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Introduction

This document is a formal submission of evidence to the Public Accounts Committee in relation to their inquiry into Government intervention in distressed companies.[1]

Five points are made in relation to distressed companies and government intervention in this evidence document. These observations are made from a company law, insolvency law, and restructuring law perspective by Dr. John Tribe, a UK academic based at the University of Liverpool's School of Law and Social Justice.[2] These five points that are addressed are:

(1) Shadow director or de facto director liability
(2) Encouragement of wrongful trading
(3) Theoretical underpinnings – communitarianism versus creative destruction
(4) Encouraging unfit behaviour
(5) Government Involvement but then walking away – dealing with the husk?

These areas will now be addressed in turn and in no particular order of importance. The points are made relatively briefly for ease of digestion. The author is more than happy to expand on any points if required.

[1] See further: https://committees.parliament.uk/work/8100/lessons-for-government-monitoring-and-responding-to-companies-in-distress/
[2] See further: https://www.liverpool.ac.uk/law/staff/john-tribe/publications/

(1) Shadow Directors or *De Facto* Director Liability

One major area of concern for any Government involvement in distressed companies must be any potential issues around liability for shadow director or *de facto* director liability. If the Government, or one of its functionaries, is engaging so closely with the company and its board as to alter the direction of the board's decision making then this might put the Government/functionary at risk of liability as a shadow or *de facto* director.

This specific point has not been tested on this Government involvement with distressed companies point. One good example was the last minute injection of £3 million into the distressed charity Kids Company (which used a corporate form to organise itself). This raised an interesting question, namely, to what extent would the decision maker who extended that loan be culpable for shadow director liability? The answer is probably not as David Cameron (as he then was) has never been pursued on this point, despite heavy litigation against other shadow/*de facto* directors in the Kids Company case.[3]

The point would need to be examined to ensure that Government/functionaries were not over stepping the boundary into a realm of responsibility. To this end relevant authorities would need to be closely examined including statute[4] and case law.[5] Section 22 of the Company Director Disqualification Act 1986 at subsection (4) states that a ""Director" includes any person occupying the position of director, by whatever name called." The next subsection notes: "(5) "Shadow director", in relation to a company, means a person in accordance with whose directions or instructions the directors of the company are accustomed to act (but so that a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity)."

Using the Kids Company example again, to what extent did the Kids Company injection of £3m come with instructions to the directors of the company? Was there "real influence"?[6]

[3] On the case an issues arising from it see: Tribe, J., & Mithani, A. *Keeping Kids Company – are the rules for disqualifying those guilty of misconduct in running incorporated charities different?* (2022) Corporate Rescue and Insolvency, 15(2), 39-42, and, Tribe, J. *Charities and Directors' Disqualification* (2021) The Law Quarterly Review, 137, 542-547.

[4] e.g. *De facto* directors s.22(4) Insolvency Act 1986 and Shadow directors s.22(5) Insolvency Act 1986.

[5] e.g. *Re Kaytech International Plc* [1999] BCC 390.

[6] On which see further: *Secretary of State v. Deverell* [2000] 2 All ER 365.

over the running of Kids Company by Government as a condition of helping the distressed (corporate form) charity?

It is this sort of danger that the Government should be cognisant of going forward when helping other distressed companies (whether charities or for profit enterprises).

(2) Encouragement of wrongful trading

There are skill and care tests in both the Companies Act 2006[7] and the Insolvency Act 1986[8] to help regulate director behaviour. These two provisions are virtually identical in terms of substance.[9] Both provisions exist to encourage responsible behaviour by directors at different points in the company's life cycle.

The wrongful trading provisions in section 214 of the Insolvency Act 1986 exist to discourage directors from continuing to trade when there is a real and substantial risk of increasing a company's exposure to its creditors in terms of liabilities. So the longer a company continues to trade the more likely it is that is could run up further indebtedness which can ultimately harm creditors and other stakeholders.

The test in section 214 of the Insolvency Act 1986 is part objective and part subjective. The relevant part of the section states:

> *"(4) ……the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both—*
>
> *(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and* [OBJECTIVE]
>
> *(b) the general knowledge, skill and experience that that director has.* [SUBJECTIVE]"[10]

This section and relevant cases[11] show that directors need to be careful, on an objective and subjective basis, do not continue to trade the company when it is inappropriate to do so. This

[7] s.174 Companies Act 2006.
[8] s.214 Insolvency Act 1986.
[9] This is why it was non-sensical to suspend the wrongful trading provisions during the pandemic. The general duty of skill and care in s.174 Companies Act 2006 was still active and relevant.
[10] s.214 Insolvency Act 1986.
[11] See for example: *Re Produce Marketing Consortium Ltd (No 2)* [1989] 5 BCC 569, *Re Brian D Pierson*

is important then for the Public Accounts Committee when considering distressed companies because Government involvement should not facilitate or encourage wrongful trading.

So when Government or its functionaries are dealing with distressed companies they need to be mindful that they are not wilfully encouraging the directors of the company to engage in wrongful trading.

(Contractors) Ltd [2001] 1 BCLC 275, [1999] BCC 26. See also: *Norman v. Theodore Goddard* [1992] BCC 14, *Re D'Jan of London* [1993] BCC 646 (solvent cases but where the s.214 provisions are discussed by Lord Hoffmann).

(3) Theoretical underpinnings - communitarianism versus creative destruction

From an insolvency law theory perspective there are two schools of thought that impact on government intervention with distressed companies. These are creative destruction and bankruptcy communitarianism.

Creative destruction is the idea proposed by Joseph Schumpeter that capitalism has a cyclical feature know as creative destruction.[12] In essence this means that some incidents of corporate failure are part of capitalism. Failure is baked into the model to encourage innovation and renewal. Government should not therefore engage with distressed companies.

Another theory that impacts heavily, and one to which the current writer subscribes, is bankruptcy communitarianism. This theory, in short, argues that community is important for companies, indeed companies would not exist without community. This means companies should act in a way that benefits communities. Government intervention could help this strategy aim. Public interest insolvencies help demonstrate why this approach is beneficial.

English and Welsh insolvency law has a long history of dealing with large-scale insolvencies which concern the public interest. Public interest in this context is broadly analogous to the concept of public benefit in charity law, namely activity that benefits the public. Or in narrower terms public interest is whatever the relevant Government minister, usually at BEIS (The Department for Business, Energy & Industrial Strategy) or the Chancellor of the Exchequer, says it is at the given time and for various political reasons. Either way examples abound in this jurisdiction of insolvencies touching on the public interest. Whether it has been, for example, steel works in South Wales or the North East (British Steel), car plants in the Longbridge area of Birmingham (MG Rover), aviation companies whose customers are abroad at the time of failure, (Thomas Cook) or large scale office developments in the Docklands area of East London (Olympia & York) to name a sample. Insolvency practitioners (IPs) and the Official Receiver are well used to dealing with broader stakeholder issues that go beyond profit wealth maximisation, creditor wealth maximisation, or the narrow confines of insolvency law and its provisions.[13] Indeed, it could be argued that Sir

[12] Schumpeter, Joseph A. *Capitalism, socialism and democracy (2nd ed.).* Floyd, Virginia: Impact Books, 1942.
[13] See further: Tribe, J. *Communitarianism and the Public Interest in Large Corporate Insolvencies: Future*

Kenneth Cork's imaginative use of receivership in the 1970s and early 1980s is an example of an IP attempting to harness a company's totality of potential to preserve value and to facilitate growth, not just for the benefit of the debenture holders but also for the other stakeholders who were affected by the insolvency, including those employed by the company in receivership and the wider community of stakeholders.[14]

In the corporate insolvency context it has been argued that there are a number of interests beyond the confines of the creditors[15] and that proponents of narrow theories such as the 'creditors bargain theory' are right to broaden out their conception of insolvency law as also serving other 'claimants'.[16] As Warren has opined (using broader American insolvency language) bankruptcy is "'dirty, complex, elastic, [and] interconnected." This sort of vision of bankruptcy policy, one that goes beyond the narrow confines of creditor wealth maximisation brings us to insolvency pluralism or stakeholder insolvency.

In public interest insolvencies in England and Wales we have seen Government intervention to help facilitate the company's ongoing activity. We have seen employees treated in a way that has been designed to safeguard their employment (e.g. MG Rover) through the injection of funds to help pay wage bills to continue employment. We have seen the government support large-scale transport infrastructure projects to the tune of billions to help ensure that a large residential and commercial offices redevelopment takes place (e.g. Olympia & York and Canary Wharf). We have seen funding for steel works to preserve jobs in specific areas of England and Wales (e.g. British Steel). All of this additional support beyond the dry mechanics of the insolvency laws demonstrates that broader aims are important in policy-making terms. Put another way, the Government has shown that broader stakeholders are important to it. Government is prepared to support employees, suppliers, communities, the environment, travellers, and other groups, as various companies have entered an insolvent phase.

Directions for Value and Potential in Commonweal Undertakings. In Harris, J (Ed.), *A Research Agenda for Insolvency Law*. Edward Elgar. 2024, hereafter *Tribe Commonweal.* Read before the Society of Legal Scholars' Annual Conference, King's College London, 7th September 2022).

[14] See: Cork, K. *Cork on Cork*, Macmillan, London, 1998, Chapters 6, 9 and 10.

[15] See: Sarra, J. *Creditor Rights and the Public Interest – Restructuring Insolvent Corporations.* University of Toronto Press, 2003; Warren, E. *Bankruptcy Policy* (1987) 54 Univ.Chicago L Rev. 775).

[16] See Professor Thomas Jackson who has moved away from his "creditors' bargain theory" towards a ""claimants' bargain" or something broader": Jackson, TH. *A Retrospective Look at Bankruptcy's New Frontiers* (2018) University of Pennsylvania Law Review, Vol. 166, No. 7 (June), pp. 1867-1879, 1872.

Communitarian bankruptcy policy provides a theoretical underpinning for why Government should get involved in distressed companies.

(4) Encouraging "unfit" behaviour?

Anthony Trollope's "*The Way We Live Now"* was published in 1875. Much like contemporary literature at the time[17] it contains a swingeing critique of nefarious behaviour surrounding limited companies.[18] These themes are recurrent through the ages in the realm of company and insolvency law where limited liability of shareholders is present[19] and where there is a division of ownership and control between owners and managers.[20] The tension between stakeholders, including shareholders,[21] creditors, and companies, as separate legal juristic persons, has been tested over the last two centuries at various pinch points in time. We might go so far as to say *plus ça change (plus c'est la même chose)* especially when it comes to controlling director behaviour[22] and the problematic use of the corporate form as a legal structure.

The most recent iteration of this tension comes in the guise of the Bounce Back Loan Scheme (BBLS) scandal.[23] The BBLS episode has stress tested limited liability forms and the risk balance between creditors, shareholders, and company directors over the course of the recent Covid-19 pandemic.

The use and abuse of the BBLS Covid-19 support mechanisms illustrate how the long-held risk tension between creditors and shareholders can be played out. This is demonstrated by two stress points that arose through the BBLS process. First, directors caused their companies

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[17] e.g. Gilbert, WS & Sullivan, A. *Utopia, Limited; or, The Flowers of Progress.* London, 1893.

[18] On literature and the law see also: Holdsworth, W. *Charles Dickens as a Legal Historian*. See also: Weiss, B. *The Hell of the English*.

[19] On limited liability and the capping of risk for shareholders see: Bainbridge, SM & Henderson, MT. *Limited Liability: A Legal and Economic Analysis*. Edward Elgar, Cheltenham, 2016, p44.

[20] On this division see the famous Berle & Means thesis: Berle, A & Means, G. *The Modern Corporation and Private Property*. Transaction Publishers, New Jersey, 1932.

[21] On the role of shareholders see: Montagnon, P. *The role of the shareholder*, in, Rushton, K (Ed). *The Business Case for Corporate Governance*. Cambridge University Press, Cambridge, 2008, p.81.

[22] See for example the debates on restraining managerial behaviour in the 1930s, where Professor Dodd noted, "The present write [Dodd] is thoroughly in sympathy with Mr. Berle's efforts to establish a legal control which will more effectually prevent corporate managers from diverting profit into their own pockets from those of stockholders…" (Dodd, EM. *For Whom Are Corporate Managers Trustees?* (1932) HARV.LR., Vol. 45, No. 7 (May), pp. 1145-1163, p.1147). See also: Berle, A. *Corporate Powers as Powers in Trust* (1931) 44 HARV.L.R 1049 and: Berle, AA. *For Whom Corporate Managers Are Trustees: A Note* (1932) HARV.L.R, Vol. 45, No. 8 (Jun), pp. 1365-1372.

[23] For further examples of limited liability misuse see: Tribe, J. *Corporate Insolvency Law: Challenging Orthodoxies in Theory, Design and Use*. Edward Elgar Publishing. 2023.

to borrow in circumstances that were not in accordance with the aims of the BBLS scheme. This has given rise to massive default levels on the loans. Secondly, it is arguable that the nominated banks lent with relatively few checks and balances, certainly with less prudence than in usual lending periods. This was because the whole BBLS system was bolstered with State guarantees for financial exposure where default on loans might occur. If the debtor companies defaulted the lending banks would be indemnified by the Government. The less than rigorous lending behaviour was also in part because the Secretary of State for Business, Energy and Industrial Strategy (BEIS), Alok Sharma, instructed the British Business Bank to, "get the money out there."[24] There was therefore direct government pressure to lend including ministerial directions to civil servants to this effect.[25] In terms of financial prudence with "other peoples' money", namely English and Welsh taxpayers, the whole BBLS episode stands perhaps as an exercise in unchecked and reckless profligacy.

We are now reaping the consequences of these ministerial instructions, company director borrowing behaviour, and, bank lending practices. Combined together these malodorous behaviours are resulting in massive default levels for bounce back loans. Estimates put default levels at £26bn, some 60% of the total loan book of £47bn.

The BBLS episode is important for the Public Accounts Committee to (further) consider because it demonstrates that some government support of distressed companies can lead to further abuse of the corporate form by company directors.

The ongoing disqualification activity of the Insolvency Service demonstrates this. We now see BBLS unfitness as the leading driver of the disqualification statistics. Without the BBLS scheme we would not now be seeing these disqualifications. In other words the BBLS scheme has fuelled disqualifications. Unfortunately, it has also fuelled the abuse of the limited liability form.

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[24] Hansard.

[25] See further: Bounce Back Loan Scheme: ministerial direction, correspondence from the Rt Hon Alok Sharma MP, then Secretary of State for BEIS, dated 1 May 2020. (available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/891455/20200501_SoS_to_AO_Bounce_Back_Loan_Scheme_Direction.pdf). See also: Smith, B. *Business secretary overrules value-for-money concerns with ministerial directions for coronavirus schemes*. Civil Service World. 11 June 2020. See also: Haslett, E, *"It was as easy as clicking a button": how the government handed billions to fraudsters*. The New Statesmen. 10 February 2022.

Put another way, Government support of distressed companies could harm the corporate form itself. We can see this when we examine the behaviour of directors during the currency of the BBLS support package against the backdrop of the risk balance between creditors and debtor companies.

This risk balance has been a perennial tension in company and insolvency law since the creation of the legal fiction that is the separate legal juristic person known as the company or corporation.[26] As early as 1897 in the seminal company law decision of *Salomon v. Salomon* Lord Macnaghten expressed his sympathy for the plight of the unsecured creditors when he said "The unsecured creditor of A. Salmon and Company Limited, may be entitled to sympathy."[27] He knew that creditor harm could flow from how companies, and debt structures, could be organised. Later commentators, including Professor Sir Otto Kahn-Freund QC, thought the House of Lords had gone too far and that the risk balance had swung too much towards creditors. Writing in 1944 Kahn-Freund observed that with, "the calamitous decision in *Salomon v. Salomon*…the courts failed to…give protection to the business creditors which should be the corollary of the privilege of limited liability."[28] He continued, "…the metaphysical separation between a man in his individual capacity and his capacity as a one-man company can be used to defraud his creditors who are exposed to grave injury owing to the timidity of the Courts and of the Companies Act."[29] Kahn-Freund

[26] This tension is perhaps best exemplified by the company objects clause debates. Here the tension arose because reliance on internal constitutional documents (the memorandum of association and the objects clause within that document) could have the effect of protecting the company and its shareholders to the detriment of the creditors. If the company was said to be acting outside its capacity in relation to certain contracts, e.g. for loans, then it would not be held to those contracts. If the contract was for a loan this would obviously then harm the creditors, perhaps a debenture holder. The pendulum of responsibility can swing back in favour of creditors by making objects clause extremely wide and without limitation on corporate capacity. It is harder to argue contracts are unenforceable due to being *ultra vires* in such circumstances. For some judicial discussion of the *ultra vires* problem and the original position at common law (to some extent now resolved by statute including the Companies Act 2006) see: *Ashbury Railway Carriage & Iron Co v. Riche* (1875) LR 7 HL 653; *Re Introductions* [1970] Ch 199, but compare: *Rolled Steel Products (Holdings) Ltd v. British Steel Corporation* [1985] 3 All ER 52. See also: *Aveling Barfoerd Ltd v. Perion Ltd* (1989) 5 BCC 677. On the main objects rule see: *Re German Date Coffee* (1882) 20 ch Div 169; *Cotman v. Brougham* [1918] 1 AC 514. On wide clauses see: *Bell Houses v. City Wall Properties Ltd* [1966] 2 QB 656; *Re New Finance and Mortgage Co* [1975] 1 All ER 684; *Newstead (Inspector of Taxes) v. Frost* [1980] 2 All ER 241.

[27] *per* Lord Macnaghten, *Salomon v. Salomon* [1897] AC 22, 53. On this seminal decision see further: Grantham, R & Rickett, C (Eds). *Corporate Personality in he 20th Century*. Hart Publishing, Oxford, 1998. Hereafter Grantham & Rickett. For an interesting discussion of the case see also: Talbot, LE. *Critical Company Law*. Routledge-Cavendish, Abingdon, 2008, p.25.

[28] Kahn-Freund, O. *Some Reflections on Company Law Reform* ((1943-1944) 7 MLR 54-66. Hereafter *Freund Reflections*. For a further Montaigne like 'gloss' on the point see: Prentice, D. *Corporate Personality, Limited Liability and the Protection of Creditors*, in Grantham & Rickett, p.99. See also: Cheffins who notes that "…the law's treatment of shareholders, directors, and officers poses some difficulties for creditors…" (Cheffins, B. *Company Law: Theory, Structure and Operation.* Oxford University Press, Oxford, 1997, p.496).

was arguing for protection of the creditors.[30] For him the partnership form was the more appropriate vehicle for small closely held groups of entrepreneurs to use. They would be more risk averse. Joint and several liability would focus their minds. But the horse had well and truly bolted by the 1940s and the private limited company was ubiquitous. It is how that legal fiction was used by incorporators and directors moving forward that would be of note.

It could be argued that BBLS behaviour has gone a step further and has actually started to infect how the corporate form is perceived and used. In other words, has the corporate form fallen into disrepute in such a way that Kahn-Freund's "calamitous" suggestion can now actually be applied to companies that have abused the BBLS support mechanisms that were extended during the Covid-19 pandemic period? Indeed, if the corporate form has fallen into disrepute will this hasten its demise so that shareholder wealth maximising entities will need to be re-envisaged with different structures and goals?

Government intervention in distressed companies can have far reaching consequences.

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[29] *Ibid.*

[30] A number of commentators suggests that UK corporate law is currently favourable to creditors, particularly those who have availed themselves of a security device. See: Armour, J & Hertig, G & Kanda, H. *Transactions with Creditors,* in, Kraakman, R £ Armour, J, et al (Eds). *The Anatomy of Corporate Law: A Comparative and Functional Approach*. 3rd Ed. Oxford University Press, Oxford, 2017, p/109., 142. Company law may also be structured to keep the interests of creditors in mind, e.g. during a merger. See further: Woolridge, F. *Company Law in the United Kingdom and the European Community – Its harmonisation and unification*. Athlone Press Ltd, London, p.36.

(5) Government Involvement but then walking away – dealing with the husk?

The Public Accounts Committee will be aware of the Baglan Operations Ltd liquidation.[31] This case is interesting from a Government intervention in distressed companies perspective because the government has intervened in the case (in the form of the Official Receiver and the Crown Estate (part of the Treasury arguably)).

What is important though is despite that involvement by Government in the distressed business there are still very real ramifications playing out on the site in south Wales that have not been dealt with. The Crown Estate will not adopt the site. The Official Receiver has dealt with the liquidation.

The highly dangerous polluted area is now languishing in a state of dangerous disrepair with no one taking responsibility. In other words, Government involvement in distressed companies must be for the long run and properly finalise the case. The liabilities in the Baglan case have meant that various Government departments are absolving themselves from responsibility for the ongoing issues in the Baglan Bay area. The power station and site are being left to rot. This is dangerous for the environment and local inhabitants.

The problems with Baglan stem from the area of escheat. This is examined by the author of this evidence submission in a 12,000 word paper that can be supplied to the Public Accounts Committee.[32]

[31] See: *In the matter of Baglan Operations Limited (in compulsory liquidation)* [2022] EWHC 647 (Ch).

[32] See further: Tribe, J. *What is meant by "subject to escheat" in the context of disclaimer of onerous property in the realm of company liquidation? A critical discussion of the Crown Estate's ownership of ownerless land*, at Exchange Chambers Annual Insolvency Conference 2023, by Invitation (Leeds and Manchester, 2023)

A final terminology. Technical insolvency and financial distress are both used in the realm of restructuring and insolvency. Distress is also used in economic literature. Clear thought would need to be given to the parameters of distress and its meaning in law.

As noted above, I am happy to expand on the above points of required.

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