BHS AND THE REFORM OF COMPANY LAW

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A CHANGE OF CLIMATE FOR COMPANY LAW

At one time, while he was leader of the Labour Party, Ed Miliband talked about fighting 'predatory capitalism'.[1] One of Labour's manifesto commitments in 2015 was to introduce employee representation on UK company compensation committees. This was a sop towards the long-held commitment by the Trade Union Congress to provide worker participation on supervisory boards essentially on the German model.[2] The manner of the acquisition of BHS Plc by Philip Green in 2000 and the payment of 'the largest pay cheque in corporate history' in the form of a dividend of £1.2 billion to his wife, Christina ("Tina") Green, in 2005, were part of the background music which led to that policy commitment. On acquiring the role of Prime Minister in July 2016, Theresa May promised employee participation on company boards and demanded that we "get tough on irresponsible behaviour in big business".[3] The backdrop to that undertaking was the scandal surrounding the failure of BHS and the massive under-funding of its pension scheme.

The treatment of BHS presents us with an important opportunity to draw clear lines as to what is acceptable and what is unacceptable in our economic life. The joint report of the Work and Pensions and the Business Innovation and Skills ("WP/BIS") select committees on the collapse of BHS is excoriating about the role of Philip Green in running a healthy company with £500 million in assets into insolvency, while allowing the corporate pension fund to fall £571 million into deficit from a healthy surplus.[4] Companies and trusts under the control of the Greens bled colossal wealth from BHS at huge cost to eleven thousand employees, twenty thousand pensioners, and thousands of other people employed in the BHS supply chain.

In this climate it is unlikely that there will not be legislative change of some sort to confront this sort of activity. However, it is Shadow Chancellor of the Exchequer, John McDonnell MP, who has produced the most detailed proposals to confront the activities of capitalists like Philip Green and his immolation of BHS. The policy was first trailed in *The Mirror* in the following way:[5]

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[1] *The Guardian*, 17 November 2011, 'Ed Miliband sets out five-point plan for more responsible capitalism'.
[2] E.g. Aline Conchon, *Workers' Voice in Corporate Governance: A European Perspective*, Trades Union Congress "Economic Report Series", 2013.
[3] Speech in Birmingham, 11 July 2016.
[4] Work and Pensions and Business Innovation and Skills Committees, "BHS", HC 54, 20 July 2016 ("WP/BIS select committee report").
[5] *The Mirror*, 30 July 2016.

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> 'Labour's Shadow Chancellor plans a "Philip Green law" to stop firms being made into debt cash cows, after high street chain BHS was plunged into administration earlier this year.'

Mr McDonnell makes six detailed proposals for the reform of company and takeover law.[6] This article analyses those detailed proposals and explains how, with a series of slight changes to our company law rules, the immolation of other companies employing thousands of people can be prevented.

THE ACQUISITION AND EXSANGUINATION OF BHS

The exsanguination of BHS is a playbook for extracting personal wealth from a public company. It is the techniques of company law which make this possible. By analysing the way in which the assets of BHS were drained out of the company through offshore trusts and other companies under the control of the Green family, the necessary reforms of company law become clear. The exsanguination of a public company takes four stages: acquisition; subtraction of value through manufactured dividends; subtraction of value through third party fees and rents; and disposal.

(1) The acquisition phase

BHS Plc was a 'quoted' public company before its acquisition in 2000, at which point it was taken private. The change from being quoted on the FTSE-100 and subject to the rules of the London Stock Exchange left BHS subject only to the comparative lack of oversight of a private company. This change in status also came before the Financial Services Authority began to introduce its full panoply of securities regulations in 2000. This meant that little information needed to be made publicly available compared to the reporting requirements on a listed company. The losers in this situation were the employees and the members of corporate pension fund.

Philip Green notionally acquired BHS Plc for £200 million in 2000 although the company did come with £44.78 million in cash[7] and the purchase was reportedly organised by West LB through an offshore family trust controlled by the Green family.[8] Another problem which has arisen in relation to the acquisition of public companies is the reliance on debt which the company itself absorbs after the purchase. For example, the acquisition of the company which owned Liverpool Football Club by Mssrs Gillett and Holt involved the acquisition of shares in that company which was funded by debt taken out by Holt and Gillett. The arrangement was always that, once the shares had been acquired, the company would become responsible for repaying the debt. Therefore, the company was repaying the debt which was necessary to acquire its own shares. This left the shareholders free to extract value from the company in the form of dividends while their debts were discharged by the income from the football club.

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[6] This author was the originator of those proposals. This article is an opportunity to explore them in greater detail.
[7] *Private Eye*, 13 May 2016, 'In the City: Green's BHS bargain'.
[8] *The Economist*, 29 May 2003 and *ibid*.

(2) Subtraction of value through dividends

After BHS Plc was taken private, it became possible for the company to be immolated in the shadows. What is significant is the way in which dividends were generated quickly from BHS Ltd. In the period from 2002 to 2004, BHS Ltd generated £208 million in post-tax profits and yet paid dividends of £414 million. Of this amount, the WP/BIS select committee report found that £307 million in dividends were paid to 'the Green family'.[9] As a simple question of arithmetic, those profits were funded by a lot more than profits taken from BHS Ltd. Instead, the WP/BIS select committee report found that these distributions 'removed value from the company' by drawing down its reserves, and using other cash from the business. Therefore, the owners were found to have been draining cash and liquidating other assets in the company for their personal gain.

In situations in which debt is raised to fund the acquisition of the shares, and then assumed by the company itself after the acquisition, the company is draining value from elsewhere in the business both to set off the debt and to fund dividends when the distributions exceed the cash in the business.

After the acquisition, Philip Green assembled the Arcadia group of companies through further acquisitions and then absorbed BHS Ltd into it. After the creation of the Arcadia group, Tina Green is said by the select committee to have received 'the largest pay cheque in corporate history' in the form of a dividend of £1.2 billion from that group in 2005.[10] This dividend was paid to a Jersey company, Global Textile Investments, controlled by Tina Green.[11] Thus, indirectly, Tina Green, a resident of Monaco, took a huge sum in cash from the corporate group which included BHS Ltd. Philip Green told the WP/BIS select committee hearing that he considered these dividends, paid within a couple of years of acquiring the Arcadia companies, to be "conservative".

Another example of taking dividends from newly acquired companies arose in relation to the acquisition of the company which owns Manchester United Football Club. The debt which was necessary to acquire the shares in Manchester United was assumed by the company while members of the Glazer family acquired shares in the company. The company was loaded with more debt by means of a bond issue, the company was listed on the New York Stock Exchange, and the club's holding company became resident in the Cayman Islands. These are the tools which company law offers to capitalists who want to extract value from their companies before making them trade at a profit.

(3) Subtraction of value through third party fees

Taking dividends from a company under your indirect control is only one way of extracting value from it. Another way is to organise for the company's other assets to be liquidated and distributed among other controlled companies. An analysis by the

[9] WP/BIS select Committee report, paragraph 10.
[10] *Ibid*.
[11] *Private Eye*, 13 May 2016.

Financial Times[12] probed the movement of money and assets within the BHS and other companies controlled by the Greens. A different company controlled by the Greens and registered in Jersey, Carmen Properties Ltd, acquired twelve premises from BHS for £105 million and then raised rents of about £12 million per annum on those same properties by leasing them back to BHS. This process generated £153 million by 2015.[13] Yet another company owns the BHS headquarters, worth £40 million.

Through controlled companies, the Greens charged BHS "fees" for services like administration and distribution which (together with dividends and rents) amounted to £1.2 billion in total, again according to the *Financial Times* analysis.[14] Administration charges levied by the Greens reached £58 million in 2013, even though profits in the Arcadia group generally were falling. This is how a modern capitalist extracts money from a company under their control: through dividends and through fees raised between controlled companies. *The Financial Times* considered that it had found as much as £400 million in fee and other income bled out in these ways which had not previously been public knowledge, leading to a total of £1.2 billion being taken out of BHS alone.

The Greens did not increase turnover in BHS, even during the boom years of the economy at the start of the 21st century. Instead, they manufactured paper profits by cost-cutting (including sourcing products from low wage economies) and by asset liquidations (including sales-and-leasebacks of premises).[15] At the same time, even during the economic boom, the pension fund was not maintained at the surplus which existed in 2002, as is considered below.[16]

(4) The disposal phase

The disposal of what remained of BHS

By the time that the Greens had finished with BHS and sold it for £1 in March 2015, there was very little left. The balance sheet makes sobering reading.[17] The BHS accumulated reserves fell from £228 million in 2002 to a deficit of £323 million by 2014. Assets stood at £501 million when BHS was acquired in 2001, but had fallen to £295 million by 2014. Balance sheet liabilities had grown from £205 million to £551 million over the same period. Most worryingly of all, the deficit in the company pension fund has grown to an estimated £571 million today. In other words, the pension deficit was larger in 2015 than the total assets of the company in 2000.

The hole where a pension fund used to be

[12] *Financial Times*, 28 April 2016, 'How much money did the Greens make?'
[13] WP/BIS select Committee report, paragraph 15.
[14] *Ibid*.
[15] *Ibid*.
[16] *Ibid*, paragraph 19 *et seq*.
[17] *Ibid*, paragraph 12.

The reason for disposing of a company like BHS, as opposed simply to winding the company up, is that any liabilities attaching to the company are transferred to the new owners. In BHS, the pension deficit grew steadily from a situation in which there was no deficit in 2002, to a £75 million deficit in 2005, a £139 million deficit in 2014, and then a colossal £571 million by 2016 (if the scheme's costs were to be covered by an insurer). Significantly, the pension fund was in deficit in 2005 during the boom years in the early 21st century and so the deficit cannot be blamed entirely on the financial crisis (which began in earnest in 2007). Rather, the funding of the pension scheme by the company simply tailed off. Another way to increase personal profits for the capitalist is to fail to keep funding the pension scheme. The select committee report demonstrates that the Pensions Regulator was insufficiently astute in the protection of that fund.

The net effect

Twenty thousand people – past and present employees of BHS – stand to lose their jobs and their pensions, with thousands more likely to lose their jobs in the supply chain. Pension fund losses are real. A company pension is deferred pay for the pensioners. The pensioners have contributed to the fund during their working lives and the company contracted with them to contribute to it too. For the capitalist to fail to maintain the pension fund is like taking money out of employees' pockets. The Pension Protection Fund set up by the last Labour government will have to step in to protect pension contributions. The welfare state will have to step in to care for workers who become unemployed. This is yet another example of the privatisation of profit and the socialisation of cost.

Adam Smith did envisage a capitalism in which the rich would "select from the heap what is most precious and agreeable", but in his view this was tempered by the moral notion that the rich "consume little more than the poor" and that the "guiding hand" would lead them to keep the economy in balance so that even the poor would become more comfortable.[18] By contrast, Philip Green owns a 90 metre super-yacht called *Lionheart* which reputedly him cost £100 million. Adam Smith would not have recognised this form of capitalism because it generates incredible amounts of wealth for the super-rich 0.1% without maintaining any balance in society.

It is time for our company law to stop conceiving of the company solely as property that is owned by its majority shareholders, because this is how super-capitalists like the Greens are able to exsanguinate those companies. Instead our company law must begin to think genuinely about the company as a community of employees, executive and non-executive directors, pensioners, creditors and consumers and, yes, shareholders too. Section 172 of the Companies Act 2006 made some steps towards advancing recognition of the position of employees, customers, and the community more generally in companies. If we do recognise – that is, genuinely recognise – that there are other bundles of claims bound up with a company beyond the inter-action of directors and shareholders then we will begin to change our country for the better.

[18] Adam Smith, *The Theory of Moral Sentiments*, 1759.

The question is what is to be done to prevent manipulative takeovers of public companies which are necessary to maintain jobs and the ordinary economy. With that in mind, we turn to Mr McDonnell's proposals. These proposals should be understood as being mutually supporting, although the fifth proposal is central to their collective operation.

THE SIX PROPOSALS FOR THE REFORM OF CORPORATE LAW AFTER BHS

1. Financial Assistance

Identifying financial assistance

The first proposal is that the laws on 'financial assistance' should be redefined. This divides into two stages. First, the law must be changed so that it applies to private companies as well as to public companies, in particular private companies which have recently been converted from being public companies. Second, the concept of indirect financial assistance in s.678 of the Companies Act 2006 ("CA 2006") must be clarified so as to encompass the company being obliged to repay the loan which was used to buy shares in that company originally.

There is a difficult line to draw between financial assistance which is paid in advance of a purchase of shares, and financial assistance which involves the company assuming responsibility for a debt which had paid for the shares previously. The only difference between these two payment structures is the sequencing. Otherwise the net effect is the same: the company has funded the purchase of shares in itself. Where the purchaser arranges with the lender of the purchase price that the repayments will be made by the company, then the company is being committed to funding the purchase price indirectly. The argument would run, from the purchaser's perspective, that they do not control the company at the time that this undertaking is made to the lender, and that once the company is under their control then they can do what they like with it. The important point from the employees' and pensioners' perspectives is that the company immediately becomes less secure as a business, as an employer and as a provider of pension funding when it is so highly geared and when it is being used simply to fund the new shareholder's extravagant lifestyle.

The proposal is that s.678(1) of the CA 2006 would be expanded to include assistance given after the acquisition in the form of the assumption of the debt by the company as part of a previous arrangement, especially where that is part of a pre-arrangement between the lender and the purchaser of the company. The second statutory prohibition on financial assistance arises under s.678(3) of the CA 2006 if the purchaser of those shares takes on a liability and if the company then undertakes to reduce or expunge that liability: thus, indirectly passing value to the purchaser and so giving financial assistance. This would be re-cast so as to capture the transfer of the debt used to acquire shares in the company onto the company itself. At present, the term "financial assistance" is defined in s.677 so as to include assistance by way of gift, or by way of guarantee or indemnity, or by way of a loan, or by way of any other arrangement such that the company's net assets are reduced (thus implying that value has shifted from the company to some other person so as to acquire shares). The time sequencing of these events would also be adjusted to include explicitly any prior arrangement that the company would take on the debt used to acquire shares in itself.

The definition of financial assistance

This reform would reframe s.678 of the CA 2006 so that there would be "financial assistance" if a purchaser entered into a agreement, arrangement or understanding whereby money is agreed to be borrowed from a lender so that the purchaser can acquire a majority or controlling shareholding in a company, and if the legal liability for that debt is transferred directly or indirectly, in whole or in part, to the company after the purchase in accordance with that agreement, arrangement or understanding. This proposal would be expanding the concept of "financial assistance" slightly so as to include transactions of this sort in which the company indirectly funds the acquisition of the shareholding.

In *Belmont Finance Corporation v Williams Furniture Ltd (No2)*[19] Buckley LJ held that where there was a collateral purpose for the assistance which was not the acquisition of shares in the company, then there would not be financial assistance. This produced a simple mechanism for avoiding the financial assistance provisions by building a collateral purpose (which was more than a mere sham) into the arrangement. By contrast, in *Charterhouse Investment Trust Ltd v Tempest Diesels Ltd*[20] Hoffmann J suggested that the acid test for financial assistance should be whether or not the company's net assets were reduced by the transaction. Similarly, reducing the net assets of the company "to a material extent" by means of providing security for a loan will constitute financial assistance.[21] In *Charterhouse*, Hoffmann J. held that, in essence, the question was whether or not there had been a net transfer of value by the company to the purchaser. Since that could not be shown on the facts of that case, there was held to be no financial assistance. However, when the company does suffer a reduction in its net assets by discharging the debt, then it is no great extension of the concept to provide that assuming the debt needed to acquire shares would constitute financial assistance.

The House of Lords in *Brady v Brady*[22] took a restrictive approach to financial assistance which will be maintained under this proposal in the wake of the treatment of BHS. As part of a family settlement there was a transfer of assets between two family companies involving paying off loan stock issued as part of the purchase price for shares. This was held to be financial assistance. Many company lawyers decried Lord Oliver's finding that the ultimate purpose was to acquire shares even though there was an unrelated commercial objective. However, in the context of protecting companies from undesirable, highly-geared takeovers, this proposal would follow that narrow approach to identifying financial assistance.

2. Dividends

[19] [1980] 1 All ER 393.
[20] [1986] 1 BCLC 1.
[21] *Selangor United Rubber Estates Ltd v Cradock (No3)* [1968] 1 WLR 497.
[22] [1989] AC 755.

Restricting dividends to earned profits

The second proposal is linked to the first. In essence, dividends should not be allowed to be paid out of borrowed money or by the liquidation of assets in circumstances which will affect the success of the company or its pension fund. This reform is directed at situations like BHS or Manchester United. The Greens took over £1.5 billion in dividends out of BHS and related companies in four years. The Glazer family took £15 million in dividends out of Manchester United in one year. Consequently, there must be a clarification of the law so that dividends can only be paid out of earned profits and not out of borrowed money, especially in relation to public companies recently taken private which are at risk of exsanguination. The requirement in s.830 of the Companies Act 2006 that dividends must be paid out of "profits available for the purpose" would be clarified in this context. There would also be closer controls on the liquidation of capital assets to pay dividends.

This reform would make it clear that dividends can only be paid by a company within a given period of time after that company was taken over if they are paid out of earned income. The proposal, furthermore, is that dividends could only be paid out of income which has actually been received in cash by the company, and not future profit which is booked in the current profit-and-loss account as profit. For example, profit and loss accounts prepared on a 'mark-to-market' or 'fair value' basis would not necessarily entitle the payment of dividends.

Identifying available profits

There are two principal concerns with dividends. First, that those who control the company might seek to distribute the company's capital among themselves by means of declaring a large dividend payable out of the company's capital as opposed to its income. This would be prejudicial to the interests of unsecured creditors and others if the company became worth less than it had been previously as a result of the company's profits being bled out of its capital and reserves as dividends. Second, that the company may want to pay a large dividend to its shareholders when its profits for the financial year have been insufficiently large. To do this, a company may seek to declare a dividend which includes an amount of future profits which it expects to earn, for example, from sales which have been agreed but for which the purchase price has not yet been paid. Profit and loss accounts frequently include a fair value for sales which have been made even if the money has not been received; whereas cash flow statements exclude amounts which have not actually been paid yet.

Section 830 of the CA 2006 requires that any company "may only make a distribution out of profits available for the purpose". This apparently has the effect of limiting all distributions from the company to income amounts (that is, profits) which can be paid out at that time. There is a further requirement in relation only to public companies, under s.831 of the CA 2006, that the company's net assets will still exceed its share capital and its reserves after the distribution. In the case of BHS, the dividend payments of £414 million were made after the company had been taken private and on profits of only £208 million.

The proposal in relation to public companies, and in relation to public companies which have been taken private within the five previous years, would be that dividends can only be paid out of cash and earned income. This proposal turns on the concept of profits which are available for distribution in this context.

Section 830(2) of the CA 2006 defines the concept of available profits in the following terms:

> "A company's profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made."

So, why does the concept of 'realised profits' not exclude dividends which are paid out of money which has been acquired (directly or indirectly) through asset disposals and through new debt being imposed on the company? Read literally, this provision would mean that the profits must be profits which have actually been received in cash and not simply paper profits, but accountants clearly disagree. The proposal is to clarify that position in relation to takeovers and to amend the rules in relation to fair value accounting.

3. The Takeover Code

The third proposal is for amendments to the Takeover Code. Building on Principle 5 of the Code – to the effect that "offeror must announce a bid only after ensuring that he/she can fulfil in full any cash consideration" – anyone proposing to acquire a public company must clarify how they will pay for the shares they are proposing to buy. Moreover, this proposal also builds on Principle 3 of the Code to place obligations on both bidder and offeree to commit to the best interests of the company. The purchaser must publish a clear strategy for the takeover for approval by the Takeover Panel which will show how they will promote the success of the company under the Companies Act 2006. That strategy must also make clear how they will maintain the pension fund and that strategy must also be approved by the Pensions Regulator. The Pensions Regulator,[23] the Takeover Panel and the Financial Conduct Authority will have the ability to prevent the takeover within their regulatory competencies.

The failure to contribute to the pension fund was the most scandalous failure in the BHS debacle. In a society in which the welfare state provision of pensions is being rolled back, the maintenance of corporate pension funds is essential. Therefore, preventing companies from having their assets stripped out of them in the form of dividends or other distributions is essential too.

The strategy required by this proposal falls into two parts. First, the strategy must make clear how the purchaser intends to fund the purchase; whether or that would involve any new debt being imposed on the company after the acquisition; and whether any other burdensome liabilities would be imposed on the company with a

[23] Since these proposals were made by Mr McDonnell, the Pensions Regulator has made public their belief that they should have this power: *Financial Times*, 13th August 2016.

benefit to the purchaser (or any connected person or any person with whom they are acting in concert) within five years of the acquisition. Second, the purchaser must make a clear statement as to the effect of the acquisition on employees of the company and the manner in which the pension will be funded.

Principle 5 of the Code is important in this context. The issue is why it is not used so as to prevent takeovers when the purchaser does not have the cash to make the purchase. The answer is that many purchases are funded by debt and by other financial instruments in the form of securities, derivatives and so forth. The argument raised by the purchaser would be: I do have the cash because a bank will lend it to me. The concern identified above would be that the purchaser will then have that debt paid off by the company, at great cost to the employees of the company and to the economy at large. Therefore, the proposal is to amend the CA 2006 and the Code, by requiring that the purchaser is able to support the debt themselves or that they publish a strategy as to how any debt will be supported and its impact on the workers and pensioners in the company.

Further to Rule 2.5 of the Code, the offeror should only announce a firm intention to make an offer once it has given the matter the most careful and responsible consideration: then this either leads to a ‘‘firm announcement’’ trailing an offer, or a statement of an intention not to make an offer. The proposal is that the publication of a strategy for the funding of any debt and as to the future success of the company would be required at this point. The Takeover Panel and the Financial Conduct Authority would be empowered to resist the takeover at this point on the basis of the inadequacy of the strategy document. Alternatively, when a mandatory offer is required under Rule 9 (once a person acquires, alone or in concert with others, 30 per cent of the voting rights in the offeree company) then the strategy must be published at that point as a pre-condition to the offer process being commenced.

4. Enhance minority shareholder rights

The fourth proposal is to expand the rights of minority shareholders in s.260(3) of the Companies Act 2006 to bring derivative actions to object to a company being sold by the majority shareholders, or having significant transactions (such as sale-and-leasebacks or administration fees) imposed on it, when that will not further the success of the company or when that would harm the maintenance of the pension fund. They must also be able to object to corporate strategies which will lead to the corporate pension fund falling into deficit. The shareholders in our largest public companies include pension funds and other institutions on which ordinary people rely. If those companies are sold off and gutted in the process, then it is ordinary people who will pay ultimately.

The basis for a derivative action as set out in s.260(3) of the CA 2006 is that it “may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company”. The proposal is to expand the list of actions beyond these four breaches so as to encompass, put bluntly, the disembowelling of a company like BHS. The real question will always be as to the trigger which would set off the action. The proposal is that the use of unearned, borrowed money to pay a dividend would be one further head of action; another is the under-funding of the pension fund as considered below.

That a derivative claim could be brought on grounds of negligence was once problematic. It used to be English law that one could only bring such actions if one could prove fraud. In *Pavlides v Jensen*[24] it was held that no derivative action could be brought when a director sold company land at an under-value, because no fraud could be proved. However, Templeman J held in *Daniels v Daniels*[25] that actions to bring a derivative claim need not be limited to cases of fraud. His Lordship held that:

> "if minority shareholders can sue if there was fraud, I see no reason why they cannot sue where the action of the majority and directors, though without fraud, confers some benefit on the directors and majority shareholders themselves".

In that case the claimant shareholders sued when directors negligently sold land to one of their fellow directors at a fraction of its true market value. By extension this approach to the derivative action would be applied in statutory amendments to situations in which the owner-controllers of the company take some personal benefit from the company by way of fees, or dividends not funded by earned income, as was the case in relation to BHS. The new supervisory board (proposed under heading 5 below) would also be empowered under statute to bring such an action as a derivative action on behalf of the company.

There are further company law doctrines which recognise the spirit of seeking the success and well-being of the company in places other than the wishes and wealth of the majority shareholders. James LJ held in *Menier v Hooper's Telegraph Works*[26] that where the majority shareholders had purported to devolve to themselves the right to divide the company's assets up between the majority shareholders then that it would be a

> "shocking thing if that could be done, because if so the majority might divide the whole assets of the company, and pass a resolution that everything must be given to them, and that the minority shall have nothing to do with it".

Evidently then, even if the majority has the power to do something in theory, it will not always be permitted to exercise that power if its exercise would be abusive. This should be the trigger in cases like the immolation of BHS where millions in assets in BHS were bled out of the company and the pension fund left under-funded.

These derivative action cases provide a useful ethic for the entirety of the area of law in which one group of shareholders or directors exsanguinates the company of its assets and leaves the pension deliberately and significantly under-funded. The principal utility of the *Salomon* doctrine in this context is that it recognises the existence of a set of benefits in the company as a separate entity as being superior to the financial well-being of the majority shareholders (or those who control them) personally. A trading company as an entity embodies (in the jurisprudential sense) a set of needs and objectives which

[24] [1956] Ch 565.
[25] [1978] Ch 406.
[26] (1873-74) LR 9 Ch App 350.

relate to the success of that business, the prosperity of its employees and trading partners, and the needs of the real economy.

5. Supervisory boards – worker and pensioner rights

The fifth proposal is a significant reform which has been too long in the waiting in our company law: supervisory boards must be created for UK companies. In principle, this proposal now has the backing of both the Conservative Government (since the assumption of the role of Prime Minister by Theresa May) and the Labour Opposition. For the purposes of the reform of company law to meet the problems raised by BHS, these boards would give rights to workers and pensioners to be involved in the company's decision-making. The supervisory board would have the power to object to a takeover of the company on grounds that the takeover would adversely affect the rights of workers or the pension fund. The only protection against predatory capitalists taking companies over and exsanguinating them is to empower a supervisory board to prevent those actions before they take effect, or to refuse to ratify them after the event.

This proposal draws the previous four proposals together. The supervisory board, comprising representatives of the workforce and the pensioners, will be given powers to object to takeovers, to object to the payment of dividends and to object to asset sales where they threaten the success of the company, the capital base of the company or the maintenance of the pension fund. In consequence, rights would be given to that board to resist takeovers in the form of outright refusal, or a cooling-off period, or a complaint to the Secretary of State for Business for a ruling, or a referral to court to ask whether there would be oppression of workers or pensioners.

Furthermore, within the supervisory board, the workers would be entitled to resist a takeover (thus triggering the legal action outlined above) if they considered that on the balance of probabilities the takeover would result in their wages not being paid or their jobs being lost, or the success of the company under s.172 of the CA 2006 being otherwise put at risk. The statute would introduce a balancing act for the court to perform between the future solvency or success of the company (if not taken over) and the impact on the workers. In this way, the future well-being of the company would be protected as a commercial entity in parallel with the rights and needs of workers. Similarly, the pensioners would be entitled to resist a takeover if it was more likely than not that the pension fund would not be fully funded (to within a level established by actuarial calculations). Again, the court would have to perform a similar balancing act between the shot-term well-being of the company and the position of the pension fund. These rights would overlap with the strategy required above in relation to a takeover.

6. Claw back

The sixth proposal is that there will be a statutory "claw back" provision to recover any dividends which are funded indirectly by debt or which breach with any of the other principles set out above. It often happens that these cases end up in the insolvency courts (as is the case with the insolvency of BHS which is now in administration). Insolvency law already contains claw back provisions (for example, in s.423 of the Insolvency Act 1986). These proposals enable the courts to order a claw back of assets several years after the transfer away of the assets in the form of the dividend.

CONCLUSION

Memorably, in *Rolling Stone* Matt Tiabbi described US investment bank Goldman Sachs as being like a great vampire squid "relentlessly jamming its blood funnel into anything that smells like money".[27] There is something of great vampire squid in the exsanguination of companies like BHS: sucking the lifeblood out of them before selling off the husk. In the 1980s we would have called this "asset-stripping". In that era, large conglomerates would be dismembered and sold off on the principle that the parts were worth more separately than the sum of those parts. In situations like BHS, the corporate presence of the company is left intact but the cash value is sucked out of it: the extraction of cash through fees and dividends has replaced the division of the company into its component parts for sale. The Greens acquired a company with assets worth £500 million and a pension fund in surplus, but they left a company with a market value of only £1 and a pension deficit of £571 million. In the meantime, they had taken an estimated £1.2 billion personally from BHS alone. At the same time 11,000 employees are threatened with losing their jobs and 20,000 people entitled under the pension fund are awaiting rescue. The husk was then sold off in an effort to distance the previous owners from any legal liabilities in relation to it.

Company law must change to prevent this sort of misuse of public companies, and the harm that causes to society more generally, from being repeated. The Pensions Regulator must also be empowered to regulate company pension funds more closely and to compel proper funding. The Takeover Panel must be empowered to resist takeovers brought by unfit people. What must be avoided is the outcome that now faces twenty thousand people closely connected to BHS.

Philip Green has come to symbolise the type of capitalist Vaughan Williams J[28] and Lindley LJ[29] feared Aron Salomon's case would create. Lopes LJ could have been talking about Philip Green when he held that: "It would be lamentable if a scheme like this could not be defeated".[30] With a few changes to our company law, it can be defeated in the future.

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[27] Reproduced in M Taibbi, *Griftopia* (New York: Spiegel & Grau, 2011), Chapter 7 "The Great American Bubble Machine", p.206 *et seq*.

[28] *Broderip v Salomon* [1895] 2 Ch 323.

[29] *Salomon v A Salomon & Co Ltd* [1895] 2 Ch 323.

[30] [1895] 2 Ch 323.