LAW AS CAPITALIST TECHNIQUE

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I. INTRODUCTION

Law as the enabler of capitalism

Law is not an accidental by-product of capitalism, nor is it a distinct social system operating in parallel to capitalist economics. Rather, law is central to capitalism. Law is the means by which capitalism gets its work done. Without a quiescent legal system and a quiescent cadre of lawyers skilled in everything from corporate reorganisations to the manipulation of trust assets, modern capitalism could not exist in its modern form. This modern form of capitalism is a newer form – dubbed 'ultra-capitalism' here – which uses corporate lawyers to bleed value out of companies, to avoid regulatory oversight and to dodge liability to tax. This ultra-capitalism is not capable of redemption; but it is urgent need of a profound conceptual revolution. It is through non-capitalist models of commercial enterprise, like the co-operative, that balance can yet be restored to the economy and to our law.

The nature of capitalism

This collection considers whether or not there is any hope of redemption for capitalism. The word 'capitalism' is itself important, and too little discussed. Capitalism is an 'ism': that is, an ideology. It is an ideology which considers it to be *right* that some people will own the capital and that everyone else will work for the capital-owners. On the classical Marxian model, the worker takes a wage while the capitalist takes the much greater surplus value.[1] The worker produces while the capitalist owns the means of production. Capitalism requires class stratification on the basis of money. Property law, employment contract law and corporate law are central to the maintenance of that stratification because they fix ownership of assets within one class while organising the obligations of the other classes as different types of workers. Jeremy Corbyn led the Labour Party into the 2017 General Election on the basis that he would combat the 'rigged system'. The law that is discussed here is the legal constituent of that rigged system.

The evolution of capitalism

There are several types of capitalism. In truth, they are different understandings of the evolution of capitalism over time. There was the first generation, modernist capitalism of the joint stock companies in the Industrial Revolution.[2] A system dedicated to narrow ownership of the means of production and of a generation of surplus value for

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[1] K Marx, *Capital: A Critique of Political Economy*, Penguin Classics, 1990, 293 *et seq*, 'The Production of Absolute Surplus Value'.
[2] E Hobsbawn, *The Age of Capital: 1848–1875*, Weidenfeld & Nicolson, 1975.

the enrichment of those owners. It is part of the 'locomotive logic of capitalism' that ever more power and ever more wealth resides in ever fewer hands.[3] The modern 'ultra-capitalist' – in the manner of Russian oligarchs like Roman Abramovich or asset-strippers like Philip Green, in the manner of multinational companies which only manage brands and information, or in the manner of the global investment banks and hedge funds – generates wealth by using law and by using specialist lawyers to strip value out of useful enterprises. Whereas law has always been a way of entrenching the wealth and power of an ownership class – from basic land ownership through to a form of corporate shareholding which shields investors from personal liability for the actions of the company – the modern use of law in the 21st century (with the connivance of both lawyers and the courts) is to enable the ultra-capitalist to bleed wealth out of income-generating, employment-providing enterprises for personal gain.

There is no space here for a complete history of the evolution of capitalism. What is suggested here is that there have been several stages of capitalism. It developed from the enclosure of common agricultural land into the industrial revolution and the construction of railroads and factories by early capitalists like John Pierpoint Morgan. Significantly, its modern incarnation is found in the global financial system which has ensured a 'financialisation' of the world economy.[4] The 'locomotive logic' of capitalism is for mergers of ever-larger, monopolistic corporations which capture markets and which capture public policy on an international scale.[5] The name 'JP Morgan' is a good metaphor for this qualitative change in the nature of capitalism. It signals a transformation of capitalism from the tangible production of a John Pierpoint Morgan who built railroads and factories, into the crisis-inducing, mathematical abstractions of the investment bank JP Morgan which developed the credit derivatives which amplified a local difficulty in US sub-prime mortgage markets into a global economic collapse.[6] Its abstractions are a metaphor for the working practices of this ultra-capitalism – it has moved from a stage of useful production to an age of financialised reproduction.

The law as facilitator of ultra-capitalism

What is important for the purposes of this essay is to observe that there have been qualitative shifts in the nature of capitalism, and that the ultra-capitalism of the 21st century is a form of capitalism which is dependent on a quiescent legal system – staffed by lawyers and by judges – to get its work done. Starbucks and Google cannot reduce their tax liabilities to vanishing point without skilled intellectual property and tax lawyers who relocate their profits to low-tax jurisdictions. Tax dodgers and international criminals cannot hide their assets from regulatory oversight without an elite cadre of trusts and corporate lawyers operating across borders through tax havens. Asset-strippers cannot dismember companies without lawyers skilled in the deft manipulation of securities regulation and company law extracting every last drop of value from viable businesses.

[3] AS Hudson, 'Too much monkey business', *Tribune*, 29 October 1993.
[4] T Palley, "Financialisation: what it is and why it matters", *The Levy Economics Institute for Democratic and Open Societies*.
[5] AS Hudson, 'Too much monkey business', *Tribune*, 29 October 1993.
[6] G Tett, *Fool's Gold*, Little, Brown, 2009.

Significantly, none of these techniques would be possible without the participation of quiescent judges allowing these approaches. A good example was the decision of the House of Lords in *Barclays Mercantile v Mawson*[7] which allowed tax avoidance schemes to be assessed against literal readings of statutes instead of purposive readings designed to root out 'artificial steps' in transactions. The judges chose to help the tax avoidance industry with that judgment by blunting the progressive *Ramsay* principle[8] which had combated artificial tax avoidance schemes with purposive interpretations of those arrangements and of tax statutes. Of course, none of these avoidance techniques would be possible without quiescent governments drafting deliberately weak legislation. A good example is the "General Anti-Avoidance Rule" in s.206 of the Finance Act 2013 which permits challenges to be brought against the obscurely-named 'abusive' tax avoidance schemes if a panel comprised entirely of tax practitioners with a background in those very techniques agrees to that action.[9] It would be difficult to imagine a means of combating tax avoidance that more evidently and intentionally contained the seeds of its own destruction. It depends upon turkeys (in the form of a panel of tax avoidance professionals) voting for Christmas (in the form of allowing HMRC to proceed against tax dodgers). The judiciary has been complicit in allowing every Englishman 'to order his [sic] affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be' (in Lord Tomlin's famous phrase[10]) as a route to allowing tax avoidance through the manipulation of our overly-complex tax codes. The legal system – through its judicial, executive and legislative branches – has been entirely complicit with these forms of ultra-capitalist abuse.

Central to the argument of this essay is the observation that lawyers and judges are vital to ultra-capitalism in its current form: that is, operating across borders, using complex financial instruments to acquire their objectives, and both generating and shielding excessive wealth for individuals by using traditional legal techniques. Thus trusts, companies and similar techniques are vital to its operation.

A map of what is to follow

By way of an example of the law as a key facilitator of this new model of capitalism, we shall consider how trusts law has been torn from its roots in the philosophy of Aristotle (and his model of equity as an ethical engine within a legal system) and transformed into a sophisticated means of concealing assets from regulatory oversight. We shall consider how corporate law is central to the manipulation of business assets so that the ultra-capitalist can enhance their own personal wealth and drain value out of commercial enterprises by using corporate restructurings, shell companies and a raft of little-known financial techniques. We shall consider how a system of the privatisation of law by banking trade associations and their lawyers

[7] *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51; [2005] 1 AC 684.
[8] *Ramsay v IRC* [1982] AC 300; *Furniss v Dawson* [1984] AC 474.
[9] Finance Act 2013, Sch.43. The first chair of the panel was a QC specialising in tax advice and the current chair is a solicitor with magic circle law firm Allen & Overy specialising in tax advice. The entire panel is comprised in fact of specialist tax advisors. This fact absolutely beggars belief.
[10] *Duke of Westminster v IRC* [1936] AC 1.

enables the ultra-capitalists and the banking industry to operate outside the confines of the nation state and national law.

An alternative model to these capitalist legal structures is the co-operative. The co-operative does not seek to separate assets off from the main business in the way that a limited liability company does. Instead it recognises the rights of the workforce as a collective in those assets and in that undertaking. It entitles them to communal ownership of the enterprise but recognises individual property rights in nothing. This also prevents the 'lines of flight' by which the ultra-capitalist company extracts profits from the geographical location in which the human beings work and sends them to an offshore world of Alice in Wonderland accounting and offshore financing vehicles.[11] Ultra-capitalism promises little regulatory oversight and few ties with a workforce or physical locations. In short, it promises little responsibility for the ultra-wealthy or for multinational corporations. As such, it is a rigged system.

The ultimate aim of this essay is to identify ways in which this form of capitalism can be closed off so that its practices of extracting value from useful undertakings can be stopped and instead its value kept geographically close to the places where the work is done. This will involve reorganising the corporate governance of modern companies; using regulation on a different model to prevent excessive activity in financial markets so as to halt the process of privatising law; and reawakening our understanding of co-operatives as alternative business models.

The common theme running through these alternative understandings of how commercial undertakings could be organised is that there needs to be democracy and not simply despotic ownership by one class (of owners) at the expense of another class (of workers). So, by way of example, corporate governance in companies in the UK should involve 'industrial democracy' to prevent the extraction of all value for the enrichment of the ultra-capitalists, and to enable common ownership of the means of production and profit.[12] Democratic structures within companies will also unlock the knowledge and expertise held inside those organisations beyond the executive board of directors. The conclusion which these reforms prompt is that capitalism as it is currently organised is beyond redemption and that only alternative understandings which are not capital*ist* can introduce democracy to our economic and commercial relationships.

The best recent example of the deployment of these ultra-capitalist techniques is the exsanguination of BHS, with which we shall start.

II. CORPORATE LAW, ULTRA-CAPITALISM AND THE IMMOLATION OF BHS

The features of the new ultra-capitalism

It is important to recognise that the form of capitalism in existence today at the multinational level is very different from the earlier, Fordist models of capitalism.

[11] Z Bauman, *Liquid Modernity*, Polity, 1999.
[12] Tony Benn, speech to the AUEW conference, Morecambe, May 1971, quoted below.

Ultra-capitalism is not concerned with building assets but rather with extracting value from them. The clearest recent example of this process in operation was the immolation of BHS by Philip Green and his associates so that a high street brand (which was in truth a warehouse for other manufacturer's products) would generate billions of pounds in profits for him personally before the husk (along with eleven thousand jobs and twenty thousand pensions) was thrown away.[13]

How company lawyers dismember companies: the example of BHS

It ought to be surprising that our laws allowed Philip Green to take an estimated £1.2 billion from BHS over several years, and then to sell the husk off for £1 in March 2015, without any legal redress against him personally. To understand how law operates as a servant of ultra-capitalism, the BHS scandal serves as a very good example. What matters for present purposes is that this exsanguination of BHS took place entirely lawfully and with the expert advice of professional lawyers, accountants and bankers.

Law is a series of rituals. Procedures must be followed. The immolation of BHS took effect by means of just such a series of rituals developed by practising lawyers. BHS Plc was a 'quoted' public company before its acquisition in 2000. That meant it was subject to the rules of the London Stock Exchange. In 2000 it would have become subject to the securities regulations implemented by the (then) brand new Financial Services Authority. Those rules would have required management to provide large amounts of financial and strategic information to the marketplace and would have opened up the treatment of BHS to public scrutiny. Instead, BHS Plc was pulled into a darkness where public disclosures were not required. This was done by the process known as 'taking it private'. That is the company law technique of converting the company from a public company (with its shares traded publicly and subject to public disclosures of information overseen by a statutory regulator) into a private company (with limited disclosure requirements and only private sales of its shares). These legal techniques operated so as to subvert the regulations which had been put in place to protect employees and investors in commercial enterprises of this sort.

BHS Plc was acquired for £200 million in 2000,[14] although the assets acquired included £44.78 million in cash.[15] Philip Green's specialist advisors constructed a web of front companies and offshore trusts which conducted these transactions. *Private Eye* reported that the purchase was conducted through an offshore family trusts and that latterly dividends were paid to Global Textiles Investments, a company based in Jersey and controlled by Christina ('Tina') Green, wife of Philip Green.[16] *The Economist* reported further that a large portion of the purchase price was acquired with instruments structured by the investment banking arm of West LB, the formerly traditional German regional bank which needed to be bailed out during the financial crisis because it had moved into structured financial products to a disastrous extent

[13] AS Hudson, "BHS and the Reform of Corporate Law, (2016) 37 *Company Lawyer*, 364-371.
[14] See, for example, *The Financial Times*, 'How much money did the Greens make?' 28 April 2016; and *The Economist*, 'A star falls?' 29th May 2003.
[15] *Private Eye*, 'In the City: Green's BHS bargain', 13 May 2016.
[16] *Ibid*.

during the boom years.[17] Importantly, the BHS pension fund was in a healthy surplus until 2002 and BHS Ltd earned profits of £208 million between 2002 and 2004.[18] Therefore, Green's collection of trusts and companies acquired a profitable business, a large number of real estate assets, a large amount of cash, and a pension fund in surplus.

What followed the purchase was the exsanguination of BHS: that is, a process through which value was bled out of the company in a number of ways, in which the business was run into loss during the boom years at the start of the 21st century, and in which the pension fund was run into an unsustainable deficit. In 2005, BHS had been folded into the Arcadia group of companies, along with companies like Topshop. This corporate reorganisation made it more difficult to identify from the outside how these private companies were being treated within the general group of companies. That the group was 'private' meant that little information had to be made public. Importantly, the public nature of the company – its presence on every major high street, its employment of eleven thousand people, and its role in the supply chain – remained the same.

The combined Work and Pensions and BIS Select Committees' joint report into the BHS collapse tells us that BHS earned profits of £208 million between 2002 and 2004.[19] Nevertheless, the company paid dividends of £414 million in this period. Importantly, this means that these dividends were more than twice the profits of the company. Therefore, there were dividends of £206 million paid out to shareholders which were not funded out of profits in that period. Rather, those profits must have been funded by bleeding other assets out of the company. The select committees found that £307 million of those dividends were paid to 'the Green family' and not to shareholders in general.[20] Despite this payment of huge dividends, there was a fairly flat turnover during the boom years of the first decade of this century. So, the business itself was allowed to stall during an economic boom and value was drawn out of the company at the same time. The objective was to take value out of the company. Corporate law practitioners and their specialist knowledge were the tools for doing that.

The headline-grabber was the payment of a dividend of £1.3 billion from the Arcadia group of companies (including BHS) to entities controlled by Tina Green in 2005. Tina Green was a resident of the tax haven of Monaco. Therefore, the lawyers contrived to take this eye-watering personal profit out of the company in a tax efficient manner. It is an important part of the ultra-capitalist's world that they are sheltered from life's inconveniences by their lawyers and their accountants. Again, payments were made in tax efficient ways into a tax haven by highly-paid professionals. The point is that for an ultra-capitalist there is no need to earn a profit. Instead, assets can be liquidated and value moved around between groups of companies in tax havens.

[17] *The Economist*, 'A star falls?', 29 May 2003. This structured products team at West LB are reported by *The Economist* to have loaded the bank with large amounts of poor assets early in the century through deals over Kyndal International, Odeon cinemas, Box Clever and so forth.
[18] Work and Pensions and Business Innovation and Skills Committees, "BHS", HC 54, 20 July 2016 ("WP/BIS select committee report").
[19] WP/BIS select committee report, "BHS", paragraphs 9 and 10.
[20] *Ibid.*

Not content with using dividend payments, the Greens' advisors found other ways of picking every morsel from the bones of BHS. The select committee report tells us that different companies controlled by the Greens acquired premises from BHS for £105 million and then raised rents of about £15 million per annum on those same properties by leasing them back to BHS. In total these property arrangements had raised approximately £150 million by 2015.[21] In similar ways, the Greens were able to raise other 'fees' from BHS, including fees for 'administration', which came to £58 million in 2013.[22]

The BHS story has an unhappy ending, of course. By March 2015, BHS's assets had fallen from £501 million in 2002 to £295 million; liabilities had grown from £205 million in 2002 to £551 million; and accumulated reserves had fallen from £228 million in 2002 to a deficit of £323 million. The company was sold to the former racing driver and twice bankrupt Dominic Chappell for £1 in March 2015. Interestingly, this was prompted not because the business failed and had to be closed down. Instead, the Greens wanted to off-load the corpse of BHS from their corporate balance sheet.

While the pension fund had been in surplus in 2002, it had fallen into an estimated deficit of £571 million by the time of the joint select committees' report in 2016. The pension fund is, of course, comprised of contributions made by BHS staff from their salaries as well as contributions made by the company. It is deferred pay for those employees. The company was simply not being allowed to perform its part in maintaining that fund, at a cost to those employees. This anomaly in pensions law which allows the pension fund to be bled dry and driven into deficit as a result of the employer ceasing to make payments into it (the euphemistically named 'contributions holiday') is a clear connivance between legislator, regulator and capitalist. The only loser in this context is the pensioner who contributes a monthly amount to the same fund with no possibility of a 'holiday'.

Capitalism on this model is without redeeming feature. What remains is the question: how do we address this ultra-capitalist abuse?

The lack of a regulator for ordinary companies

There is no regulator for ordinary companies simply qua companies in the UK. There is no entity which can intervene in the way that the Financial Conduct Authority, or the Prudential Regulation or Financial Policy Committees of the Bank of England, could intervene in relation to a failing bank under the Financial Services and Markets Act 2000 or the Banking Act 2009. Rather, trading companies are allowed to fail unless they contravene some other regulatory norm in another area of law.

The process of registration with Companies House under the Companies Act 2006 does not accompany regulatory oversight of the performance of the company. There is no sanction in the form of the withdrawal of a licence to trade (either as a public

[21] *Ibid.*
[22] *The Financial Times*, 'How much money did the Greens make?' 28 April 2016.

company or as a private company with limited liability) if the company is being wilfully driven *towards* insolvency. Instead, political hand-wringing accompanies corporate failures long after the event as the professionals go to work on dismembering the corpse. The running down of the pension fund and the reduction of the company's assets should trigger a regulatory response, especially where individual shareholders are taking dividends of £1.3 billion out of a company, thus reducing the asset base of the enterprise to the cost of its suppliers, employees and pensioners. The withdrawal of the authorisation to trade as a company with limited liability should be a weapon granted to a new corporate regulator, akin to the power of the financial regulatory bodies to withdraw authorisation to trade in financial services business from failing banks and other financial institutions. In tandem with the creation of supervisory boards in UK companies (discussed below) this would enable parties outside the shareholders and the executive board of directors to control how the company's business is conducted.

Reforming corporate law to meeting the challenge of the super-capitalists

So, what else can be done to combat situations like the exsanguination of BHS? There are five things which can be done to reform our corporate law and prevent the immolation of more public companies in this way.[23]

First, expand the concept of 'financial assistance'.[24] At present, it is unlawful for a company to assist anyone directly or indirectly to acquire shares in that same company.[25] So, for example, a company may not give money to an investor nor may it make a loan to that investor for the purpose of buying shares in the company itself. Thus, A Plc may not lend money to Bernice to buy shares in A Plc. Otherwise, this would make a false market in those shares and it would make the company's capital base look much bigger than it actually was. Oddly, in practice, this does not seem to prevent one particularly common transaction. In that situation, the person taking over the company organises to borrow money, uses that loan to purchase the target company's shares, and then passes the responsibility for repaying the loan to the newly-acquired company. This will have been the plan from the outset between the purchaser and the lender. Despite this being an arrangement in which the company would be responsible for the loan which funded that purchase of shares ultimately, this is not prosecuted as being unlawful financial assistance. The only distinguishing feature between normal financial assistance and this method is that in this method the financial assistance is made immediately after the acquisition rather than immediately before. Several Premier League football clubs have been acquired in this way.[26] The purchasers buy the shares using borrowed money and then transfer the debt to the club as soon as the deal is complete. A concerted arrangement of this sort should be treated as being financial assistance.[27]

[23] AS Hudson, "BHS and the Reform of Corporate Law, (2016) 37 *Company Lawyer*, 364-371. John McDonnell MP adopted these ideas as Labour Party policy in July 2016, after seeing a draft of an early draft of this and connected papers, and presented them in his speech to Labour Party Conference in Liverpool in September of that year.
[24] Companies Act 2006, s.678(1).
[25] *Ibid*.
[26] AS Hudson, *The Law of Finance*, 2nd ed, Sweet & Maxwell, 2013.
[27] *Brady v Brady* [1989] AC 755.

Second, prevent dividends being paid out of borrowed money.[28] When BHS paid twice the level of its profits to its shareholders in dividends, that meant that value was being sucked from somewhere else in the company. That dividend payment was only possible if other assets were liquidated or if the company was taking on debt (directly or indirectly). The rules on dividend payments need to be tightened up so that they cannot be paid directly or indirectly out of borrowed money. In the case of BHS that allowed money to be sucked out of the company and paid to the Green family, leaving BHS with a shrinking asset base even in the boom years before the 'credit crunch' of 2007.

Third, there should be a right to claw back dividends when a company has been dismembered and then allowed to fail. Insolvency law allows the recovery of assets when they have been put unlawfully beyond the reach of creditors. This statutory power has been allowed by the courts to last for a long period of time and is the nemesis of anyone who tried to 'put the house in their wife's name' or hide their valuables in their mother-in-law's garage before going bankrupt. The case law is equally prepared to act retrospectively in relation to 'asset protection trusts' and other devices which people use to protect their property against insolvency before they start a risky venture.[29] There is no reason why asset-strippers should escape the statutory claw on their shoulder.

Fourth, the Takeover Code needs to be reformed so that a public company cannot be taken over until the intended purchaser presents a strategy to the regulators for the 'success of the company' (which the directors are required to promote under the Companies Act 2006) and for the maintenance of the pension fund. That strategy must also make plain how the acquisition of the company will be funded, and whether or not the company will be required to assume responsibility for the purchaser's debts afterwards.

Fifth, trading companies with employees and pensioners must now be required to have supervisory boards. This idea is considered next.

III. INDUSTRIAL DEMOCRACY AND CORPORATE GOVERNANCE

Towards Industrial Democracy

Capitalism is, by its very nature, anti-democratic. Its intention is to recognise the property and profit-sharing rights of a capitalist ownership class, and thus to exclude any other claims. That ownership class is to be protected from the loss of its assets, and it is to be shielded from any liability arising from its investment. Nevertheless, there is a curious tendency in the West to think of the capitalist system as being bound up with democracy.[30] In essence, the wealth that cascades down in the form of wages

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[28] See Companies Act 2006, s.830.
[29] AS Hudson, 'Asset protection trusts' in D Hayton (ed), *The International Trust*, Jordans, 2011, 261.
[30] In the sitcom *Peep Show*, the character Mark Corrigan exclaims with no little passion that the rights and happiness of the other people around him are attributable only to 'the miracle of consumer capitalism'.

is said to be sufficient reward for adherence to this system, accompanied by the political promise of neoliberalism that each citizen could potentially become excessively wealthy too. Other models are, of course, possible but they require the displacement of the ideology of capitalism that the wealth should be owned by a narrow social class and that the decisions about the direction of a company should be controlled by that same narrow class.

The limited liability company is at the heart of this model of capitalism. The UK company law approach to corporate governance sees the company as an autonomous creature of the shareholders under the control of the directors in practice. The Victorian model of the limited liability company emerges clearly from Trollope's *The Way We Live Now* in which titled aristocrats lent the lustre of their names to the company by constituting its board and shareholders, but the day-to-day work was done entirely by middle-class professionals employed for the task. Hence the recognition in *Re City Equitable Fire Insurance* that directors need not attend the company's premises nor company meetings very often at all.[31] This has prompted Ireland to think of these sorts of shareholders as being akin to 'rentier landlords' who take an income from property with which they have little day-to-day connection.[32] As emerges below, the current composition of shareholders in UK public companies shows that 54% of shares are held by overseas investors and that the typical shareholding lasts for only one month. Therefore, the majority of shareholders have only slight connections with companies.

Rather long-term stakes are held by the employees, those who deal with these companies in the supply chain, and the pensioners in the company pension scheme. Nevertheless, the workers have no direct rights *qua* workers in the affairs of the company. Rather their powers are reserved to their contracts of employment or to exercises of industrial action or negotiation. As such, a company is not a democratic place: there are no rights to be heard simply because you are a human being with a stake in the performance of the company.

Democracy in the workplace

In Britain, we talk about democracy in relation to elections but not in relation to our workplaces. Other thinking is possible. By definition, *social* democracy should require bringing the democracy into social and economic life. There is a seam in corporate theory – especially in the work of Charles Handy[33] – which understands the company as being a community of people and not simply as a legal person forming contracts. In a workplace that is itself a community (in the way that Handy explains the company) there is a need for democracy to represent all of the participants in that community.

[31] *Re City Equitable Fire Insurance Co. Ltd* [1925] Ch 407. Romer J took the approach that directors bore little personal responsibility to turn up for anything more than board meetings and that they could delegate the day-to-day administration of the company's business to subordinate managers and employees.

[32] P Ireland, 'Company law and the myth of shareholder ownership', (1999) 62 *Modern Law Review* 32; P Ireland, 'Corporate governance, stakeholding, and the company: towards a less degenerate capitalism?' [1996] 23 *Journal of Law and Society* 287.

[33] C Handy, 'People and Change', in G Radice (ed), *What Needs to Change?* HarperCollins, 1996.

Tony Benn gave us a model[34] of how a democratic company might work and why that might be important:

> 'If we are going to talk about industrial policy, let's start with the people. Let's forget about legislation for a moment and start talking about industrial democracy. And I mean industrial democracy and not just better communications, or more personnel managers, or consultations, or participation or company news-sheets. Least of all am I talking about putting one 'tame' worker on the board of a company, or trying to pretend that a few shares for the workers will make them into little capitalists and iron out real conflicts of interest.
>
> I am talking about democracy. And democracy means that the people ultimately control their managers. Just that, no less and no more. It's time we asked ourselves some fundamental questions about the management of industry.'

There are three important ideas bound up in these two paragraphs. First, a form of democracy which involves all of the workers in the operation of the business that employs them. More than involving them, it gives them control of that business. This is the antithesis of the traditional British model where the capitalists control the business through their managers, the directors. The British model assumes not only that workers have nothing meaningful to contribute but also that they should have no right to participate despite it being the workers who are closer to the means of production, to the customer base and to the underlying success of the company than the corporate executives.

Second, democracy on this model is more than the disingenuous development of internal corporate communications like circular emails. It is also more than the token representation of one or two workers' representatives on the corporate board. Instead it requires genuine democracy in which the workers are able to exert control over executive management and over the shareholders, especially when they are seeking short-term financial returns for the company.

Third, this question is particularly important in relation both to public companies and to large private companies with significant numbers of employees precisely because they are such a significant part of our society. They do not operate in a way that is sealed off from the rest of society. It is only capitalist corporate law theory which considers companies (and particularly their shareholders) as being hermetically sealed off from the rest of society. Large companies employ large numbers of people directly and are significant for the good health of the economy indirectly. Consequently, their investment and commercial decisions have a significant impact on the general economy as well as having direct impacts on the position of individual employees. This requires democratic intervention in the decision-making processes of companies in the form of stakeholder boards, as is considered next.

[34] Tony Benn, Speech to the AUEW conference, Morecambe, May 1971, reproduced in *Best of Benn*, R Winstone (ed), Arrow, 2015, 168.

The democratic stakeholder board

Democratic models in the UK should operate as a two-tier board on the German model, or as a way of allowing one or two representatives of the workers on the executive board, or as a hybrid of those two.[35] The weakness of having only one or two workers' representatives on a single, unitary board (as some suggest) is that they will always be voted down by the executive members of the board on any controversial matter.

A two-tier board means that there is an 'executive board' comprised of the directors (and perhaps one or two representatives of the workers) which takes the day-to-day management decisions in relation to the company. There is also a 'supervisory board' (on the German model) comprised of representatives of workers and shareholders which has specific powers reserved to it. The supervisory board would be in control of the approval of the long-term strategy of the company, the decision to award dividends, the decision to make or withhold contributions to the company pension plan, the decision to approve or reject takeover offers, the decision to approve the annual audit and accounts, and so forth. Consequently, the long-term interests of the company are represented by this supervisory board. It is also possible (and this should be the case in the UK) to involve other stakeholders who are impacted by the affairs of this company into the supervisory board: representatives of the environmental and social impacts of the company, representatives of other interests in the economic supply chain, and representatives of the members of the company pension scheme. The advantage of having a two-tier board representing other stakeholders is that this second-tier, 'stakeholder board' can be reserved sole decision-making power over issues affecting the long-term position of the company. The Companies Act would require amendment to specify those issues which are reserved to the stakeholder board, and how the rights of shareholders are to be qualified by the enlarged rights of other stakeholders in the company.

The composition of the stakeholder board should include representatives of the workers and of the long-term shareholders in equal measure. The presence of workers on the stakeholder board with half of the voting rights would look to the long-term interests of the company and to the treatment of its employees. Different forms of company should have different stakeholders involved in their decision-making. For example, supermarkets should have representatives of the food chain – including farmers and manufacturers – to intervene in relation to the way in which companies contract with their suppliers, how they set their payment policies, and how they squeeze margins in the economy generally.

The arguments against this sort of proposal are generally based on a perceived understanding of traditional, capitalist corporate models. In particular, the property rights of the shareholders are said to be in peril. What this argument overlooks is that the nature of shareholdings in the UK economy has changed markedly in recent years. At present, shareholdings in UK public companies are held 54% by overseas investors.[36] The understanding that shares in public companies are held by UK-based institutional investors no longer holds true. Today, the Bank of England's Chief

[35] M Andenas and F Wooldridge, *European Company Law*, CUP, 2012.

[36] See, on this older understanding, J Parkinson, *Corporate Power and Corporate Responsibility*, Oxford University Press, 1993.

Economist estimates that only 12% of shares are held by individuals and 9% by pension funds in the UK.[37] The average period for which shares are held in public companies in the UK has declined from five years in the mid-1960s,[38] to two years in the 1980s, and is now estimated by the Bank of England's Chief Economist to be only about one month today.[39] The crisis of short-termism in modern capitalism is no more clearly expressed than that. The run-of-the-mill capitalists will probably not own their shares in those companies for more than a month. Where dividend pay-outs used to equate to about 10% of corporate profits, today they amount to about 70% of those profits, thus indicating how value is bled out of companies instead of being invested in research and development, staff training, staff salaries and pensions.[40] Consequently, the modern shareholder capitalists have very little attachment to these companies.

It is important to focus on the long-term success of the company. Those with only a short-term interest in the company's share value should not be permitted to vote at company meetings nor to be represented on the stakeholder board. A minimum qualifying period (e.g. twelve or six months) for shareholding should be adopted before any shareholder can vote, as recommended in 2012 by the 'Kay Review of UK Equity Markets and Long-term Decision Making'.[41] Speculators who drive up share prices in the event of a takeover should not be eligible to vote. Shareholding has become a short-term, profit-orientated activity in ways that were never previously imaginable.[42]

The etymology of the word 'company' is enlightening. The English word 'company' derives from the Latin word 'com' (meaning 'together') and 'panio (meaning 'bread'). Thus a 'company' was originally someone with whom one broke bread – like a company having dinner together or going to the theatre. This sense of the word suggested a bond between individuals. There is no likelihood of any such bond between the majority of shareholders today. Rather, the modern investors are concerned only with a short-term return from their shares, and are likely to be investors situated outside the UK.

Due to the short-term nature of investment in companies, there is a great difference between the objectives of the investors in a company and the people who are employed by that company. The people with a long-term stake in the company are the employees, not the majority of modern shareholders. Consequently, it makes considerably more sense to give the employees legal control through a stakeholder

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[37] AG Haldane, Chief Economist at the Bank of England, 'Patience and Finance', Speech at Oxford China Business Forum, Beijing, 2 September 2010.

[38] For a BBC *Newsnight* interview with Haldane on this topic, see here: http://touchstoneblog.org.uk/2015/07/andy-haldane-shareholder-primacy-is-bad-for-economic-growth/. (http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech445.pdf).

[39] *Ibid,* AG Haldane, as reported in *The Daily Telegraph*, 'Thatcher's dream for UK investors has become a nightmare', 17 May 2015 (http://www.telegraph.co.uk/finance/11610490/Thatchers-dream-for-UK-investors-has-become-a-nightmare.html).

[40] As measured by the Capita Dividend Monitor: see, e.g. http://www.bbc.co.uk/news/business-41716283 .

[41] https://www.gov.uk/.../bis-12-917-kay-review-of-equity-markets-final-report.pdf

[42] The anticipated investment return from companies has also changed. Whereas companies used to pay out 10% of their profits by way of dividends in the 1970s, public companies typically pay out 70% of their profits in that form today (with even more being paid out by companies like BHS).

board over the long-term strategy and behaviour of the company than to give that control to shareholders who are likely only to hold their shares for a few weeks.

Replacing formalistic directors' duties with meaningful social engagement

Beyond the need for long-term focus within trading companies, there is also a need to consider the place of the company within the public life of a society. Companies are employers, they occupy physical space, they impact on the environment, they participate in significant ways in the economy, and they form a significant part of UK pension portfolios. Nevertheless, our corporate law takes too little account of this role of the company as a public, social actor. All social actors, it is suggested, must be subject to democratic control.

The arguments about the nature of corporate control have resulted in a series of weak compromises over the generations. Section 172 of the Companies Act 2006 was the uneasy compromise made between, on the one hand, expanding the duties of directors so as to make companies more socially aware and, on the other hand, the traditional approach of allowing the company's shareholders and directors to focus solely on the desire of the company to make profit. Building on the pre-existing, unclear case law concept, s172 requires that each director must act in a way (not necessarily ensure that the company acts in a way) which 'would be most likely to promote the success of the company'.[43] The director must '*have regard* (among other matters)' to the long-term effects of any decision; the interests of the company's employees; business relationships with customers and creditors; the impact of the company on the environment; the desirability of a reputation for high standards of business conduct (not necessarily high standards of business conduct); and the 'need to act fairly between members of the company'.[44] Significantly, none of these factors bears any sanction if they are not implemented in any individual director's decisions. The director must 'have regard', merely that, to the social impact of the company.

Companies have direct, social impacts constantly: every expansion of their premises, every hiring or firing decision, every withholding of pensions contributions, every relocation of business activities, has a direct effect on the human beings, communities and commercial enterprises around them. This places companies in a public, social space which needs to be recognised as such. Companies are not simply private, capitalist investment relationships. Rather, they are public reservoirs of economic power which have public effects. Consequently, they should be subjected to internal, democratic controls through supervisory boards and to greater regulatory oversight.

IV. TRUSTS AND ULTRA-CAPITALISM

The roots of trusts law

[43] Companies Act 2006, s172(1).
[44] *Ibid*.

Trusts are central to the way in which law has supported capitalism over the centuries. The central paradox of trusts law is that it has its roots in Aristotle's *Ethics* and in the idea of conscience as developed in the case law,[45] and yet the core principles of express trusts law are based on the rigid requirements of the three certainties[46] and the need for a beneficiary before an express trust can be validly constituted.[47] There is a tension between ethical flexibility and rigid rules. This is significant because, paradoxically, tax avoidance requires hard-and-fast rules if it is to function. There is a Peanuts cartoon which explains perfectly the philosophy behind all regulatory avoidance. Linus has just had the rules of a game explained to him. He is delighted because knowing the rules has given him power. As he put it:

> 'I love the rules. Once you know the rules you can cheat.'

When law is organised as a system of rules, it becomes possible for people to manipulate those rules or to slip through the cracks between those rules. UK tax law is predicated on statutory rules which are applied literally, even when it is a trust which is being used to avoid tax. Consequently, the rigidification of trusts law in several key cases has helped lawyers to create structures which avoid tax.

The strength of trusts law ought to lie in the inherent flexibility of equitable concepts. It is a combination of open-textured principles and rules-based techniques which has made the trust so successful because it grants endless possibilities for holding property on a foundation of strict rules which can be moulded and adapted as context demands. Crucially, these high-level principles also allow the courts to prevent 'crafty contrivances'[48] by reference to over-arching principles of good conscience. Successful 'anti-avoidance' law depends on a combination of flexible principle which can meet artificial avoidance schemes but which nevertheless give rise to a firm pattern of reliable rules which can be obeyed and understood in society.

Nevertheless, trusts are central to ultra-capitalism precisely because their rules are complex, often rigidified in key areas, and because the professional illuminati who use them for their wealthy private clients are free to mould them to service their clients' needs. Trusts law was moulded by skilful practitioners over the centuries to service the needs of the landed classes, and then ratified by the courts after the event. It is important to observe that the case law on trusts is *reactive* to what has happened in practice. The law has always followed along behind developments in practice and thus has been its servant. The principles of trusts law were in truth only ever *ex post facto* explanations of how practical innovations and earlier court judgments fitted together.

Hitherto, clever practitioners have always drafted trusts so that property could be concealed from spouses and creditors, so that taxes could be avoided (often by leaving it unclear as to which potential beneficiary might take an equitable interest), and so that unknown mistresses and children could take secret benefits without the family

[45] Alastair Hudson, *Equity & Trusts*, 9th ed, Routledge, section 1.1. The decision of Lord Ellesmere in *Earl of Oxford's Case* (1615) 1 Eq Cas 1 clearly draws on Aristotle's idea that equity is superior to law and that its role is to 'mollify and soften the extremity of the law'.
[46] *Knight v Knight* (1840) 3 Beav 148.
[47] *Leahy v Attorney-General for New South Wales* [1959] AC 457.
[48] As identified by Lord Ellesmere in the *Earl of Oxford's Case* (1615) Ch Rep 1.

knowing.[49] So important are practitioners to the international tax avoidance industry that the trusts statutes in many jurisdictions were drafted by prominent practitioners precisely to facilitate tax avoidance in those territories.[50] We shall consider the example of the Cayman Islands below.

The lack of registration for trusts in the UK – due to the fact that they can be inferred into existence without the parties even knowing that they exist[51] – means that they can hold assets beyond regulatory oversight.[52] A key reform of UK tax law to deal with trusts should be to require the withholding of preferential tax treatment for trusts unless those particular trusts are registered and their trust instruments lodged with HMRC.

The connivance of the Chancery courts in tax avoidance

The ways in which the legal system connives in the deployment of law as a capitalist technique are several. The courts do it frequently by supporting the enforceability of trusts law models which are solely useful for tax avoidance and asset management. They do this directly on occasion by approving tax avoidance techniques, and they do it indirectly by a style of law-making which prioritises hard-and-fast rules and literal interpretations of statutes. The legislature connives in tax avoidance by insisting on drafting a colossal tax code in the form of a collection of rigid, micro-rules, as opposed to flexible principles combined with specific rules.

The courts are often engaged in helping the legal professionals avoid tax. The *Vandervell* litigation provides a good example well-known to every properly-prepared English or Welsh undergraduate law student. Section 53(1)(c) of the Law of Property Act 1925 requires that dispositions of an equitable interest must 'be in' signed writing. This posed an obstacle to taxpayers who wanted to avoid having to pay stamp duty on transfers of shares which required a formal transfer document. In *Grey v IRC*,[53] Viscount Simonds held that the word 'disposition' should be given its natural meaning such that an oral instruction to transfer shares would not be effective until it was reduced to writing subsequently, thus requiring signed writing.

However, the House of Lords in *Vandervell v IRC*[54] held that this statutory requirement could be avoided if the legal title and the equitable interest in those shares were transferred together. This decision created an arbitrary exception to the statutory rule which created a highway down which tax dodgers could drive their stamp duty avoidance schemes. Significantly, it was this judgment of the House of Lords which created a mechanism for avoiding stamp duty which had not previously existed in English law. Similarly, in *Chinn v Collins*,[55] the House of Lords held that a contract to transfer the equitable interest would also avoid this rule. Again, a decision

[49] Eg *Re Boyes* (1884) 26 Ch D 531.
[50] See GW Thomas and AS Hudson, *The Law of Trusts*, 2nd ed, Oxford University Press, 2010, Part V generally.
[51] *Paul v Constance* [1977] 1 WLR 527; *Re Kayford* [1975] 1 WLR 279.
[52] AS Hudson, "Asset Protection Trusts" in *The International Trust*, D Hayton (ed), Jordans Publishing, 2011, p.345-522.
[53] [1960] AC 1.
[54] [1967] 2 AC 291.
[55] [1981] AC 533.

of the highest court knowingly manufactured a means of avoiding tax. An entire undergraduate seminar can be devoted to cases assisting professionals in eluding this principle. Our law schools typical train students how to use these techniques rather than teach them how to protect beneficiaries in pension funds. Our courts often proactively help tax dodgers by creating the loopholes which they then exploit.

International trusts law and ultra-capitalism

After the publication of the Panama Papers in 2015 and the Paradise Papers in 2017, the popular press has finally begun to take tax avoidance seriously. It was already well-known that offshore tax havens shielded assets from taxation and from regulation. The OECD had already published several reports about uncooperative tax havens. Lord Wilberforce – in a show of laudable judicial creativity – had developed the principles in the 1980s which slowed tax avoidance by refusing to allow 'artificial' avoidance schemes to be treated as being effective for tax purposes.[56] That was before a different generation of judges (with former practices in commercial chancery law) reverted to the old ways of using literal interpretations of statutes to allow disingenuous tax avoidance schemes to be effective if they complied – in a way that Linus would have recognised in the Peanuts cartoon – with the literal requirements of the rules.[57] However, until the global financial crisis, the popular press had never taken tax avoidance seriously. Nor had any British government. What is more significant perhaps is that the trust device has been used by the legislatures in tax havens to encourage regulatory avoidance by that cadre of professionals who service the ultra-capitalists like those birds that pick parasites off basking hippopotami.

The role of trusts law in offshore tax dodging

The colossal international tax avoidance industry relies on a few, very small technical innovations. For example, the commercial attractiveness of tax havens – like the Cayman Islands, the Cook Islands and the British Virgin Islands – depends in large part upon trusts laws which dispense with the need for a beneficiary.[58] In England and Wales, the 'beneficiary principle' provides that there cannot be a valid express trust without there being a beneficiary.[59] The absence of a beneficiary – such that there is only an abstract purpose underpinning the trust – will lead to the trust being void.[60] Thus, one of the most tedious parts of an undergraduate law programme is pivotal to one of the most significant political questions of our day: how to stop international tax avoidance.

[56] *Ramsay v IRC* [1982] AC 300; *Furniss v Dawson* [1984] AC 474

[57] *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51; [2005] 1 AC 684.

[58] See AS Hudson, 'Asset protection trusts' in D Hayton (ed), *The International Trust*, 3rd ed, Jordans Publishing, 2011, 345, at 442 *et seq*.

[59] *Morice v. Bishop of Durham* (1804) 9 Ves 399; (1805) 10 Ves 522.

[60] *Re Nottage* [1885] 2 Ch 649; *Leahy v. Att-Gen. for New South Wales* [1959] AC 457; *Re Grant's WT* [1979] 3 All ER 359.

The challenge for the seller of offshore trusts services is the following. To attract investors, they must promise a tax efficient structure and/or an absence of regulatory oversight. The former structure is attractive to the ultra-capitalist who wants to shield their wealth from the indignities of taxation, whereas the latter is attractive to international criminal and terrorist organisations who want to garner wealth beyond regulatory control.[61] To this end, it is advantageous if the investor can invest in a trust structure in such a way that they, and their associates and affiliates, will not be identified as having any beneficial interest in the investment property or its profits. Consequently, the imaginative approach taken by jurisdictions of this type has been to provide that an official known as a 'protector' or 'enforcer' can stand in the place of the beneficiary, but without having any equitable interest in the trust property, and be empowered to ensure that the trustee performs their duties. This means that the investor has no property rights which can be taxed and has only a contractual relationship with the investment manager. Security is provided by the protector.

By reducing the trust from the level of a proprietary relationship, as traditionally understood in the English tradition in cases such as *Saunders v Vautier*,[62] to that of a mere contract (as commentators like Langbein,[63] Hayton[64] and Penner [65] suggest), the trust can be used as an investment device without the investors being recognised for tax purposes as having proprietary rights in the trust fund. As outlined above, these tax havens have generally altered their own trusts law codes explicitly to accept as trusts such devices where there is no equitable, proprietary title for the beneficiary. Let us consider one example of this phenomenon in a little detail.

The "STAR trust" was created by statute in the Cayman Islands by means of the "Special Trusts (Alternative Regime) Law 1997" which created this "special trust".[66] This statute provides that there does not need to be a beneficiary with any enforceable equitable rights for there to be a valid trust (which is therefore the opposite of the English approach). Rather, the legal practitioners who drafted the statute decided to use another model: rather than a beneficiary with property rights in the income-generating trust property, there can be an "enforcer" who can proceed against the trustees in the event that the trustees do not perform their duties properly but without having any proprietary rights.[67]

Clearly, this would not satisfy the beneficiary principle (as currently understood) in England because the beneficiary cannot enforce the trust in their capacity as a beneficiary and the beneficiary does not have an enforceable right to the trust property. However, it is valid under Cayman Islands trusts law. The concern of practitioners in jurisdictions like the Cayman Islands is that if English courts will not accept such structures as being trusts (and if they would therefore consider the client-taxpayer to be still the absolute owner of the property on resulting trust principles),[68]

[61] *The Guardian*, 'Why we are shining a light on the world of tax havens again', 5 November 2017.
[62] *Saunders v Vautier* (1841) 4 Beav 115.
[63] J Langbein, "The contractarian basis of the law of trusts" (1995) 105 *Yale Law Journal* 625.
[64] D Hayton, 'Developing the obligation characteristic of the trust' (2001) 117 LQR 96.
[65] J Penner, 'Exemptions', in P Birks and A Pretto (eds), *Breach of Trust*, 2002, Oxford: Hart, 241.
[66] That statute has since been consolidated into Part VII of the Trusts Law (2001 Revision).
[67] Section 100(1) of the 2001 Revision Law provides: 'A beneficiary of a special trust does not as such have standing to enforce the trust, or an enforceable right against a trustee or an enforcer, or an enforceable right to the trust property.'
68 *Vandervell v IRC* [1967] 2 AC 291, HL.

then a so-called 'limping trust' is created[69] which would be accepted as being validly constituted in their jurisdiction but not in England. The argument is advanced by others that there is no need to enforce the beneficiary principle strictly if there is some other person (typically dubbed a 'protector' or 'enforcer' in such a jurisdiction) who can sue as though a beneficiary under the trust, so satisfying the beneficiary principle by other means.[70]

The key point is that the investor should be able to say to their domestic tax authorities:

> "I have no equitable interest in any trust. Quite how all of this income keeps paying for the roofs over my head, the yachts beneath my feet and the aeroplanes that whisk me hither and yon, is a matter of no little amazement to me."

All of this, of course, is entirely disingenuous nonsense. The tax havens are in hock to the service providers – law firms, private client arms of investment banks, accountancy firms, shadow bankers and others – who attract clients to these territories. The good people of the tiny island of Anguilla, for example, undoubtedly lead lives of blameless, productive domesticity in which tourism and fishing play no small part. However, the most profitable activities performed on that island are not linked to tourism or fishing. Rather, foreign interests use that island for the benefit of their foreign clients. Anguilla plays little physical part in many of these transactions. Instead, the island nominally plays host to many offshore tax avoidance arrangements. Importantly, trusts law as it is used by international trusts lawyers is a central part of modern ultra-capitalism.

How to eradicate offshore tax avoidance

It is an unacceptable truth that some jurisdictions give over legislative time to allowing bankers, lawyers and accountants to attract tax dodgers, organised criminals and international terrorists to invest assets secretly, and without payment of a meaningful amount of tax through their territories. It is an even more unacceptable truth that many of these jurisdictions are British Overseas Territories and British protectorates. Different territories have different constitutional arrangements – in some cases, such as Anguilla, those rules are set by the British administrator, whereas in other territories it is the domestic legislature which chooses to legislate (as in the Cayman Islands) in a way that benefits the regulatory avoidance community. In either case, the British government should insist (along with a genuine provision of adequate levels of aid) that these territories must repeal the statutes which facilitate and encourage tax dodging and transactions in dark money, and that they must make information about funds being invested in their territories publicly available to revenue and other regulatory authorities, on pain of losing British support for their territories. The Foreign and Commonwealth Office is potentially the most significant actor in bringing an end to offshore tax avoidance. Diplomacy is thus the greatest weapon against tax avoidance and international terrorist and criminal funding.

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69 D Waters, 'Reaching for the sky – taking trusts laws to the limit, in D Hayton (ed), *Extending the Boundaries of Trusts and Similar Ring-fenced Funds*, 2002, Hague: Kluwer Law International, 59.

70 D Hayton, 'Developing the obligation characteristic of the trust' (2001) 117 LQR 96.

The beneficiary principle and the great game of modern democracy

Clearly a large amount of modern trusts law is therefore involved in what Victorians might have called 'a great game'. A game in which the TUC has estimated that £25 billion may be lost to the UK public exchequer annually at a time when social security benefits and public services are being cut to the bone.[71] So, if it is a game, then it is not a funny one. There have been calls by Hayton and others to dispense with the beneficiary principle in favour of the use of protectors in English trusts law.[72] This is a development which must be resisted with all of the earnestness at our disposal. At a time of austerity in particular it would be obscene to make it easier for tax dodgers to elude their liabilities to the state. The beneficiary principle remains a bulwark against tax dodging with impunity in England and Wales and it must be maintained.

As Lord Denning put it:[73]

> 'The avoidance of tax may be lawful, but it is not yet a virtue. The Court of Chancery should not encourage or support it - it should not give its approval to it - if by so doing it would imperil the true welfare of the children, already born or yet to be born [who are beneficiaries under trusts].'

The role of the courts in this regard is complex: sometimes complicit in tax avoidance, sometimes resistant to it. The modern trend, however, has been for a permissive approach, as in cases like *Barlcays Mercantile v Mawson* where the House of Lords opted for the literal reading of tax statutes which would appeal to cheating Linus, instead of proceeding on the basis of progressive principle.

V. THE PRIVATISATION OF LAW

The logic of capitalism is that it takes control of everything it can control, that it takes ownership of everything that it can possibly own, and that it evolves beyond the nation state into international markets.[74] The effect on the rule of law is complex. In international financial markets, law has been 'privatised'. That is, the law has had its most useful features extracted from it by the lawyers who facilitate it. These are lawyers in the largest international law firms, lawyers employed in-house in investment banks, and lawyers who work in tax havens. They work alongside accountants, public relations specialists, professional lobbyists, investment bankers and traders. Those legal techniques, taken principally from the creative incubators of common law jurisdictions, are then deployed as part of a closed system by legal

[71] TUC, 'The Missing Billions', https://www.tuc.org.uk/touchstone/Missingbillions/1missingbillions.pdf Authored by Richard Murphy, http://www.taxresearch.org.uk/Blog/

[72] D Hayton, 'Developing the Obligation Characteristic of the Trust' (2001) 117 LQR 97. See also the essays in D Hayton, *Extending the Boundaries of Trusts and Similar Ring-fenced Funds*, Kluwer Law International, 2002.

[73] [1969] 1 Ch 234, at 245.

[74] AS Hudson, 'Too much monkey business', *Tribune*, 29 October 1993.

professionals who want to achieve clear goals for their clients: such as the protection of assets, the acquisition of preferential rates of funding through financial engineering, and the avoidance of regulatory oversight.

A good example is the derivatives markets. The derivatives markets operate across borders. That is to say, derivatives are contracted on trading floors in the leading financial centres and then 'booked' through whichever office of that bank is the most convenient from a legal, fiscal and regulatory standpoint. For example, an interest rate swap contracted by telephone between traders in Paris and Frankfurt may be expressed to be governed by English law and recorded in the accounts of both institutions as having taken place in the Dutch Antilles through shell corporations registered in that territory for that purpose. Such transactions are common and are facilitated by specialist lawyers and accountants employed or retained by both institutions. The legal relationships between banks are conducted in accordance with standard market contracts drafted by the International Swaps and Derivatives Association ('ISDA'), which is a trade body representing the interests of the derivatives trading community and funded by the largest investment banks through their membership of it. The concepts which underpin the ISDA documentation architecture dominate those markets and include its Master Agreement which governs 90% of all derivatives in the \$20 trillion derivatives market.[75] These standard documents are comprised of hybrid concepts taken from English law and New York law. That is, domestic legal techniques which have been abstracted for this international, avowedly non-territorial, supra-national purpose.

Financial institutions very rarely take their disputes to court. Instead, the ISDA Master Agreement was drafted by committees of employees from the largest investment banks to find a consensus between them in advance of any disputes.[76] ISDA even created an alternative dispute mechanism to prevent its contracts ever being taken to court and tested. The greatest risk to those markets in the 1990s when the markets began in their modern form was considered to be judges interfering and ruling those contracts invalid in some way. Consequently, litigation was avoided by simply never going to court. This is a simple way of acting beyond the law: you never involve the courts at all. Disputes have only gone to court when outsiders – principally municipal water authorities,[77] UK local authorities,[78] and corporations which are not major investment banks – have sought a court's ruling on the efficacy of those contracts.[79] In the wake of the global financial crisis, the English courts have been eager to support the validity of these contracts so that the insolvency of Lehman Brothers could be processed as calmly as possible.[80] The UK Supreme Court has even overturned one of the shibboleths of English trusts law (as to the requirement of certainty of subject matter prior to the validity of a trust) to procure the outcome

[75] The derivatives market was estimated by the Bank for International Settlements ("BIS") to be worth a gross amount of US\$ 19.5 trillion in June 2011, down from US\$ 25.3 trillion in June 2009: see *Lomas v JFB Firth Rixson* [2010] EWHC 3372 (Ch), [2011] 2 BCLC 120.
[76] AS Hudson, *The Law on Financial Derivatives*, 6th ed, Sweet and Maxwell, 2018.
[77] E.g. *UBS AG, London Branch and another v Kommunale Wasserwerke Leipzig GMBH* [2010] EWHC 2566 (Comm).
[78] Eg *Westdeutsche Landesbank v Islington* [1996] AC 669.
[79] A slew of cases involving SME's who were sold interest rate swaps disastrously before the global financial crisis has begun to emerge: e.g. *Green v RBS* [2013] EWCA Civ 1197.
[80] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2011] 3 WLR 521.

which the liquidators of Lehman Brothers considered most beneficial for the winding up of that bank.[81]

In consequence, the rule of law has been subjugated to the short-term demands of the banking system. Not only did every judgment in the several streams of Lehman Brothers litigation prostrate itself on the altar of commercial necessity, but the rules were altered or re-explained so as to accommodate the needs of the liquidators. Meanwhile, those responsible for the collapse of those financial institutions and the reckless construction of ruinous financial instruments have never faced personal liability in court.

The question of the rule of law in an era of ultra-capitalism is significant. The regulations which govern financial institutions are created in consultation with them – in a way that burglars are not, for example, invited to give their view of the impact on their businesses of any reform of the law of theft. At the most visible level, the Dodd-Frank Act in the USA was controlled and limited by the work of bank lobbyists, to the constant outrage of Senator Elizabeth Warren (formerly a professor of banking law at Harvard). The 'Bank Lobbyists Act', as Warren calls it, that is currently passing through Congress (at the time of writing in March 2018), promises to re-categorise many US investment banks so that they are no longer covered by the Dodd-Frank capital maintenance requirements nor by the Volcker rule prohibiting them from investing their own capital in derivatives transactions (so-called 'proprietary trading'). Many more lawyers and other professionals have worked on dismantling the Dodd-Frank legislation than worked on assembling it originally.

At a more quotidian level, the work of the EU in processing financial services legislation is in hock both to the banks' formal lobbyists and to their informal lobbyists in the form of largest legal and accounting firms. Eurostar is like a moving walkway between the largest law firms, accountancy firms and lobbyists in London and the European institutions in Brussels. The Financial Conduct Authority consults on every mooted change and development, even in the wake of the financial crisis. No one asserts that there is a statutory power granted to the FCA to create regulation for the 'obedience' of banks. Instead, the financial sector seeks merely to 'comply' with regulatory principles, almost begrudgingly. Banks have 'compliance' departments not 'obedience' departments. The word 'comply' meaning to 'work with' rather than to obey. It suggests a partnership of equals rather than the exercise of positivist sovereign power by the statutory regulators. Significantly, the principles governing the implementation of those regulations are also created in negotiation with the financial sector. Having brought capitalism to the brink of collapse in 2008-09, the financial sector is still allowed to have an input into the creation of the rules which are supposed to bind it. Thus the ultra-capitalism practised in the largest financial institutions exerts pressure and insists on being an equal partner in the creation of the laws which bind it.

This process of a refusal to accept the idea of the rule of law *by lawyers themselves in the banking industry* came home to me when I worked in investment banking in the 1990s.[82] An anecdote will serve to make the point. I was invited to attend a meeting of

[81] *Lehman Brothers (International) Europe v CRC* [2012] UKSC 6, [2012] Bus LR 667.

[82] I worked, for a while, in investment banking while researching my PhD and first two books. An old-fashioned approach, I know.

the full board of the International Accounting Standards Board to advise them on the content of the law on derivatives as they looked to create new accounting standards for the treatment of derivatives globally. This body sets the standards which apply in each jurisdiction although they operate (as a visual spectacle) somewhat like the organisation SMERSH in a James Bond film: all members participating via video link from various parts of the world, each participant sitting behind a nameplate bearing the name of the territory they represented. The Board was concerned not to change its rules on a false assumption that there were no legal problems facing derivatives markets. I reassured the Board that there remained several problems in the detail of the law dealing with derivatives and that, consequently, they should not change their sceptical approach on the erroneous understanding that all was well with the law on derivatives. The basis for this assertion was that different judges had come to different conclusions about the operation of English law in relation to that standard market contract.[83] I explained that the courts had taken several surprising or, alternatively, principled approaches to standard market derivatives contracts in recent years. A lawyer representing a magic circle law firm or an investment bank (it was difficult to tell because he shifted around behind two different nameplates during the morning session) then said one of the stupidest things I have ever heard come out of a lawyer's mouth:

> 'Why should I care what judges think?'

His attitude – one which I have encountered frequently in international banking circles, particularly among middle-management[84] – was that domestic law is unimportant and that national regulation is something that can be eluded or managed away (like all other risks). The belief is that international finance operates at a level above the nation state.

In practice, those lawyers who work inside the derivatives industry have taken what they find useful from English law and New York law and privatised it in their offshore markets beyond the reach, they hope, of the domestic courts. One example of this tendency would be the concepts informing taking security through contract and property law which have been moulded into the troublesome concept of 'collateralisation' by the derivatives markets' lawyers, and then transmitted back into domestic law through the EU's Collateralisation Directive which enshrined the bankers' practice into law at their insistence. These proposals were enshrined in EU and domestic law at the instruction of the banking industry. This is so even though they fail completely to make important differentiations between assets being held subject to a 'mortgage, charge or pledge' (as the central provision in the ISDA Credit Support Deed provides) as if those concepts were one-and-the-same thing – which clearly they are not.[85] The result is the creation of law at the behest of the banking industry which is predicated on a legal nonsense in the standard market contracts created by that same banking industry. This reflection back into domestic law might be considered to be a respect for national law after all. In fact, it reflected a fear that national law might interfere and rule on the efficacy of these arrangements in an

[83] Eg *Peregrine Fixed Income Ltd v. Robinson* [2000] C.L.C. 1328, [2000] Lloyd's Rep. Bank, 304.
[84] The rank is significant. Middle management do not have to face the Press or the shareholders. Middle management conduct most of the bank's business unseen. Consequently, their attitudes are very important and should be overseen more closely by the FCA Systems and Controls rulebook.
[85] AS Hudson, *The Law on Financial Derivatives*, 6th ed, Sweet and Maxwell, 2018.

unhelpful way. Consequently, the finance industry lobbied the policymakers in Brussels to change the law so that their practices would not be challenged in domestic courts. The law is captive in this process, not sovereign.

VI. Addressing Deeper Questions of Ownership: Co-operatives and Industrial Democracy

Commercial enterprise is possible without capitalism. Commercial enterprise without capitalism means that the capital assets are not owned by a narrow social class but rather are owned by everyone who participates in that enterprise. The clearest example of this alternative model is the co-operative. The difficulty is that in the 21st century, the capitalists' analysis of co-operatives is that they can be put to work as micro-financial institutions, as is illustrated by recent changes to the regulation of friendly societies and co-operatives in the UK. Those bodies are now treated as small financial institutions regulated by the Financial Conduct Authority shorn of the 'common bond' which were previously essential to their constitution legally and which were central to their formation historically as mechanisms for working class solidarity.

Traditionally, a co-operative combined a contractual agreement between members of a society with a form of property-holding that meant that those members owned nothing individually but rather that they held everything together as a collective.[86] Co-operatives are a hybrid of contract and property law concepts in which assets are used communally. That contract establishes a set of common objectives and the rules by which those assets can be used. Importantly, property law here does not operate so as to identify separate property rights for members in the same way that shareholders in a limited liability company have distinct property rights expressed through and embodied by their share. Rather, the members of a co-operative have property rights only when acting together in deciding how their co-operative's assets should be used. An industrial and provident society was a 'body corporate' but not a limited company with shareholders. Consequently, it had all the benefits of being able to contract as a legal entity in its own right without any of the paraphernalia of a group of shareholder capitalists entitled to take away the surplus value from the enterprise based on their property rights. While the members contributed the capital of that society, they did so on the basis of contract. The principle of equality between the members of the society extended beyond democratic control of the activities of the society to an equal right in the surplus of the assets of the society. Distribution of surpluses could only take place in accordance with the terms of the society's constitution, and not in the form of dividends or 'fees' bleeding value out of the organisation.

The Co-operative and Community Benefit Societies Act 2014 repealed the Industrial and Provident Societies Act 1965 and all subsequent legislation. Registration as a 'community benefit society' (as a co-operative is now described) is now dependent upon the financial services regulator, the Financial Conduct Authority, being satisfied formalistically that any cooperative society is a "bona fide" society and that any

[86] AS Hudson, *The Law on Investment Entities*, Sweet and Maxwell, 2000.

community benefit society will be "for the benefit of the community".[87] What is lost here is the 'common bond' which was always required by legislation for registration as a co-operative (or, industrial and provident society). Instead, a more nebulous idea of a 'community benefit' (using language akin to charities law) is used. Modern charities have developed – as the under-funded, statutory Charity Commission has reported[88] – into conduits for money-laundering and tax avoidance with often only minimal benefit being delivered to the community by many of the 168,000 charities currently registered in the UK. Consequently, the focus on a diffuse community benefit as opposed to the solidarity of the old 'common bond' marks a significant shift in the legal conceptualisation of co-operatives.

As the Labour Party manifesto suggested, there needs to be a regulator specific to the co-operative sector which is also competent to advise co-operatives' members on establishing new associations. There needs to be clarity on the rights of co-operatives to borrow money and (especially in relation to Community Land Trusts which are responsible for so much social housing construction today) clarity about the ways in which they can go into insolvency so that lenders can recover their security. Without clarity as to the ability for lenders and investors to recover their security – for example, in relation to Community Land Trusts which have their land 'locked' for the purposes of the trust – there is great difficulty in raising capital for them. This combination of treating co-operatives as micro-financial institutions, and yet not legislating for them in ways which explain the rights of parties dealing with and through them, conspires to hinder their development.

The Oxford Shorter English Dictionary definition of the verb "to co-operate" is "to work together for a common goal".[89] The legal sense of a co-operative combines the notion of people working together for a common goal with the idea that those people must not be carrying on a business mainly with a view to earning distributable profits in the manner of a limited liability company. Under general co-operative principles established by the International Co-operative Association, the property of a co-operative must come under the democratic control of its members, and the members must be able to participate economically in the activities of the co-operative.[90] Another feature of the principles of co-operatives is said to be that membership ought to be open to the public, and not closed to a narrow ownership class.[91] Co-operatives are also supposed to provide education and training for their members, and to work for the sustainable development of their communities through policies approved by their members.[92]

This is the deeper point about the nature of co-operatives. A co-operative is a remnant of a working class self-help association of the sort described by EP Thompson in *The Making of the English Working Class.*[93] Those early co-operatives, to take that term loosely, evolved from the earliest corresponding societies (which were taken to be

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[87] Co-operative and Community Benefit Societies Act 2014, s 2(2).
[88] Charity Commission, 'Charities: fraud and financial crime', https://www.gov.uk/government/publications/charities-fraud-and-financial-crime
[89] Oxford Shorter English Dictionary.
[90] *http://www.cooperatives-uk.coop/Home/mini-webs/miniwebs/whatIsACo-operative/principles*
[91] See I Snaith, *The Law on Co-operatives*, 1984.
[92] *http://www.cooperatives-uk.coop/Home/mini-webs/miniwebs/whatIsACo-operative/principles*
[93] EP Thompson, *The Making of the English Working Class*, 1963, London: Victor Gollancz.

seditious) through the industrial and provident societies, credit unions and friendly societies which grew out of working-class solidarity in the pre-Victorian era. They were later formalised by legislation in the 19th century as the Victorians realised that these structures enabled the working class to take care of themselves and thus provide a reliable workforce without the need for a welfare state. They were then ruinously converted into small-scale financial services providers in the 21st century shorn of the bonds which had been vital to their creation originally. By transferring friendly societies, credit unions and cooperatives to the comforting embrace of the Financial Conduct Authority[94] there was no longer a need for those societies to express a common bond between their members. This has been central to the success of co-operatives as resilient commercial enterprises which are more likely to survive economic troubles because of the commitment of their members to their identified common goals when compared to corporate business models. Moreover, it prioritises the financial services aspect (especially of friendly societies which are now recognised as insurance providers rather than as a local means of protecting workers who require assistance) or the capital-raising aspect (especially in relation to community benefit societies) of the enterprise, rather than its positive, collectivist objectives.

In parallel with the Labour Party's 2017 manifesto *For the Many Not the Few*, a document was published titled *Alternative Models of Ownership*[95] which advocated a radical change to the British economy by means of developing co-operatives alongside traditional capitalist models. This is built on a critique of current British economy which is said to contain 'a number of fundamental structural flaws that undermine economic strength and societal well-being'. One of the key flaws is identified as being the unprogrammed rise of automation which threatens the jobs of a huge part of the workforce, and the reservation of wealth and power to corporate interests which can be expected to create wealth for the few at the expense of the many. This concentration of wealth in the UK is said to be class-based and geographically-based, particularly draining wealth away from the former manufacturing and mining heartlands of the UK down to the financial services and governmental hubs in London and the South-East. The ambition in *Alternative Models of Ownership* is the development of the co-operative sector in the UK with four resultant benefits: strengthening democracy in the economy; promoting equality and financial security; remedying the lack of public funding for infrastructure projects; and organising the increasing automation and the digitisation of the economy. Briefly put, these goals are expected to flow from the very resilience of co-operative enterprises due to the bonds that exist de facto between their members (even if they are not now obligatory de jure), and the way in which they can be used by local government to acquire services locally from co-operative businesses so that that wealth stays locally (as opposed to being passed to multinational service-providing corporations which take that surplus wealth away from the local economy).

In perhaps its most striking passage, *Alternative Models of Ownership* presents a history of neoliberal economics which has focused on arguments about limited liability companies and refining their regulation, but which has ignored the more profound political questions about whether that system is the right one (or the only possible one) at root. Despite all of this focus on regulating the limited liability

[94] AS Hudson, *The Law and Regulation of Finance*, 2nd ed, Sweet and Maxwell, 2013.
[95] http://labour.org.uk/wp-content/uploads/2017/10/Alternative-Models-of-Ownership.pdf

company, it is said that 'there remain deeper questions of ownership.' This cuts to the heart of the nature of capitalism as an '*ism*'. Capitalism requires that ownership of the means of production rests with the capitalist class, the landlords and the shareholders. By contrast, co-operatives come from another tradition which pre-dates the possibility of the acquisition of property rights by working class people.[96] Co-operatives evolved at a time when working people owned nothing. The syndicalist and collectivist traditions emerged at a time when the members of the collective themselves as serfs were literally the property of a 'land lord' under the master-servant relationship. Therefore, the tradition of collective activity is based on accumulating wealth in a central pool so that it could be distributed for the common good of the members of the collective.

There was simply no notion of individual rights: rather there was an understanding that the members were bound by their compact and entitled to the common wealth established by their collective labour and thrift. Their enforceability as contracts would only be effective once such people were recognised by English law as having sufficient personality to contract outwith the master-servant bond.[97]

The common bond which was required of the older industrial and provident societies addressed the deeper questions of ownership identified by *Alternative Models of Ownership* by displacing the divisive idea of separate, individual property rights and replacing it with the collective idea of a contractual, co-operative bond between those members. This operates on the basis of democracy within the co-operative. The Labour manifesto *For the Many Not the Few* suggested a return to these values together with a complete reorganisation of the mechanisms for both the regulation and support of co-operatives as commercial enterprises.

VII. CONCLUSION

Our theme in this volume is whether or not capitalism has any redeeming feature. What is argued here is that it is not capital*ism* – the ideological system in which the wealth is held by a small social group – which might have any redeeming feature. Capitalism is redeeming only for the capitalist and for those who are content to take the little that the capitalist trickles down on them. Instead, redemption may come in the form of alternative models for commercial enterprises which are democratic and which do not depend on the despotic ownership of that undertaking's assets by a narrow social class. This stretches from the reform of the limited liability company to make it democratic through to the reinvigoration of co-operative enterprises.

Therefore, for there to be any redemption from within the capitalist system, that system must no longer be truly capital*ist*. This is particularly true of the 21st century's particular form of plutocratic ultra-capitalism in which the wealthy have access to power and previously-unimaginable, purposeless wealth. This requires a conceptual revolution in some areas (introducing stakeholder boards and all that that entails, international diplomacy as a solution to tax avoidance, and detailed changes to

96 EP Thompson, *op cit*; E Hobsbawn, *op cit*.
97 AS Hudson, *The Law of Investment Entities*, 2000.

corporate law which will prevent the exsanguination of companies like BHS), and strategic reinforcement in others areas (the bolstering of the beneficiary principle in trusts law, the reintroduction of principles like the 'progressive artificial steps doctrine' in tax avoidance law, and the enlargement of the financial assistance principle in company law). It requires a recognition that it is law and that it is lawyers who are central to the operation of this rigged system; but that it is also through law that the challenges to the excesses of this ultra-capitalism can be brought.