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*The Capture of Corruption: Complexity  
and Corporate Culture*

Janet M. Dine



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## The Capture of Corruption: Complexity and Corporate Culture

Janet M. Dine\*

“Corruption is often discussed in the kinds of language and symbolism reserved for life-threatening diseases.”<sup>1</sup> The World Bank insists that it “has identified corruption as the single greatest obstacle to economic and social development.”<sup>2</sup> This is problematic, as no one seems to have found a universal definition of corruption. Nor is there absolute consensus on what types of behaviour within a loose definition are harmful. Johnson, however, argues that in some respects there is *too much* consensus. “The new wave of concern has been driven primarily by business and by international aid and lending institutions. While there is nothing inherently wrong with that, their vision of corruption, like any other, is partial.”<sup>3</sup>

Johnson points out that the major anti-corruption players (“USAID,” World Bank, “OECD,” “UNDP” and “TI”)<sup>4</sup> rarely address differences in the societies whose corruption they seek to cure. Noting the way in which corruption and anti-corruption has emerged on to the

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<sup>1</sup> M. Johnson, “Political Corruption” (Colgate University, 2003)

<sup>2</sup> <http://www.worldbank.org>

<sup>3</sup> M. Johnson, “Comparing Corruption” in W. Heffernan & J. Kleinig, eds., *Private and Public Corruption*, *Private and Public Corruption* (Maryland: Rowman & Littlefield, 2004) 276

<sup>4</sup> United States Agency for International Development; Organization for Economic Development and Cooperation; United Nations Development Program; Transparency International

international agenda, Samson notes, “In the last five or six years, anti-corruption practices have diffused transnationally and have become organized globally. We have seen the emergence of a *world of anti-corruption* with its own actors, strategies, resources and practices, with its heroes, victims and villains.”<sup>5</sup> Samson moots two possible explanations for this powerful recent emergence of the anti-corruption movement: first, “[t]he fight against corruption is virtuous, and those who form part of the anti-corruption community’ are thus ‘integrity warriors;” second, the need to increase system rationality arguably “will make market economies more efficient, state administration more effective, and development resources more accessible.”<sup>6</sup>

Pointing out that when anti-corruption norms are applied to projects “‘global morality’ [becomes] . . . a social process. It is a process by which virtue is transformed into a specific activity called a project—one which includes formulating a funding strategy, approaching donors, analyzing stakeholders, hiring consultants, developing NGOs, conducting project appraisals, making evaluations and so on. Anti-corruptionism . . . is a stage in which moral projects are intertwined with money and power.”<sup>7</sup> Because of this “Anti-corruption . . . is not innocent. It can be manipulated to serve the interest of even the most unscrupulous actors.”<sup>8</sup>

Further, the interdependence of world economies makes the condemnation of certain behaviours one-sided; that is, the behaviour of one set of actors is condemned while those on the other side of the transaction are regarded with disinterest. This paper argues that such a

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<sup>5</sup> S. Samson “Integrity Warriors: Global Morality and the Anti-Corruption Movement in the Balkans” in D. Haller and C. Shore, eds. *Corruption*, (Ann Arbor: Pluto Press, 2005) 106. Italics in original.

<sup>6</sup> *Ibid*, 107

<sup>7</sup> *Ibid*, 109-10

<sup>8</sup> *Ibid*, 129.

system operates in certain tax havens, and will spotlight the British Virgin Islands to put detail on a complex moral phenomenon.

The British Virgin Islands are a tiny group of islands composed of the remains of a volcano. As such they are mountainous and have very poor soil. With 20,000 inhabitants in such a location making a living is extremely difficult. Moreover, the islands have a troubled history:

“The English ousted the Dutch from Tortola in 1672, and from Anegada and Virgin Gorda in 1680. The new rulers introduced the two quintessential features of the colonial era in the Caribbean: sugar cane and slaves. At first, most of Tortola’s ‘planters’ were more interested in piracy and smuggling than agriculture, but by the 18th century they were displaced by a new wave of experienced planters and a settlement of hard working Quakers. Between the mid-18th and early 19th centuries, the islands prospered, producing sugar, cotton, rum, indigo and spices. Slave unrest and ideological doubt brought an end to slave auctions in 1803. By the 1830s, slaves had been emancipated. Abolition and competing sugar production in Europe and the USA were disastrous for the islands: capital and settlers departed for more buoyant economies, and for the next 100 years the islands’ economy stagnated.”<sup>9</sup>

The British Virgin Islands (“BVI”) are an Overseas Territory of the United Kingdom.<sup>10</sup> From

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<sup>9</sup> Lonely Planet on-line guide

<sup>10</sup> Although the Territory is popularly known as the British Virgin Islands its correct name, as the Constitutional Commissioners pointed out in their 2005 report, is the Virgin Islands. For stylistic reasons, and to avoid confusion, while using the term ‘Virgin Islands’ in the long form, where abbreviation was necessary we have used ‘BVI’.

a desperately poor economy based primarily on agriculture, the economy has evolved to a service economy based mainly on the twin pillars of tourism and financial services. The economy is very stable and one of the most prosperous in the Caribbean. The estimated GDP per capita income in 2004 was \$38,500, one of the highest in the Caribbean.<sup>11</sup>

The financial services industry has seen significant growth in the last few years mainly due to the government's careful development of its offshore legislative package and professional infrastructure. In the budget address in December 2005, Finance Minister, the Hon R. W. Skelton, projected that this sector will contribute approximately \$130,000,000 (63.99%) of the country's revenue during 2006. There can be no doubt that the sector is vital to the continued growth of the economy.

However, the BVI was on the OECD list of corrupt economies and only removed in 2002. While one of the OECD issues was the possibility of money laundering, the very existence of tax havens is frequently condemned. While concealment of the proceeds of crime fits almost any definition of corruption, there are many who argue that the establishment of tax havens to facilitate the avoidance of tax is in itself corrupt. The condemnation, however, tends to be one-sided, with the criticism focused not on the corporate culture, which seeks to use tax havens to maximize shareholder profits, but on the countries which establish the tax havens themselves. This paper will also raise a number of issues thrown up by this partnership between the culture of companies that have established more than 400,000 "shell" companies on the BVI and the development aspirations of those living on the barren (but beautiful) rocks which make up the BVI. As we will see the public interest is often held to be significant in definitions of corruption, but the public interest is a complex phenomenon, especially where

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<sup>11</sup> [www.cia.gov/publications/factbook/geos/vi.html](http://www.cia.gov/publications/factbook/geos/vi.html).

cross-border issues are at stake. Specifically the issues are:

- a) what should the definition of corruption be?
- b) what consequences flow from wide or narrow definitions
- c) what are the advantages or disadvantages of selecting wide or narrow definitions

### **Corruption: Definition Issues**

One definition of corruption was put forward by Edward Banfield in 1975. He described corruption as a relationship between three parties: the public as principal, the public official as agent obligated to fulfil the wishes of the principal, and a third party seeking to have the agent work on its behalf instead.<sup>12</sup> This is a simple description of corruption but it raises a number of issues. Kleinig and Heffernan explain, “it is not the predominant understanding of the term in the *Oxford English Dictionary*; it leaves out much of what has historically been deemed corrupt; and it relies on the superficial clarity of a private/public distinction and an unexamined view of what counts as improper use. Corruption is not the exclusive failing of public officers; there may also be personal corruption, corrupt institutions, and corrupt cultures.”<sup>13</sup> Heidenheimer distinguishes between black, white and gray corruption, with black corruption being perceived by both elites and ordinary people as fundamentally detrimental to society, white acts seen by both groups as of some benefit to society, and gray acts those about which the groups differed.<sup>14</sup> Holmes debates the definition but settles for a “core” definition for the purpose of studying corruption in post-communist states.<sup>15</sup>

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<sup>12</sup> E. Banfield, “Corruption as a Feature of Governmental Organization”, *Journal of Law and Economics* 18/3 (1975) 567-605.

<sup>13</sup> J. Kleinig & W. Heffernan, “The Corruptability of Corruption” in Heffernan & Kleinig *supra* note 3, at 3. Emphasis in original.

<sup>14</sup> A. Heidenheimer, *Political Corruption* (New York: Holt, Reinhart & Wilson, 1970)

<sup>15</sup> L. Holmes, *Rotten States*, (Durham & London: Duke University Press, 2006)

While all these issues cannot be explored here, this paper challenges the narrow definition of corruption and examines the concept of institutional corruption. It also raises further issue of cross-border corruption. Interestingly, the Banfield definition is most apt in describing a bribe which takes place *within a single jurisdiction*. It contains an assumption that a public official is being bribed to act against the interests of his public. If we widen the description to take account of behaviour in (for simplicity) two jurisdictions we may have an instance where the definition does not do any harm; if the condemned behaviour is approved of by the public in both jurisdictions, does the corruption disappear? What if one public condemns the behaviour and the other approves?

Let us consider the BVI example. As a moral and legal issue the use of tax havens is problematic, some would say inherently corrupt, since it is clearly contrary to the beneficiaries of taxation in the home state of those companies offshoring their activities. However, it would seem to benefit one other public interest within that same jurisdiction; the shareholders will receive greater profit and the share price will go up. This is at least to their *financial* benefit. The third public interest resides in the tax haven. Especially on such unpromising volcanic soil as the BVI, how else to develop? Tourism has natural limits; financial skulduggery has none? If the scheme benefits two publics and disadvantages one, do we accept majority rule? And if so, why was the BVI on the list of corrupt tax havens when it was being used by many companies in rich jurisdictions to increase their profits?

The problem with narrow definitions is that they can be selectively used by the powerful to displace blame on to others and away from their own actions. An explanation of the way in which selective narratives arise from narrow definitions has been provided by Global

Witness.<sup>16</sup> They report that in Congo Brazzaville, Angola, and Equatorial Guinea huge sums of oil and extractive revenues have vanished; paid as bribes by the companies to the local elites. This is despite the voluntary disclosure code launched by the UK government in 2003. A UK government spokesperson explained that it was for the governments of these countries to stamp out corruption. Global Witness had suggested preventing parent companies from listing on the London Stock Exchange, Dow Jones or Bourse (or any powerful country's stock exchange), unless companies were transparent about these sums of money. The UK spokesperson explained that this was not possible since laws would have had to be passed in all the countries where the mining companies were registered.<sup>17</sup> This is a manifest inaccuracy, since European Union ("EU") rules and US rules would cover most of the operations. The stock exchange of Angola has, to say the least, a low profile in world affairs, but this attitude displaces the burden to act on to the corrupt governments. Manifestly, a recipe of appeasement of the companies by smoke and mirrors while apparently "tackling the problem."<sup>18</sup>

It is noteworthy in this context that corruption indices have always concentrated heavily on rating countries by the frequency of receipt of bribes, rather than the source of the bribes, although there are some signs of change.<sup>19</sup> In 2005, 159 countries were included in

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<sup>16</sup> Time for Transparency: Coming Clean on Oil, Mining and Gas Revenues, [www.globalwitness.org](http://www.globalwitness.org), March 24, 2004.

<sup>17</sup> BBC Today Programme, March 24, 2004

<sup>18</sup> In Angola one in four children die of preventable disease under 5 years old while \$1.7 billion goes missing each year. Companies involved in the scandal in the three states include Elf, Mobil and Chevron.

<sup>19</sup> For a detailed examination of comparative indices see M. Johnson "Comparing Corruption" *supra* note 3, 275 et seq.



Transparency International's *Corruption Perception Index*.<sup>20</sup> Only in 2006 was a Bribe Payers Index composed rating companies from 30 countries.<sup>21</sup> Further, the UN Convention against Corruption encompasses acts such as trading in influence, abuse of functions, and embezzlement of property in the private sector.<sup>22</sup> It takes two to be corrupt, and, in the Global Witness instance, it is clear that the bribes were coming from the West. It is therefore necessary to consider much more carefully the definitions of corruption that we use.

As we have seen, Kleinig and Heffernan argue that corruption is by nature “essentially contestable” both as to its definition and its desirability.<sup>23</sup> It is suggested here that the culture which has grown up in some of our largest and most powerful multinationals is a corrupt culture which merits as much attention as public corruption, and may often be a contributory factor in the development of other corruptions, including illegal or marginally legal offshore financing. Euben argues from the basis of the *Oxford English Dictionary*, which associates corruption with a cluster of words--decay, degeneration, disintegration, and debasement.<sup>24</sup> This much wider definition opens up an investigation into corporate culture.

Definitions that restrict corruption to public officials run the risk of being accused of capture of the concept, that is, used selectively to condemn behaviour to achieve particular policy

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<sup>20</sup> Transparency International Annual Report 2005, [www.transparency.org](http://www.transparency.org), Berlin 2005 and see Transparency International *Global Corruption Report 2004*, (London: Pluto Press, 2004)

<sup>21</sup> Transparency International *Bribe Payers Index*, October 4th 2006, Transparency International, Berlin.

<sup>22</sup> UN Convention against Corruption, came into force December 14th 2005 when the 30th state ratified it. See D. Jayasuriya “The expanding frontiers of international law in the fight against corruption,” *Amicus Curiae* 67/7 (2006).

<sup>23</sup> Heffernan & Kleinig, *supra* note 13, at 3

<sup>24</sup> J. P. Euben, “Pure Corruption”, in Heffernan & Kleinig, *supra* note 13, at 54.

outcomes. This is particularly important when corruption is used to impose conditionality on the grant of aid or loans. It misses altogether the institutional corruption that is to be found in the aggressive, deregulated corporate sector. Scenarios such as that in Enron and Worldcom are informative on this point. It should be remembered that Arthur Anderson was indicted, *inter alia*, for “knowingly, intentionally and corruptly” inducing employees to shred documents relating to Enron. Shore and Haller are clear that such financial scandals “remind us that Europeans and Americans cannot assume that grand corruption is something that belongs primarily to the non-western ‘Other’ or to public-sector officials in defective state bureaucracies: corruption (both massive and systemic) we should not be surprised to learn, can also be found in the very heart of the regulated world capitalist system.”<sup>25</sup> This seems to have been missed by the World Bank whose definition is “the abuse of public office for private gain.”<sup>26</sup>

### **Definitional Problems: Corruption As A Moral Deflection Device?**

Thomas Pogge explains the ability of rational humans to shape their thinking to suit their interests; “moral norms, designed to protect the livelihood and dignity of the vulnerable, place burdens on the strong. If such norms are compelling enough, the strong make an effort to comply. But they also, consciously or unconsciously, try to get around the norms by arranging their social world so as to minimize their burdens of compliance.”<sup>27</sup> Pogge labels such avoidance techniques “moral deflection devices.”<sup>28</sup>

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<sup>25</sup> D. Haller & C. Shore, eds., *Corruption* (London: Pluto Press , 2005)

<sup>26</sup> World Bank (2002) The New Anticorruption Home Page [www.worldbank-homepage.htm](http://www.worldbank-homepage.htm), accessed 6/10/2006

<sup>27</sup> T. Pogge, *World Poverty and Human Rights*, (Oxford: Polity Press in association with Blackwell, 2002) 5

<sup>28</sup> Pogge, *ibid*, p9

There are strong reasons for believing that narrow definitions of corruption act as a moral deflection device. It is certainly used as a “persuader” by lobby groups with a particular agenda:

“Most corruption involves agents seeking favours from public officials. The larger the realm of government, the greater the opportunity for such favours ‘to be granted’. If the government regulates trade, the corruption can play a part in allocating export or import quotas. If the government does not regulate trade there are no such opportunities for preferment. . . . But . . . certain enduring values seem to be more important than the amount of government intervention in determining the level of corruption (most notably personal honesty). What are we to make of the fact that there are some relatively uncorrupt countries with very intrusive governments, such as in Scandinavia? . . . Can we create a virtuous ‘chain of events with less government leading to less corruption and then to a better functioning of the expanded domain of the market economy?’”<sup>29</sup>

No surprise that the right-wing, free-market Institute of Economic Affairs would like to argue deregulation of companies and a smaller State, if only the inconvenient evidence of the Scandinavians did not impede the argument. Neild takes a more balanced approach. Neild examines the emergence of “clean government” in north-western Europe<sup>30</sup> in the 18th and 19th centuries, which by no means went hand in hand with less government, and points out the dangers of the reduction of government. “[A] policy of trying in a heavily governed

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<sup>29</sup> P. Booth, “Foreword” in I. Senior, ed., *Corruption—The World’s Big C* (London: Institute of Economic Affairs, 2006)

<sup>30</sup> Although even these societies are subject to corruption; see M. Bull and J. Newell (eds) *Corruption in Contemporary Politics* (Basingstoke: Palgrave, 2003).

country to reduce the scope of government, and hence the number of rules that have to be enforced, may be accompanied by denigration of the public service and by cuts in its pay and conditions of such severity that, in combination with an idealization of private gain, it may produce an increase rather than a decrease in the rate of corruption. Russia today is an example.”<sup>31</sup>

However, at least corruption can be used by such lobbyists as an argument to restrict aid: “The most effective way of putting international pressure on corrupt, pauper nations is for aid to be available only to those that are demonstrably rooting out corruption. Countries with corrupt governments should be excluded from all aid programs and soft loans. Their international debts should not be cancelled.”<sup>32</sup> As Haller and Shore note the main structural approaches to corruption have colonialist overtones; either by perceiving corruption as a social pathology of “primitive” nations or by measuring corruption against concepts of good governance.<sup>33</sup> “While advocates of this approach claim that the concept of ‘good governance’ is based on neutral, objective and a-cultural values, critics argue that it reinforces the hegemonic values of the West as universal—precisely by defining them as ‘above’ the realm of politics and culture.”<sup>34</sup> A similar problem lies with the Banfield approach noted above, the concept of harm to the public interest being a notably slippery concept. In particular, Haller and Shore point to the complex nature of the public-private distinction, which is fundamental to many approaches to corruption. “In the conventional political science approach, as in neoliberal ideology and in Transparency International (TI) initiatives, it is the violation of this

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<sup>31</sup> R. Neild, *Public Corruption* (London: Anthem Press, 2002) 6

<sup>32</sup> I. Senior *Corruption*, IEA 2006, p189

<sup>33</sup> For example, by Transparency International.

<sup>34</sup> D. Haller & C. Shore, *supra* note 25, 4

public/private distinction by individuals that fundamentally defines corrupt behaviour. Corruption is thus viewed as a measure of how well a society distinguishes between public and private spheres.”<sup>35</sup> Further, the distinction between gifts and bribes is an incoherent one in some cultures.

“Neoliberalism has set the frame for analytical models of corruption, particularly in its restrictive World Bank definition of corruption as the abuse of ‘public’ office. Stripped to its basics, the neoliberal thesis holds that since corruption is primarily a pathology of the public sector, the solution lies in reducing public spending and rolling back the frontiers of the state. Shrinking the public sector, so the argument goes, reduces the scope for public officials to engage in malfeasance. It also subjects public officials to the regulatory disciplines of the market, to cost-consciousness, and to entrepreneurial business ethics. To focus on corporate crimes and corruption within the private sector is simply not on the current agenda of the U.S. government or the IMF.”<sup>36</sup>

However it is on the agenda of TI, which, following the Enron scandal, expanded its operations and definition of corruption from “abuse by public officials for private gain” to abuse of “entrusted power for private gain.”<sup>37</sup> The limitations of this latter definition restrict the discussion to the “bad apple” theory of corporate corruption, much favoured in the Barings and Enron cases, which argued that it was identifiable, corrupt individuals that caused the

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<sup>35</sup> *ibid*, 5

<sup>36</sup> *ibid*, 18

<sup>37</sup> Transparency International, *Global Corruption Report 2004*, (London: Pluto Press, 2004)

problem rather than an underlying corrupt culture.<sup>38</sup>

As Thomas Pogge points out, the belief that corruption is a “pathology of primitive nations” is common to “many citizens of the affluent countries” who hold that the global economic order is not to blame for severe poverty and increasing global inequality. Rather, “poverty is substantially caused not by global, systemic factors, but—in the countries where it occurs—by their flawed national economic regimes and by their corrupt and incompetent elites, both of which impede national economic growth and a fairer distribution of the national product.”<sup>39</sup> This comforting belief is accompanied by demands that the poor countries must first help themselves by giving themselves respectable political regimes. Or, in other words, since (until imposition of regime change in Iraq) it is not the responsibility of rich nations to impose regimes on others, nothing can be done. Aid, if given, would only be lost to corrupt elites. However these comfortable beliefs “are nevertheless ultimately unsatisfactory, because it portrays the corrupt social institutions and corrupt elites prevalent in the poor countries as an exogenous fact: as a fact that explains, but does not itself stand in need of explanation.”<sup>40</sup>

The prevalence of bad regimes itself requires an explanation. By way of providing an explanation, Pogge focuses on the extraordinary double standards applied to a gang of thieves overpowering the guards at a warehouse and stealing the contents as opposed to a group overpowering an elected government. The latter becomes the owner of the contents able to dispose of the natural resources of the country, transferring ownership to buyers, and can

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<sup>38</sup> For a further discussion of this see below, especially the work of MacLennan.

<sup>39</sup> Pogge, *supra* nota 27, 110

<sup>40</sup> *Ibid*, 112

borrow freely on its resources (the “international resource privilege”<sup>41</sup>).

“Indifferent to how governmental power is acquired, the international resource privilege provides powerful incentives toward coup attempts and civil wars in the resource-rich countries. Consider Nigeria, for instance, where oil exports of \$6-\$10 billion annually constitute roughly a quarter of GDP. Whoever takes power there, by whatever means, can count on this revenue stream to enrich himself and to cement his rule. This is quite a temptation for military officers, and during 28 of the past 32 years Nigeria has indeed been ruled by military strongmen who took power and ruled by force. Able to buy means of repression abroad and support from other officers at home, such rulers were not dependant on popular support and thus made few productive investments towards stimulating poverty eradication or even economic growth.”<sup>42</sup>

The failure to alter the prevalence of corruption under Olusegun Obasanjo has provoked surprise. But it makes sense against the background of the international resource privilege: Nigeria’s military officers know well that they can capture the oil revenues by overthrowing Obasanjo.

### **Consequence of Adopting a Broad Definition: Companies & Corruption**

As noted above, if we reject the narrow definition of corruption and associate our search for a definition with Euben, looking at decay, degeneration, disintegration, and debasement,<sup>43</sup> this

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<sup>41</sup> *Ibid*, 110

<sup>42</sup> *ibid*, 113

<sup>43</sup> Euben, *supra* note 23, 54

much wider definition opens up an investigation into corporate culture. Recent scandals, including Enron, receive mention in mainstream corruption publications, but from restricted viewpoints. TI's Global Corruption Report 2004 traces the US \$6 million donated by Enron to candidates for Congress or the presidency and the national political parties.<sup>44</sup> Although limited, it is a welcome perspective as it opens the debate to the concept of "state capture," or the excessive deference of state organs to private power. This author has argued elsewhere that the metamorphosis of modern states into "market states" has led to the "willing capture" of states since politicians consider that the money-making function of giant companies is unequivocally good for their countries.<sup>45</sup> Beyond that, it is arguable that corporate culture has itself become corrupt by limiting the focus of companies to the production of profit for shareholders. Enron had more than 3,000 subsidiaries including 400 registered in offshore tax havens as part of its strategy to enhance shareholder value.

MacLennan traces the roots of the current waves of corporate corruption in America to early industrialization. He says there is inevitable and fundamental conflict between the emergent values of market capitalism and democratic goals to protect the public interest.<sup>46</sup> The author argues that this conflict was met by a network of regulations creating an American welfare state that "not only provides a social safety net for the disadvantage in the economy, but also welfare for the very rich and their corporations."<sup>47</sup> Examining why this system seems to have failed so spectacularly over recent years, MacLennan advances the argument in saying that, while the regulatory system is based on the idea that regulation is needed only during

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<sup>44</sup> Transparency International, *Global Corruption Report 2004* (London: Pluto Press, 2004), 74

<sup>45</sup> J. Dine, *Companies, International Trade and Human Rights*, (Cambridge: Cambridge University Press, 2005)

<sup>46</sup> C. MacLennan, "Corruption in Corporate America: Enron-Before and After" in D. Haller & C. Shore, *supra* note 24, 156.

<sup>47</sup> *ibid*, 157-8



“*moments of business failure*,”<sup>48</sup> the clash of values runs deeper:

“Market values, which have their root in a pre-industrial, liberal society based upon democratic citizenship and agrarian, small business enterprises, have morphed into a new ethic of corporate capitalism which no longer resembles the business culture of the past. . . . Corporate behaviour in the United States has become increasingly ‘corrupt’ and the behaviour of officials in the Enrons and Worldcoms is not isolated. . . it is pervasive and institutionalized. That means, it is more than criminal behaviour by a few bad actors in an otherwise clean enterprise. It is institutionalized in the everyday world-view and processes of corporate action.”<sup>49</sup>

MacLennan’s study is of the close networks that link the political and economic elites, but also notes that “[d]efinitions of morality, public interest and personal responsibility in corporate board rooms and executive offices may in fact be quite different from those of the rest of the middle, working and poor classes.”<sup>50</sup> An interesting example of this is the belief by Enron’s ex-CEO Jeffrey Skilling that he is entirely innocent of wrongdoing. This is unlikely to be mere denial and may well stem from an unholy mixture of the “Alpha male entitlement” syndrome which leads powerful people (not *always* males) to refuse to believe that the rules of ordinary life apply to them, and by the fact that by constantly driving up the share price he believes that he was doing precisely the job that the company required in accordance with its aggressive market forces culture.

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<sup>48</sup> Italics in the original

<sup>49</sup> MacLennan, *supra* note 46, 158

<sup>50</sup> *ibid*, 163

MacLennan insists:

“[C]orruption implies something systematic, institutionalized and perhaps endemic to an organization or culture. It is pervasive, infused or embedded in the system . . . Corrupt or criminal *behaviour* is individual. If an alleged crime occurs, individuals are held responsible and receive punishment through the courts. But *corruption* is institutional, patterned—perhaps criminal and unethical from outside, but not necessarily perceived as such by insiders. All of the attention to the individual criminal executive is a detour from figuring out how corruption works. An example is the coverage of the prosecution of Enron’s executives, CEO Jeffery Skilling and Chief Financial Officer Andrew Fastow. All eyes are on the courtroom . . . and on possible jail sentences—thus isolating the executive as the criminal. The corporate culture that bred corruption, and the social expectations of the elite that ruled the organization, have escaped scrutiny.”<sup>51</sup>

Let us look at some instances of the Enron culture as translated into action by Skilling. Skilling introduced a rigorous employee performance assessment process that became known as ‘rank or yank’ under this system the bottom 10 percent in performance were shown the door. There was heavy pressure to meet targets, and remuneration was linked to the deals done and profits booked in the previous quarter.<sup>52</sup>

“One thing the traders all loved about Enron was the sense they had of operating in the purest environment that had ever been created in corporate America. By pure, they meant that the trading floor operated strictly by the dictates of the free market.

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<sup>51</sup> C. MacLennan, *supra* note 46, 164-165, italics in original.

<sup>52</sup> S. Hamilton & A. Micklethwait, *Greed and Corporate Failure*, (Basingstoke: Palgrave, 2006) 36

The company's credo had always been that free markets worked best, of course. But the traders grabbed on to that belief with a cult-like fierceness . . . Maximizing profit was not inconsistent with doing good, they believed, but an inherent part of it."<sup>53</sup>

"And always, hovering over everything and everyone at Enron, was Wall Street. . . . In the Skilling era, the stock became . . . Enron's obsession. A stock ticker in the headquarter's lobby offered a constant update on the price of Enron shares. TV monitors broadcast CNBC in the building elevators . . . for Skilling himself . . . 'the stock price was his report card.' When it rose, he was exultant; when it dropped, he was glum."<sup>54</sup>

"Skilling's methods of arriving at Enron's quarterly and annual targets was downright perverse. Instead of going through a rigorous budget process and arriving at a number by analyzing all the business units and their prospects for the coming year as Kinder used to do, he would impose a number based solely on what Wall Street wanted. He would openly ask the stock analysts "What earnings do you need to keep our stock price up?"<sup>55</sup>

"And the number he arrived at was the number Wall Street was looking for, regardless of whether internally it made good sense. . . . Invariably, as the quarter drew to a close, Enron's top executives would realize that they were going to fall short of the number they'd promised Wall Street. . . . when the realization took place that the company was falling short, its executives undertook a desperate

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<sup>53</sup> B. McLean & P. Elkind, *The Smartest Guys in the Room*, (London: Viking, 2003) 219

<sup>54</sup> *ibid*, 125

<sup>55</sup> *ibid*, 125

scramble to fill the holes in the company's earnings."<sup>56</sup>

A similar corruption was evident in the fall of Barings. The lack of supervision of Nick Leeson was attributable in a substantial degree to the feeling that he was the goose laying the golden eggs so that stringent enquiries into his activities or limitation of them should be avoided at all costs.

In a brief investigation of corporate culture, MacLennan notes the prevalence of "shared corporate values predicated on the rights of property and the rule of the market."<sup>57</sup> Let us look more carefully into property rights and market assumptions.

The US/UK model of companies and corporate law has shareholders as the primary focus; the company must serve the interests of shareholders who appoint and dismiss directors. However, the directors are to act in the interest of the company and usually owe no direct duties to shareholders. This structure does not necessarily equate shareholders with the company, nor does it equate shareholder interests with 'profit maximization' and impose a duty on directors to achieve such a goal. Nevertheless, recent discourse has imposed the concept of profit maximization on the assumption that this is what shareholders require and the second assumption that shareholders and the company are one and the same thing. Such an understanding of corporate aims has wide implications for their behaviour since all considerations other than profit are seen as negative externalities to be adhered to or to be bargained away if possible. There is no doubt that this philosophy was one of the underlying causes of spectacular bankruptcies such as Enron and WorldCom. In terms of moral

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<sup>56</sup> *ibid*, 127

<sup>57</sup> C. MacLennan, *supra* note 46, 165

responsibility such a construct of corporations means that they become another method of moral deflection: because the purpose of corporations is to make as much money as possible those who tolerate and profit from their existence have no responsibility for the methods they pursue. This ignores not only the fact that national laws structure companies, but also that those who profit from an activity have a responsibility to prevent that activity from harming others. However, offshore financing muddies the water since, as noted above, we have at least three different competing interest groups that may claim to represent the public interest.

### *Underpinning Corrupt Companies' Free Markets' and Neo-Classical Economics*

The Enron vision of free markets was based on neo-classical economics. It is therefore important to examine closely the foundational concepts of this thinking to understand how norms have emerged from the analysis. A key concept is “efficiency,” a term which also has emotive power. Who has ever heard of a government asking advisers to formulate an inefficient economic policy? However, notions of the measurement of efficiency vary. Pareto efficiency requires that someone gains and no one loses. However, the Kaldor-Hicks test accepts as efficient “a policy which results in sufficient benefits for those who gain such that potentially they can compensate fully all the losers and still remain better off.”<sup>58</sup>

The neo-classical economists believe that rational actors utilizing perfect information will produce maximum allocative efficiency by making choices that exploit competition in the market. In plain English, this means that everyone is assumed to be equally rational, have equal bargaining power, and that there is no asymmetry of information. Stiglitz explains the theories in this way:

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<sup>58</sup> Explanation given by Ogus in A. Ogus, *Regulation: Legal Form and Economic Theory* (Oxford: Clarendon Press, 1994) 24, who immediately points out that there is no requirement for the gainers to compensate the losers.

“One of the great intellectual achievements of the mid-twentieth century . . . was to establish the conditions under which Adam Smith’s ‘invisible hand’ worked. These included a large number of unrealistic conditions, such as that information was either perfect, or at least not affected by anything going on in the economy, and that whatever information anybody had, others had the same information; that competition was perfect; and that one could buy insurance against any possible risk. Though everyone recognized that these assumptions were unrealistic, there was a hope that if the real world did not depart too much from such assumptions—if information were not too imperfect, or firms did not have too much market power—then Adam Smith’s invisible hand theory would still provide a good description of the economy. This was a hope based more on faith—especially by those whom it served well—than on science. My research, and that of others, on the consequences of asymmetric information . . . has shown that one of the reasons that the invisible hand may be invisible is that it is simply not there.”<sup>59</sup>

Since the invisible hand is not to be fettered, state regulations should be removed so that a free market is permitted to reach maximum efficiency. However, deregulation distorts the concept of freedom by removing regulation that seeks to protect the vulnerable: trade union law, employment regulation, and environmental legislation. Freedom to trade in this sense becomes someone else’s lack of freedom. It is notable that the slave traders defended their practices on the basis that they must be allowed free trade.

It must be noted that any identified defect in the underlying assumptions tends to have a cumulative effect, each building block contributing to a picture which emphasizes the

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<sup>59</sup> J. Stiglitz *The Roaring Nineties: Seeds of Destruction*, (London: Allen Lane, 2003)

necessity for a market free of regulatory interference, disguising the reality of imbalances of power that might be addressed by regulation. The basis of the theories on a pseudo-scientific notion of efficiency and the claim that creating wealth is beneficial for society as a whole means that the end result is a picture where interference with the freedom of markets needs to be justified by anyone who argues for any regulation of market behaviour. It is important to note that Enron rose in the context of deregulation of the utilities industries and of the accountancy profession.

Take first the Kaldor-Hicks notion of efficiency. The concept that net gains and losses need to be calculated and any net gain to any party is equivalent to efficiency is open to “several powerful objections, at least as a conclusive criterion of social welfare.”<sup>60</sup> Ogus points to the coercive imposition of losses on individuals, the assumption that one unit of money is of equal value whoever owns it and its hostility to the notion of distributive justice. Ogus gives the following example:<sup>61</sup>

“Suppose that the policymaker had to choose between: (A) a policy that increased society’s wealth by \$1 million and benefited the poor more than the rich, and (B) a policy that increased its wealth by \$2 million, the bulk of which devolved on the rich? Many would argue for (A) on the grounds of fairness,<sup>62</sup> but (B) would be considered to be superior in Kaldor-Hicks terms.”<sup>63</sup>

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<sup>60</sup> *ibid*, 25

<sup>61</sup> *ibid*, 25

<sup>62</sup> A. Ogus, *supra* note 58; see also, J. Rawls, *A Theory of Justice* (Oxford: Oxford University Press, 1972).

<sup>63</sup> This argument has powerful resonance when the operation of transnational and global corporations is under scrutiny.

Now, if we see this argument in the light of Karl Marx's views on equality and the concept of freedom we can see how the approach is based on the idea of "notional equality" of the Kantian and Hegelian kind and how clearly Marx saw the reality that given real inequalities which pre-date the time of the transaction, inequalities will not only persist but become more and more accentuated. The Pareto-Hicks formula does not insist that the winning individuals and the losing individuals should be different in different transaction; in practice the powerful become more powerful, the poor more poor and disadvantaged. O. Lange writes:<sup>64</sup>

"[L]et us imagine two persons: one who has learned his economics only from the Austrian School, Pareto and Marshall, without having seen or even heard a sentence of Marx or his disciples; the other one who, on the contrary, knows his economics exclusively from Marx and the Marxists . . . Which of the two will be able to account better for the fundamental tendencies of the evolution of Capitalism?"

Lange also makes the contrast between Marx's theory of economic "evolution" and the fact that "for modern 'bourgeois' economics the problem of economic evolution belongs not to economic theory but to economic history."<sup>65</sup> This static nature may be seen as flowing from the essentially moral emptiness of current economic theory; unlike Marxism it is not driven by a desire to achieve freedom and fulfillment of a spiritual nature.<sup>66</sup>

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<sup>64</sup> D. Horowitz, *Marx and Modern Economics*, (Michigan: University of Michigan Press, 1968)

<sup>65</sup> *ibid*, 73

<sup>66</sup> A. Van Leeuwen *Critique of Heaven*, (London: James Clarke Co., 1972), especially chapter IV "Human self-consciousness as the highest divinity"



## *Advantages and Disadvantages of Definitions*

### Deregulation, Market Failure, Corporate Governance and Failures to Fulfil Human Rights

It is clear, then, if we adopt a wide definition of corruption that we are obliged to take a fundamental look at some of our own institutions and to consider corruption other than traditional bribe-taking behaviour. This is consistent with the scholars who call for constant re-assessment of institutions to prevent their continuous and inherent tendency towards corruption.<sup>67</sup> The disadvantage of adopting a broad definition is that it defeats the move towards justiciability so popular with the “integrity warriors” as something so ephemeral as corporate culture cannot be reduced to command and control outlawing tactics. It is therefore sensible to adopt a criminalizing approach in “black” situations of corruption, provided the consensus is wider than western organizations, particularly where financial decision making is consequential on categorization as “corrupt” or not. However, the recognition of corruption in a wider sense emphasizes that it is not a hard and fast concept and exists beyond practices condemned by all as fundamentally wrong. The understanding of institutions as tending always towards capture by powerful interest groups enhances debate about regulatory structures which can be found to counterbalance this inherent trend.

### **Counteracting Corrupt Corporate Culture**

The call for regulatory structures to rebalance the company’s focus on shareholders so that it serves to deliver a more just economic outlook may be a way of counteracting corrupt corporate culture. One of these institutions is the capitalist market. Corrupt corporate culture

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<sup>67</sup> See M. Blecher, *Law in Movement: Paradoxontology, Law and Social Movements* in J. Dine & A. Fagan, eds, *Human Rights and Capitalism*, (Cheltenham: E. Elgar, 2006); O. Perez & G. Teubner, eds., *On Paradoxes and Self-reference in Law* (London: Hart, 2004)

is a market failure. Where there is market failure there is a good case for regulations to try to correct the market failure so far as possible.

“But for the market economy to function well there is a need for laws and regulations—to ensure fair competition, to protect the environment, to make sure that consumers and investors are not cheated.”<sup>68</sup> Stiglitz examines the ways in which deregulation in the United States in the 1990s was instrumental in assisting the economic “bubble” to grow and then burst and the spectacular bankruptcies and revelation of fraud that followed.

“Regulations help restrain conflicts of interest and abusive practices, so that investors can be confident that the market provides a level playing field and that those who were supposed to be acting in their interests actually do so. But the flip side of this is that regulation restrains profits and so deregulation means more profits. And in the nineties, those who saw the larger profits that deregulation would bring were willing to invest to get it—willing to spend megabucks in campaign contributions and lobbyists.”<sup>69</sup>

So far as corporate governance is concerned, market failure occurred by failure to regulate competition adequately, by permitting banks and accountancy firms to merge and take on tasks that inevitably involved conflicts of interest, and by using perverse incentives as part of the rewards packages for CEOs.<sup>70</sup> Competition regulation failure came partly from the argument that the “New Economy” had arrived, that it provided new conditions where innovations would keep competition healthy so regulation was not necessary. Stiglitz was not

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<sup>68</sup> J. Stiglitz, *supra* note 59, 91

<sup>69</sup> *ibid*, 90

<sup>70</sup> *ibid*, chapter 4

convinced. Analyzing the telecommunications market he writes;

“There were two reasons that I was suspicious of those who simply said ‘Let competition reign.’ The first [was] . . . everyone talked about the importance of being the first mover into a market. In doing so, they were, in effect, admitting that they did not anticipate *sustained* competition. There would be competition *for* the market, but not competition in the market. That, in fact, was why those who had a head start in the race were lobbying so hard: they thought they had the inside track, and the payoff, if they won, would be enormous. . . But secondly, why, if the local phone companies really thought that competition would break out, were they so resistant to efforts to make sure that there was strong anti-trust oversight?”<sup>71</sup>

The second significant failure lay in permitting accountancy and banking firms to merge into huge giants carrying out activities which were clearly in conflict of interest. Thus accountants were making huge profits by carrying on consultancies for firms whose accounts they were supposed to be auditing and banks were simultaneously lending money to firms such as Enron, while also undertaking the placing of Initial Public Offers (“IPOs”) of shares with the public. The independent assessment of the lending branch of the bank as to the creditworthiness of the firm was likely to be undermined by the wish of the investment branch to do business issuing shares for the firm. This removed an important device for monitoring the solvency of the company and gave false signals. If the bank is still lending, investors would believe that the firm was still solvent. Loans were granted to Enron until the last moment before the scandal broke and such loans only increased the size of the eventual shortfall for employee pension schemes as well as investors.

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<sup>71</sup> *ibid*, 97-98, italics in the original

A third significant failure was “the strange corporate practice of giving corporate executives stock options—the right to buy company stock at below market prices—and then pretending that nothing of value had changed hands.”<sup>72</sup> These transactions were not adequately disclosed. The importance of this is clear to Stiglitz:

“As a longtime student of the role of information in a well-functioning economy, I [understood that] . . . the executives are being paid too much partly because *it isn't widely known exactly how much they are really being paid*. And if no one knows how much the CEOs are being paid, that means no one knows how much profit (or loss) the company is making. No one knows how much the firm is really worth. Without this information, prices cannot perform the roles they are supposed to in guiding investment. As economists put it somewhat technically ‘resource allocations will be distorted.’”<sup>73</sup>

Further, compensation packages for CEOs ran out of control with boards accepting huge increases and shareholders unable to prevent the packages going through. “While senior executive compensation rose 36 percent in 1998 over 1997, the wages of the average blue-collar worker rose just 2.7 percent in the same period. . . . Even in 2001, a disaster year for profits and stock prices, executive CEO pay increased twice as fast as the pay of the average worker.”<sup>74</sup> And you can be sure that it was not a percentage calculated from equivalent pay at the outset. Stiglitz understands the cause of the downturn of the US economy as being

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<sup>72</sup> *ibid*, 115.

<sup>73</sup> *ibid*, 118, italics in the original

<sup>74</sup> *ibid*, 124

significantly caused by these factors, which were all brought on by deregulation and a failure to understand the correct role of regulation in preventing or minimizing market failures. And, market failures impact most significantly on the poorest in the community and are likely to directly cause non- or under fulfilment of human rights. The imperative is to prevent perverse incentives and competition failures from so distorting the market that it fails. We must be on guard against the simplistic economic viewpoint which is analyzed above since it is still endemic in many policy think-tanks and government advisors all over the world. Deakin argues, “[w]e have acquired a framework of perverse incentives that rewards most those managers who are best at shifting risks and liabilities on to the under-represented within the corporation (mainly employees) and in society at large. This is the result of entrenching a particular version of the “shareholder value” norm, associated with short-run share price maximization, in corporate culture and practice.”<sup>75</sup>

### **Combating Corruption: Companies Are Not Property**

Paddy Ireland has made it clear that companies fit with difficulty into the property rights discourse.<sup>76</sup> This is because the traditional idea of companies is that they are “the property of the shareholders” or “in the ‘nexus of contracts’ or ‘agency’ theory of the company, in what amounts to the same thing, that the shareholders own not ‘the company’ but ‘the capital’, the company itself having been spirited out of existence.”<sup>77</sup> Ireland also shows that there is considerable convergence between the property rights of creditors and those of shareholders; each can be seen essentially as outsiders having contractual rights against the company rather

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<sup>75</sup> S. Deakin, “Squaring the Circle? Shareholder Value and Corporate Social Responsibility” *GEO WASH L. REV.* 70 (2002) 976, at 977

<sup>76</sup> P. Ireland, “Company Law and the Myth of Shareholder Ownership” *Modern Law Review* 62 (1999); see also J. Hill “Visions and Revisions of the Shareholder” in *American Journal of Comparative Law* 39 (2000).

<sup>77</sup> *ibid*

than insiders with membership rights. The remaining insider rights of shareholders are relics of the time when joint-stock companies were run by members, and, of an even earlier time, when lending for interest was banned but partnership for profit was not. An investment as a “sleeping partner” was a convenient way to circumvent this rule.

The shareholder value norm itself rests on the myth of shareholder ownership, that this myth is rhetoric appealing to the concept of property as an important right which has distorted our understanding of companies and of directors’ duties by accepting that the gap between ownership and control should be plugged by duties designed to align the interests of directors with those of shareholder-owners. Because this structure is based on the myth of ownership it is unhelpful and distorting, leaving out of account many of the real risks that companies run: risks of damage to the company by poor treatment of employees, the environment, and consumers, leading not only to loss of reputation but to the real danger of collapse from striving for a short-term goal of shareholder value maximization at the expense of sustainability and long-term goals. As we have seen, although greed motivated some of the fraud which was important in the downfall of Enron, one of the most important motivating factors was a desire to keep the share price rising. “I don’t want us ever to be satisfied with a stock price; it should always be higher . . . . Indeed, we still think that over the next several months that there’s a good chance that the stock price could be up as much as fifty percent, and I think there’s no reason to think that over the next two years we can’t double it again”<sup>78</sup>

There is, however, room for optimism:

“For almost a quarter century, beginning in the early seventies, the *rational*

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<sup>78</sup> Kenneth Lay speaking at a n Enron meeting, December 1, 1999, cited by B. McLean & P. Elkind *supra* note 53, 242; see also B. Cruver, *Enron, Anatomy of Greed* (London: Arrow, 2003)

*expectations* school of economic thought dominated economic thinking. This portrayed the individual not only as a rational being, making consistent choices, but as someone capable of processing complex information and absorbing all the relevant knowledge. Its advocates focused on models in which everyone had the same information—there were no asymmetries. In fact, few people know enough math to process even the range of knowledge bearing on the simplest investment decision. (the rational expectations theorists conceded as much, yet asserted that, somehow, individuals acted *as if* they had processed it all. Not content with upholding the rationality of individuals, they portrayed the economy itself as a rational mechanism—one in which, miraculously, prices reflect instantaneously everything that is known today, and prices today reflect a consistent set of expectations about what prices will be *infinitely far into the future*. The political agenda of this work often seemed barely beneath the surface: if the rational expectations school was right, markets were inherently efficient, and there would be little if any need, ever, for government intervention. The heyday of the rational expectations movement has ended, I am pleased to report.”<sup>79</sup>

It is most notable that the most fervent believers of this creed have profited from it (at least until they have gone to prison); a clear example of Pogge’s understanding that human beings prefer to take comfort from beliefs that will favour themselves.

### **Combating Corruption: New Uses for Concession Theory**

Nowhere is there complete adherence to the theory that companies ought to be permitted to function free of all regulation: all states operate a mixed system of market freedom and

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<sup>79</sup> Stiglitz, *supra* note 59, 151-2, italics in the original

regulatory control.<sup>80</sup> However, traditional discussions of corporate governance give little weight to the web of regulation that surrounds every corporate operation and, in particular, the impact of regulations on corporate culture has not been examined in its legal context. Is the way in which companies actually work reflected in discussions of corporate governance and an adequate legal framework?

The imposition of regulations may easily be justified by traditional concessionary approaches: in its simplest form this approach views the existence and operation of the company as a concession by the state, which grants the ability to trade using the corporate tool, particularly where it operates with limited liability. In return this concession implies the right to impose limits on a company's freedom.<sup>81</sup> The imposition of regulations inevitably identifies those at most risk from particular corporate decisions and seeks to protect from or minimize that risk. Thus, environmental regulation identifies whole communities as at risk, financial regulation protects shareholders and health and safety regulation principally targets employees. As Teubner rightly says:

“Putting it quite bluntly, a corporate enterprise does not exist simply as a self serving and self-realizing institution for the unique benefits of its shareholders and workers, but rather exists, above all, to fulfil a broader role in society.”<sup>82</sup>

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<sup>80</sup> J. Dine, *Governance of Corporate Groups* (Cambridge/New York: Cambridge University Press, 2000)

<sup>81</sup> *ibid* and S. Bottomley ‘Taking Corporations Seriously: Some Considerations for Corporate Regulation’ [1990] 19 *Federal Law Review* 203, W. Briton jnr ‘The New Economic Theory of the Firm; Critical Perspectives from History’ 1989 *STANFORD L. REV.* 1471.

<sup>82</sup> G. Teubner, “Corporate Fiduciary Duties and their Beneficiaries: A Functional Approach to the Legal Institutionalization of Corporate Responsibility” in Hopt & Teubner, eds., *Corporate Governance and Directors’ Liabilities* (Berlin: de Gruyter, 1987) 149, at 157.



Indeed, large companies have a huge on influence our social, economic and political lives. In the words of Chayes, “[T]hey are repositories of power, the biggest centres of nongovernmental power in our society.”<sup>83</sup> In the UK, the influence of companies is just as evident as in the United States. The food we eat is dependent on how it is grown, processed, packaged, advertised and sold to us. Every one of these stages is determined or influenced by companies. Increasingly companies are involved in the provision of public services with the government having created mechanisms such as private finance initiatives, and more recently the proposals for community interest companies. Such mechanisms are recognition of the influence of companies and their role in society. In such a context it seems that the two company law assumptions that share the structure of company law and corporate governance are not only anachronistic but in fact wholly inaccurate in their representation of the character of companies today. Teubner argues for a proceduralisation of fiduciary duties that enables non-shareholder interest-groups to participate in the monitoring and decision-making functions. The role of the law, in Teubner’s view should be to control indirectly internal organizational structures, through external regulation. The role of the law is the external mobilization of internal control resources.<sup>84</sup> The organizational structures should allow for “discursive unification processes as to allow the optimal balancing of company performance and company function by taking into account the requirements of the non-economic environment.” In short, Teubner advocates a constitutionalisation of the private corporation to make the corporate conscience work “if that meant to force the organization to internalise outside conflicts in the decision structure itself in order to take into account the non-economic

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<sup>83</sup> A. Chayes, *The New Sovereignty: Compliance with International Regulatory Agreements* (Cambridge, Mass: Harvard University Press, 1995) 25

<sup>84</sup> Teubner, *supra* note 82, 160

interests of workers, consumers, and the general public.”<sup>85</sup> Teubner highlights the role of disclosure, audit, justification, consultation and negotiation and the duty to organise. He emphasizes the need to proceduralise. Ultimately, the point is to ensure that the decision-making processes allow participation by those affected by the decisions, whether in terms of profit, consumer choice, working conditions, or environmental impact of corporate activities. If the decisions are made jointly with the directors the monitoring role ought to reduce. Teubner’s proceduralisation would mean a complete change in conceptualisation of the company and directors’ duties. The following tries to put some flesh on the bones’ in the context of a new look at UK company law.

As we have seen, Berle and Means identified the separation of ownership and control in the 1930s,<sup>86</sup> showing that, with dispersed ownership of shares, control of corporations lay less with shareholders and more with the professional managers of large companies. This led to corporate governance being discussed primarily as involving antidotes to such a separation, and, in particular with implementing mechanisms to align the managers’ interests with those of shareholders. Today there is a second shift in the governance of companies, this time strengthening the degree of separation between ownership and control and also shifting the focus and perhaps the power centre of decision making to a lower level in the company. This second shift calls into question the reality of the vision of a company exclusively directed by the “controlling minds” of managers, but by acknowledging that directors still have the ultimate decision making power which is in line with the reconceptualisation of a company as an owner; the directors are exercising their property rights powers on behalf of the company. Limits on their decision-making, however, appear by a way of providing them with

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<sup>85</sup> *ibid*, 165

<sup>86</sup> A. Berle & G. Means, *Modern Corporation and Private Property* (New York: Macmillan, 1962)

information from throughout the organization and insisting that the focus of their decision-making should be an assessment of risks to the organization. This new understanding would reject the idea of the company being composed solely of its organs but, in some ways embrace the “organic” view of companies.<sup>87</sup> The organic analysis is borrowed from the analysis of states. Wolff<sup>88</sup> cites John Caspar Bluntschli who “found something corresponding in the life of the State not only to every part of the human body but even to every human emotion, and designated e.g., the foreign relations of a State as its sexual impulses!” In fact, the organic theory is remarkably wide in its vision, many current theories would omit the inclusion of the “hands” at all, regarding employees as negative externalities, rather than as an integral part of the company’s existence.

There is a multiplicity of regulations that companies must implement and within companies, systems are set up to implement them. A simple example (and the most obvious) is the systems which must be set up to ensure financial control. In the Barings collapse, one of the problems that was clearly identified was the lack of knowledge of the derivatives operation displayed by the directors. They were eventually disqualified as directors as being unfit following their failure to put in place proper systems of financial control. However, in order to create effective systems they needed to fully familiarize themselves with the functioning of the derivatives operation. It is argued here that, because detailed knowledge of the operation of systems that make up a functioning company are to be found elsewhere than at board level, and that proper systems of control cannot be designed without this detailed knowledge, it is incumbent on the eventual decision-makers to take account of the knowledge and experience of those most intimately involved in the systems necessary to control the risks that are the

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<sup>87</sup> M. Wolff, “On the Nature of Legal Persons” *Law Quarterly Review* (1938) 494

<sup>88</sup> *Ibid*, 499

subject matter of the regulations.

This is not to say that the power to make the eventual decision has moved, but that proper decisions cannot be made without wide consultation. This, in turn, gives those consulted standing to influence the decision-making process, and, in particular, change the culture of the company from focusing on shareholder profit alone.

The example of financial controls is just a single example of the regulations which impinge on decision-making within companies. The company must remain within the criminal law and must have systems that ensure this happens. This may extend to ensuring consistency between methods of working and achievable targets. For example, if time targets for repairs to electric signals on a railway cannot be achieved without electricians working excessively long hours, the inconsistency may in future be identified as a reason for holding the company (and its directors) criminally responsible for an ensuing disaster. Similarly, proper systems for implementation of health and safety and environmental regulations must rely on detailed knowledge of the way things actually work.

In effect, the imposition of regulations which must be implemented, gives the company a greater degree of autonomy from the shareholders. As we have seen, the shareholder property rights model led to a narrow definition of what is meant by “Corporate Governance” with most commentators concerned only with the methods by which management action can be controlled in order to ensure management behaviour for the benefit of the company, meaning, in the vast majority of situations, for the financial benefit of shareholders. This tendency has been reinforced by the legal boxes that have been constructed, particularly in common law jurisdictions. Company law is seen as a separate discipline from labour law, ignoring the fact

of enormous proportions that the huge majority of employees work for companies and that companies cannot work without employees. Similarly, other regulatory structures impinge on corporate decision-making so that it is no longer open to the shareholders to insist on profit at the expense of compliance with health and safety standards, environmental regulations,<sup>89</sup> or consultation with employees. Nor can systems to ensure compliance with criminal law be neglected.

In the recent U.S. scandals, particularly those like ENRON and WORLDCOM, which involved manipulating accounts in order to maintain inflated share prices, we see a conflict between the old fashioned view of corporate governance that sought to create mechanisms for aligning the governance of the company with shareholders' interest in profit maximization and the vision described here which seeks, by regulation, to make sure that companies have proper systems in place to ensure their compliance with the requirements of society generally. Although it is true that directors of these companies stood to gain personally from inflated share prices, the primary motive for the creative accounting was the pressure to do better than competitors so far as a continuously rising share price was concerned. The system of corporate governance that relies primarily on shareholder enforcement is shown not only to be inadequate but counterproductive, imposing pressures destructive of both the company and the wider interests of society, both in loss of faith in markets and destruction of things such as pension benefits.

## **Conclusion**

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<sup>89</sup> See on this point M. Blecher "Environmental Officer: Management in an Ecological Quality Organisation" in G. Teubner (ed) *Environmental Law and Ecological Responsibility: The Concept and Practice of Ecological Self-Organisation* (London: John Wiley, 1994)

And so back to the BVI; even if such reforms were to lead to a more sustainable, socially responsible and less corrupt corporate culture this will not solve the conundrum of the corruption of offshore tax havens. If reformed companies decided that shareholder value was not the sole determinant of their behaviour, would they desert offshore financing? And if so, what would happen to the development potential of the ex-slave colonies that currently rely on it? Pogge would undoubtedly point to a duty to support the development of previously exploited peoples. What should replace the easy income from invisible companies?