

# **Time for radical change in our corporate laws**

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As though we did not know it already, after the BHS affair the time has certainly come for our corporate law to change radically. The time is right for a number of long-standing ideas held dearly by socialist lawyers to be put into action immediately. The goal must be to prevent another public company being taken private and then being immolated in the shadows at such cost to its employees and pensioners.

In this world of the super-wealthy 0.1% floating apart from the laws that bind the rest of us, we need to ensure that the rule of law continues to bite. The super-wealthy are able to disembowel companies to fund their lifestyles without company law seeming to be able to stop them. Trusts law, tax law and pensions law also seem to help rather than constrain them. This is nothing less than a challenge to the rule of law.

This article sets out six specific proposals to prevent a repetition of the BHS farrago. First, let us think about what happened to BHS long before it passed into insolvent administration in 2016.

The joint report of the Work and Pensions and BIS select committees (“BHS”, 20 July 2016) is unlikely to leave any reader unmoved. The cost in snapped pencils and broken coffee cups alone must be enormous. Briefly put, the company was taken private, immolated and the pension fund allowed to run into eye-watering deficit. The ‘Green family’ (as the purchaser is generally described in the select committee report) acquired BHS Plc for £200 million in 2000, when its pension fund was in surplus. A *Private Eye* investigation (13 May 2016) found that the purchase was conducted through an offshore family trust and, while it cost £200 million, it also included the acquisition of a £44 million cash pile. *The Economist* reported (29 May 2003) that the complex transaction was put together by the troubled investment banking arm of West LB, the German regional bank, which needed to be bailed out in the financial crisis.

After the acquisition in 2000, BHS was quickly ‘taken private’, thus putting it beyond the reach of the regulations and the oversight which governed listed public companies (including those issued by the new Financial Services Authority which came into existence that same year). On profits of only £208 million between 2002 and 2004, £414 million was paid out in dividends. The dividends in the first few years were therefore double the company’s profits, meaning that those dividends were being funded directly or indirectly through other assets or through debt. In 2005, after the Arcadia group of companies had been formed to include BHS, a dividend of £1.2 billion was paid by Arcadia to Christina Green (or, rather, to a company under her

control) to stuff metaphorically under the mattress of her home in the tax haven of Monaco. These trusts and companies were like remote drones working for the Greens.

The Greens were able to do several other things through companies under their control. They charged BHS millions of pounds in “administration” fees (£58 million in 2013 alone). Premises were acquired from BHS and then leased back at rents of approximately £12 million annually. In these ways, the Greens sucked cash out of BHS using all the old tricks: manufactured dividends, sale-and-leaseback arrangements, and service fees. Consequently, the Greens were able to take £1.2 billion out of BHS in total without the burdens of owning any of it directly.

BHS was immolated. The company’s assets fell from £501 million in 2001 to £295 million by 2014, and the accumulated reserves shrank from a surplus of £228 million to a deficit of £323 million over the same period. Genuine trading turnover in the company remained flat and then fell away latterly. Purported early profits were primarily based on the sale of assets and cost-cutting. Even *The Economist* was fooled into thinking that BHS had been ‘revived’ (17 February 2005) when that growth was supplied by paper profits. Growing the business itself does not appear to have been a part of the plan. A company worth £501 million in 2001 was sold to a man with no relevant experience in 2015 for £1. The principal reason for offloading the company for any savvy capitalist would have been the stricken pension fund.

Most controversially of all, the pension fund went from a surplus in 2002 to a deficit of £571 million today. That cannot be blamed entirely on the credit crunch. The pension fund was already in deficit to the tune of £75 million in 2005, at the peak of the boom. In essence, the company was simply hollowed out. While Philip Green spends his summer aboard his £100 million, 90 metre super-yacht (“Lionheart”), the employees and pensioners of BHS are left worrying what will be left for them as the company wallows in insolvent administration.

Six key changes are needed for our corporate laws to combat this sort of activity. Shadow Chancellor of the Exchequer John McDonnell signalled his support for them in an interview in *The Mirror* on 30<sup>th</sup> July 2016 with the proposed introduction of a “Philip Green law”.

First, the laws on ‘financial assistance’ must be redefined. It is currently ‘unlawful’ for a company to give money (directly or indirectly) to anyone so that they can buy shares in that company. The law must be changed so that it applies to private companies as well as to public companies. The concept of indirect financial assistance in s.678 of the Companies Act 2006 must be clarified so as to encompass the company being burdened with the repayment of a loan which was used to buy the shares originally. The concern here is that it is common for the purchaser to arrange to take out a loan to acquire the company and also to plan from the outset to use the company to repay that loan after the acquisition is complete. The only thing preventing this structure from being ‘indirect financial assistance’ currently appears to be the sequence of events; but the practical effect is the same in that the company is eventually funding its own purchase. This has been unlawful since the 19<sup>th</sup> century because it gives a false picture of the amount of capital held in a company. This mechanism has been used to buy several Premier League football clubs, before the

company pays dividends to its new shareholders while it also repays the loan which acquired those shares in the first place.

This leads to a second proposal relating to the ways in which dividends can be paid out of companies. The Greens took a total of about £1.5 billion in dividends out of BHS (even putting to one side the single dividend payment of £1.3 billion paid to Christina Green in 2005 from the Arcadia group). When dividends are double the company's profits then that requires in general terms that the dividend was funded from the liquidation of assets or from debt. The Glazer family has taken £15 million in dividends out of Manchester United in one year after issuing bonds through the company (i.e. burdening it with extra debt), listing it on the NY Stock Exchange and moving its holding company to the Cayman Islands. These companies are having their balance sheets liquidated or turned to account in other ways so that dividends can be paid to the super-wealthy capitalists who own them. There must be a clarification of the law so that dividends can only be paid out of earned profits and not out of borrowed money. The requirement in s.830 of the Companies Act 2006 that dividends must be paid out of "profits available for the purpose" must be clarified in this sense. If the company's assets are liquidated, if debt is piled on and if the pension fund is under-funded then it is the company's employees, pensioners and creditors who are funding the capitalists' profits.

Third, there must be an amendment to the Takeover Code (building on Principle 5 of that code) so that anyone proposing to acquire a company must clarify how they will pay for the shares that they are buying. They must publish a clear strategy for the takeover for approval by the Takeover Panel which will show how they will add to success of the company under the Companies Act 2006. That strategy must also make clear how they will maintain the pension fund and that part of the strategy must be approved by the Pensions Regulator. These principles will build on Principle 3 of the code to place obligations on both bidder and offeree to commit to the best interests of the company, as understood under the Companies Act 2006.

Fourth, there must be an expansion of the rights of minority shareholders in s.260(3) of the Companies Act 2006 to bring derivative actions to object to a company being sold by the majority shareholders when that will not further the success of the company. They must also be able to object to corporate strategies which will lead to the corporate pension fund falling into deficit. The shareholders in our largest public companies include pension funds and other institutions on which ordinary people rely. If those companies are sold off and gutted in the process, then ultimately it is ordinary people who will pay either through their loss of pension (a form of deferred pay) or through the increased burden on the welfare state.

Fifth, there must be a statutory "claw back" provision to recover any dividends which are funded indirectly by debt or which breach any of the other principles set out above. It often happens that these cases end up in the insolvency courts (as is the case with the insolvency of BHS which is now in administration). Insolvency law already contains claw back provisions (for example, in s.423 of the Insolvency Act 1986) which allow the courts to recover assets purportedly transferred away several years before the insolvency if the intention was to defraud creditors.

Sixth, and most significantly, supervisory boards must be created for UK companies. These boards will give rights to workers and pensioners to be involved in the company's decision-making. The supervisory board should have the power to object to a takeover of the company on grounds that the takeover will adversely affect the future success of the company, the rights of workers or the pension fund. The only protection against predatory capitalists taking companies over and disembowelling them is to empower a supervisory board to prevent their actions before they take effect.

This progressive idea was in the last Labour manifesto and was then copied by Theresa May when she assumed the role of Prime Minister. ("Remind you of anybody?") It seems that the democratisation of company boards is now genuinely on the agenda. However, it is only the Corbyn-led Labour party which is really talking in earnest about the complete raft of measures which are necessary to protect our economy, our productive businesses and our pension funds, alongside the "Tax Transparency" code announced in April.

There is much more to do in reforming our corporate laws to prevent a repeat of the BHS debacle. There needs to be more pro-active regulation of pensions. The Pensions Regulator appears to have been too sanguine about the treatment of the BHS pension scheme, for example. A deficit of over half a billion pounds was allowed to build up steadily over thirteen years without its intervention. Similarly, the activities of private equity firms who take public companies private so that they can be disembowelled in the shadows must be regulated more closely. Employees and the real economy must not be affected by their determined asset-stripping. After all, BHS was reduced to its bones within a few years of its acquisition. Dividends of £1.6 billion were taken out of the Arcadia group by 'the Green family' (as the select committee report describes the recipient) within five years of the acquisition of BHS. It is unsurprising that the business struggled and that the pension fund went unfunded when so much had been stripped out of it.

Furthermore, our corporate governance code remains voluntary when it must become enforceable by law (not just for listed public companies). The corporate governance failures at the board level in banks like HBOS, on trading floors in Barclays and on the sales floors of every British bank are truly staggering. The inability of anyone to challenge the asset-stripping activities in relation to BHS, as the main business stalled even during the boom years of the mid-2000s, has left many thousands of people in uncertainty.

The devil is both in the detail of these sorts of activities (which went unnoticed even in the financial press) and in the implementation of the reform of our corporate law.

Philip Green's 90 metre super-yacht *Lionheart* was said to be sailing among the Greek islands when the Work and Pensions and BIS select committees issued their joint report on the collapse of BHS. His wealth remains under his wife's mattress in Monaco despite the harm he has caused to 20,000 employees and pensioners (and many more besides in the supply chain). The super-wealthy 0.1% in our society must be controlled. They are the ultimate in rentier capitalists: milking corporations of their assets using trusts and shell companies, and then disposing of the husk when there is

nothing left. There is no useful production in this activity. The super-rich get richer while the workers get unemployment benefit.

The continued existence of laissez-faire corporate law and tax havens within developed countries (like Monaco, the Channel Islands and Delaware) puts the super-wealthy beyond the reach of the laws and the burdens which bind the rest of us. Making radical changes to our regulatory culture is essential both to control the super-wealthy asset-strippers and to maintain the rule of law.

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