, 'Berle and Means' in M Dietrich and J Krafft (eds), *Handbook on the Economics and Theory of the Firm'* (Elgar, Cheltenham, 2012).
142. E.g. P Halpern et al., 'An Economic Analysis of Limited Liability in Corporation Law' (1980) 30 University of Toronto Law Journal 117.
143. Hansmann and Kraakman, n 36 above.

than enabling such subjective and self-serving choices in corporate structuring.[144] The innocuous proposal to perform anti-money laundering checks on some key corporate constituents – and not others – provides a chill[145] to those who wish to argue that both shareholders are the dominant corporate constituency, *and also that* corporate groups should be free to cherry pick the legal structures that benefit them best. The emphasis on directors and PSCs in the UK proposals to the exclusion of shareholders seems to either demonstrate that:

1. we should consider shareholders on a pass-through basis. Adopting this approach means that attention to PSCs does not undermine a shareholder-centric approach to the corporate purpose, but risks undermining the claim for enabling limited liability to operate on a selective, self-structured basis; or
2. we should not consider shareholders on a pass-through basis. Adopting this approach means that the emphasis on the PSC undermines arguments in favour of shareholder-centric theoretical approaches, but justifies current flexibility for structuring.

Either way, this apparently minor proposal for corporate transparency has wider implications for company law. It does not, of course, entirely remove the ability to argue in favour of both shareholder centricity and entity-based limited liability. However, it does make it harder for theorists to coherently argue that both should be the case. Thus, once again, we see company law theory predicated on a particular doctrinal landscape being vulnerable to changes in argument structures should that landscape shift.

Implications

There are four key implications of the foregoing for company law scholarship. First, the debates outlined above are not settled. They are not settled because each theorist approaches them using a particular calibration of doctrine or factual circumstances. Arguments in these debates – ostensibly of universal application – are therefore predicated on factual circumstances. These arguments are, therefore, merely extrapolations from descriptions identified by the relevant arguer. Such arguments cannot and do not exist in isolation of doctrinal company law and factual assumptions about the dynamics of a company. Second, this illustrates a weakness in the arguments advanced in each area. The arguments advanced for each debate are subject to an important caveat that the underlying legal status quo does not change. They are not normative arguments of universal application, but instead implicit extrapolation (or interpolation) from a particular doctrinal framework. A change to this doctrinal framework will affect the balance of arguments in any such debate.

Third, such change does not have to be major. The proposals for corporate transparency seem minor, and are not accompanied by major new theoretical declarations about the operation of companies. But they do affect the balance of arguments within each area. The shift is not major – it is not likely that someone will now consider that the UK company registry will

144. E.g. CD Stone, 'The place of enterprise liability in the control of corporate conduct' (1980) 90 Yale Law Journal 1; GL Priest, 'The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law; (1985) 14 Journal of Legal Studies 461.
145. See D Kennedy, 'The Stakes of Law, or Hale and Foucault!' in *Sexy Dressing: Essays on the Power and Politics of Cultural Identity* (HUP, Harvard, 1993); RL Hale, 'Coercion and Distribution in a Supposedly Non-Coercive State' (1923) 38 Political Science Quarterly 472.

become an adequate gatekeeper or that shareholder primacy is undermined by these new proposals. However, it will make certain argumentation structures more difficult – such as arguing in favour of a self-selecting limited liability structure within a corporate group (comprising of a number of limited liability companies, each with its own limited liability to third parties but able to pool assets within the group) whilst conceding that the most important constituency is ultimate owners on a pass-through basis. The modern balance of arguments in the debate over the root of separate legal personality, however, is currently less clear cut than either of these positions. Interposing the state into the establishment of companies, and director appointments, gives a clear boost to the state gift argument and may tip some people towards following it, together with its embedded assumption about a lower justification being required to trigger state intervention in the activities of companies. Thus, law makers must be careful: as ostensibly normative arguments in company law are based on the current legal framework, even minor changes to that framework will affect company law theory. If the UK government keeps making proposals on an issue-by-issue basis, rather than extrapolating from principled statements and positions on these key debates, then we may well end up with an entirely different normative outcome by stealth. UK tweaks to company law risk the butterfly effect.

The fourth implication is of a different nature. Corporate transparency has, historically, been considered at least partially a tool to lower agency costs arising between shareholders and directors. These proposals are targeted at transparency's other purpose – assisting outsiders interacting with the companies. The implications of the proposals are that shareholders will have arguably a less important theoretical role in company law. If they enjoy a less important theoretical role, they should enjoy a less important practical role, and have fewer rights and powers against the company. Thus focusing on victims of one agency cost may have harmed victims of another. To an extent, this is intuitive: a major reason why third parties experience agency costs from a company is that shareholder limited liability creates a moral hazard which encourages the exportation of risk to third parties.[146] The way to resolve this agency cost is, therefore, to increase shareholder liability. This obviously increases agency costs experienced by shareholders.[147] It is not argued that protection against agency costs is inevitably a zero sum game in which protection of one category of sufferer immediately and automatically causes equal loss to another category of sufferer. It is, however, argued that it is not automatic that reducing one category of agency cost will have no negative effect on other victims of agency costs. Some may be mutually beneficial, others will be harmful. Ultimately, any attempt to resolve agency costs cannot be considered in isolation, but needs to be considered holistically due to a risk of the butterfly effect.

Conclusion

The UK government is considering an apparently minor procedural tweak to company law processes to help fight misuse of the corporate form. This proposed reform appears small, but has important implications for theories of corporate law. First, it starts the process of the public

146. M-L Djelic and J Bothello, 'Limited Liability and its Moral Hazard Implications: The Systemic Inscription of Instability in Contemporary Capitalism' (2013) 42 Theory and Society 589.
147. Not least because there is an increased risk for shareholders, which means they will have to spend more time monitoring management, itself an agency cost – see FH Easterbrook and DRR Fischel, 'Limited Liability and the Corporation' (1985) 52 University of Chicago Law Review 89; SE Woodwards, 'Limited Liability in the Theory of the Firm' (1985) 141 Journal of Institutional and Theoretical Economics 601.

registry acting as an adequate corporate gatekeeper. There is still a way to go, but it can be considered an important step in the right direction. Second, it provides additional strength to the arguments of those who consider that the separate legal personality of the company arises as a gift from the state. Indeed, it could become determinative in tipping this balance. Third, it weakens arguments for those in favour of shareholder primacy in the UK doctrinal framework. This is unlikely to be fatal to such argument, but raises awkward questions that cannot be easily and neatly explained. Due to this, it highlights that arguments in company law theoretical debates are predicated on a particular doctrinal framework, and amendments to this framework can have large effects on ostensibly abstract arguments. The proposal reviewed in this article may not drastically change the relative strength of arguments deployed in corporate law debates. However, this article illustrates how this is inherently possible, especially from piecemeal reform of company law. Every time a minor change to the legislative framework is proposed, a butterfly flaps its wings, and company law commentators have to brace the structures of their argument for the oncoming hurricane.

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