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ARTICLE

Company Law, Corporate Governance and the Banking Crisis

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Introduction

During late 2007 and 2008 five United Kingdom banks failed and had to be saved by HM Government.[1] The banks were very large. Their assets in aggregate well exceeded the UK's gross domestic product. The biggest, Royal Bank of Scotland, had 40 million customers, 225,000 employees and operated in over 50 countries. All of them to a greater or lesser extent participated in a global financial network and, as the Governor of the Bank of England put it, the problem was that '... global banking institutions are global in life, but national in death'[2]. As a result, HM Government had to commit vast resources in order to save them. There was no alternative. The eventual cost to the taxpayer will not be known for many years.

Given that this is, very probably, the greatest financial catastrophe to inflict the United Kingdom, it is not surprising that much attention is being paid to the question of 'what went wrong?' So far, a unanimous view of the various general reports[3] that have been published on the banking crisis is that boards of directors were at fault. However, the public enquiries that have been conducted into the causes of UK bank failures have been limited and general in nature. In particular, there has been no detailed investigation of the facts and circumstances of the failures of the five banks in question on an individual basis, by investigators with power to access every relevant document and to interview all of the key officers who were arguably responsible for corporate governance lapses within these institutions. Such officers include directors, senior managers, risk managers, external and internal auditors, and relevant external advisers.

Sir David Walker appears to share the view that there are questions to be answered in an investigation. At paragraph 1.16 of his second Report,[4] Walker states that:

> 'In the light of the scale and scope of the financial crisis, the key questions from a corporate governance perspective must be: could boards of failed entities have done more to prevent the collapse and, if so, what stood in their way? ... [I]t is critically important to know how the boards of the entities that best survived the storm were different or "better" than the boards of entities that were effectively taken over by the state or lost their identity through forced merger.'

Yet the Walker Report, despite making 37 specific recommendations for improvement of corporate governance in banks and other financial institutions, did not provide the answers to these questions.

This article accordingly argues that there should be an investigation of the facts and circumstances surrounding at least two of the five UK banking failures,[5] that it should be a Companies Act investigation,[6] and that the reports from the investigation should be published. My focus throughout the following discussion is on ensuring the collective responsibility of the board.

1. Collective responsibility and statute

The Companies Act 2006 codified the duties of directors. The duties are introduced as 'The general duties ... owed by *a* director of a company to the company',[7]

Notes

1 Northern Rock, Bradford & Bingley, Royal Bank of Scotland, Halifax Bank of Scotland and Lloyds TSB.

2 Financil Services Authority, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (March 2009) at 36.

3 All of the de Larosière report (the High-level Group on Financial Supervision in the EU chaired by Jacques de Larosière issued its report on 25 February 2009), the Turner Review (*ibid.*), the Treasury Committee of the House of Commons (Seventh Report of Session 2008-09 at para. 4; Ninth Report of Session 2008-09 at para. 134), and Sir David Walker's Reports (*A Review of Corporate Governance in UK Banks and Other Financial Industry Entities*, first Report for consultation published July 2009, at para. 1.9; second Report with final recommendations published November 2009, at para. 1.10) criticised some of the boards.

4 *Ibid.*

5 Royal Bank of Scotland and HBOS are widely regarded as constituting the two most serious failures.

6 Under Part XIV of the Companies Act 1985.

7 CA 2006, s. 170(1) (my emphasis added).

and each duty is expressed in terms of the formula: '*A* director of a company must …'.[8]

For example, the first general duty, in section 171, reads 'A director of a company must – (a) act in accordance with the company's constitution and (b) only exercise powers for the purposes for which they are conferred.' And the individualistic, 'director by director' approach is emphasised in the second general duty in section 172, which reads: 'A director of a company must act in the way *he* considers, in good faith, would be most likely to promote the success of the company …'.[9]

Nothing is said about the collegiate or collective responsibility of the directors.

The Act itself imposes detailed responsibility on directors in four different ways:

1. Certain sections require the company to do something, and impose a sanction on every officer in default. Thus, section 113(1) provides that '[e]very company must keep a register of its members', and section 113(7) states that '[i]f a company makes default in complying with this section an offence is committed by … every officer of the company who is in default.'

   Section 1121 makes clear that 'officer' includes 'director', and that an officer is in default 'if he authorises or permits, participates in, or fails to take all reasonable steps to prevent, the contravention.'
2. Certain sections require action by each director. For example, section 418 effectively obliges each director to take all reasonable steps to make himself aware of relevant audit information (that is information 'needed' by the auditor for his report) and to establish that the auditor is indeed aware of the information.
3. Certain sections require action from 'the directors' as a whole. Therefore when members effectively requisition a general meeting under section 303, section 304 states that … the 'Directors required … to call a meeting … must call a meeting … within 21 days …'.
4. Certain sections require action by 'the board of directors'. The sections dealing with the annual report and accounts draw a clear distinction between 'the directors' and 'the board of directors'. Sections 394 and 415 oblige 'the directors' to prepare, respectively, accounts and a directors' report for each financial year. However, sections 414 and 419 specify that the accounts and the report 'must be approved by *the board of directors*.'[10]

However, the heart of collective responsibility lies not in the miscellaneous imposition of statutory obligations on 'directors', but rather in each company's constitution ascribing powers of management to the directors. Responsibility goes hand in hand with power, and the collective responsibility of a board of directors flows from the attribution of the powers of the company to the directors as a group. The only limitations on their powers derive from the powers given to members/shareholders in general meeting by statute or by the company's constitution.

The directors may of course delegate but as common sense, case law and the Combined Code[11] make clear, they cannot delegate away all responsibility. The Code (see Provision A.1.1) specifically requires 'a formal schedule of matters specifically reserved …' for determination by the board.

2. Collective responsibility outside statute

The expressions 'collective duty' and 'collective responsibility', although not used in the Companies Act, have become familiar in European law, in case law, and in the literature on corporate governance.

– The 4th and 7th Company Law Directives require the directors to '… have the collective duty to ensure that the annual accounts [and] the annual report … are drawn up' in accordance with the law
– In 1997, in the *Westmid Packing* case, the Court of Appeal accepted as correct the proposition that '… the collegiate or collective responsibility of the board of directors of the company is of fundamental importance to corporate governance under English company law'.[12]
– The Combined Code begins with the principle: 'Every company should be headed by an effective board, which is collectively responsible for the success of the company'.[13]

The Companies Act is specific, as shown above, as to which of the responsibilities it imposes are for the board, which for the directors, which for each director

Notes

8 My emphasis added.
9 My emphasis added.
10 My emphasis added. The same distinction is made in relation to the directors' remuneration report required of quoted companies. Notably, the ability of a third party acting in good faith to avoid limitations in the company's constitution of which he is deemed to have notice arose under the 1985 Act in relation to decisions of 'the board of directors'. In the 2006 Act the decisions are specified as those of 'the directors'.
11 The Combined Code on Corporate Governance published by the Financial Reporting Council (latest edition June 2008).
12 *Re Westmid Packing Services Limited, Secretary of State for Trade & Industry & Griffiths* [1998] 2 BCLC 646.
13 Main Principle A.1.

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and which for the company acting by one officer. Case law provides generalities only. Some matters are for the board as a whole; some can be delegated. In the *Westmid Packing* case the Court of Appeal, after declaring the importance of collegiate or collective responsibility, explained:

'That collegiate or collective responsibility must however be based on individual responsibility. Each individual director owes duties to the company to inform himself about its affairs and to join with his co-directors in supervising and controlling them. A proper degree of delegation and division of responsibility is of course permissible, and often necessary, but total abrogation of responsibility is not.'

In *re Landhurst Leasing PLC* [14] Hart J, after citing the above passage from the *Westmid Packing* case, went on to consider '... the question of the extent to which an individual director may trust his or her colleagues.'[15] He found that 'even where there are no reasons to think the reliance is misplaced, a director may still be in breach of duty if he leaves to others matters for which the board as a whole must take responsibility.'[16]

3. Remedies for breach

The Companies Act, as it does not mention collective responsibility, does not, in terms, provide any remedy for breach.[17] The principal remedies available against individual directors in the courts are suit for damages and disqualification proceedings.

3.1. Companies suing former directors

Section 174(1) of the 2006 Act states succinctly that:

> 'A director of a company must exercise reasonable care, skill and diligence.'

An onlooker observing the collapse of the banks might well ask: 'Given that the directors owe a duty of care, skill and diligence, why can they not be sued?' That question cannot be properly answered without knowledge of the facts and circumstances of each specific case. However there are a number of general considerations which strongly militate against litigation.

- First and foremost is the scale of the banks' losses. Some of the directors may be well off, but even if litigation was successful the fruits would be miniscule in comparison with the losses. And the cost of the litigation would probably assume greater significance than any potential recovery.
- Secondly, the banks have been saved and are not in insolvent liquidation. The duty of directors is owed to the company and enforceable by the company. In liquidation any claim on the company's behalf against its directors is pursued by the liquidator, for the purpose of recovering assets and/or funds for the benefit of creditors. The liquidator has no role to play in the actual running of the company's business. However, where the company survives but with a new board, that new board's principal preoccupation is with the continuing business. A claim against the previous board would be a huge exercise involving a comprehensive and detailed investigation of the company's history, which would take up a considerable part of a new board's (and particularly a new executive team's) time and energy.[18]
- Thirdly, the businesses of the banks were exceptionally complex, and the directors' understanding and handling of these complexities may be at the heart of any examination of their conduct. Unravelling these complexities before a judge in adversarial litigation would be very difficult.
- Fourthly, the case must be proved against each director individually. Executive directors must be distinguished from non-executives, and recently appointed directors from long serving ones. Issues as to who could reasonably rely on whom inevitably arise, on a director by director basis.
- Further, as with all negligence cases[19] a claimant must, in order to recover damages, prove not only breach of duty but also recoverable loss arising from that breach. This involves issues of causation (did the breach cause a loss?) which, given the history of the collapse of each of the banks, would be a fertile field for controversy.
- Finally, under section 1157 of the 2006 Act the court may relieve a director from liability where

Notes

14 [1999] 1 BCLC 286.

15 *Ibid.* at 346.

16 *Ibid.*

17 But of course the power of the shareholders by ordinary resolution to remove any director – whatever the contract between him and the company – is provided by s. 168 of the 2006 Act and enables the removal of all the directors at a stroke. This power is crucial to the relationship between the shareholders in general meeting and the board of directors.

18 A new board that may have regretted claiming against an old board is that of Equitable Life Assurance Society, the insurance mutual. It claimed GBP 3.3 billion and failed to recover a penny. See *Equitable Life Assurance Security v Bowley and others* [2004] 1 BCLC 180.

19 Cases against directors for breach of the duty of care, skill and diligence are now subsumed in the general tort of negligence. See P.L. Davies, *Gower and Davies' Principles of Modern Company Law* (8th edn, 2008, Sweet & Maxwell) at 494-495.

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he has 'acted honestly and reasonably and … having regard to all the circumstances of the case … ought fairly to be excused.' Thus, both breach of duty and damage flowing from the breach may be found, but nevertheless the court, looking to the circumstances of the individual director, may still grant relief.

All of these considerations would weigh in the minds of the new boards of the banks considering action against the old boards. The question for a new board would be: is it in the interests of the company (i.e. the continuing body of shareholders) to bring proceedings? The interests of the company are essentially private interests, even if for the time being HM Government is a substantial shareholder. These interests are not the same as the public interest in determining: (a) what went wrong, (b) is anyone to blame and (c) are there any lessons to be learned?

3.2. Disqualification

The process that *does* formally involve the public interest is disqualification proceedings.

Under section 6 of the Company Directors Disqualification Act 1986 ('the Disqualification Act') every director of a company that has entered any type of insolvency proceedings is in jeopardy of a disqualification order if his '… conduct as a director of that company (either taken alone or taken together with his conduct as a director of any other company or companies) makes him unfit to be concerned in the management of a company.' The disqualification order is mandatory[20] if the two tests of (a) insolvency and (b) unfitness are satisfied. The minimum period of disqualification is two years and the maximum period is fifteen years.

Under section 7(3) of the Disqualification Act every insolvency practitioner must, in insolvency proceedings, consider the conduct of directors and, if it appears that the two tests in section 6 are satisfied, '… forthwith report the matter to the Secretary of State.' Thus, if the banks had not been saved, the administrator or liquidator would have considered the conduct of the directors as a matter of course.

Insolvency is not the only route into disqualification proceedings. Under section 8 of the Disqualification Act the Secretary of State[21], if it appears to him from 'investigative material' that '… it is expedient in the public interest that a disqualification order should be made against a person who is or has been a director … of a company … may apply to the court for such an order.' 'Investigative material' means reports made following, or information or documents obtained during, a Companies Act investigation or a Financial Services Authority investigation under the Financial Services and Markets Act 2000.

There is a substantial body of case law under the Disqualification Act and in many ways the cases provide more up to date authority on the responsibilities of directors than the more infrequent cases concerning the duty of care, skill and diligence. Of significant interest are the Barings cases which of course concerned an insolvent bank. The principal disqualification proceeding related to Mr Andrew Tuckey,[22] who was in substance but not in name the Barings group's Chief Executive Officer. A Mr Leeson had been conducting a switching business (essentially arbitrage in derivatives between markets) in Singapore. It appeared to be remarkably successful, generating a substantial proportion of the Barings group's profits. Because it was conducted on margin there were repeated calls, as the business grew, for the transfer of funds from London to Singapore to provide additional margin. Some GBP 300 million was transferred. In fact the business was not profitable but incurred losses of some GBP 827 million and brought the whole group down.

The judge found that the management committee in London had not understood the business and had shown no curiosity as to how the profits were being generated. The allegation found proved against Mr Tuckey was one of non-management. He had been seriously incompetent not to inform himself about the switching business. He was disqualified for four years.

The facts are far from the circumstances of the failures of the five banks in 2007 and 2008. But the judgment of Jonathan Parker J is of importance in emphasising the fundamental principles that apply. In particular, Jonathan Parker J stated:

> 'It is a truism that if a manager does not properly understand the business which he is seeking to manage, he will be unable to take informed management decisions in relation to it.'[23]

After a careful review of the authorities he summarised the relevant duties of directors in this way:

(i) 'Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors.

Notes

20 See s. 6(1) of the Disqualification Act: 'the court *shall* make a disqualification order against a person …' (my emphasis added).

21 The Secretary of State for Business Innovation and Skills.

22 *Re Barings plc and others (No 5), Secretary of State for Trade and Industry v Baker and Others* [1999] 1 BCLC 433 ('the Barings case').

23 *Ibid.* at 528.

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(ii) Whilst directors are entitled (subject to the articles of association of the company) to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions.

(iii) No rule of universal application can be formulated as to the duty referred to in (ii) above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company.'[24]

Jonathan Parker J drew an important distinction between: on the one hand, breach of duty and, on the other, unfitness founded on incompetence:

> 'It is, I think, possible to envisage a case where a respondent has shown himself so completely lacking in judgement as to justify a finding of unfitness, notwithstanding that he has not been guilty of misfeasance or breach of duty.'[25]

A serious failure to observe the principles of corporate governance can, in itself, lead to disqualification. *Re AG (Manchester) Ltd (in liquidation) Official Receiver v Watson and another*[26] concerned the insolvency of a substantial company involved in claims handling and after the event insurance. The principal allegation against Mr Watson (the former finance director) was that he, together with two others, 'usurped the proper function of the board' and 'without any delegation of ... powers to them by the full board took all the strategic and financial decisions including the authorisation and payment of dividends.'[27] Patten J upheld this allegation and made a disqualification order 'based on lack of competence rather than lack of probity' because of the 'acquiescence in the system of governance.'[28]

4. Corporate governance

The Combined Code prescribes particular practical steps which should be taken by boards essentially as regards the composition and conduct of the board, the remuneration of the board and the discharge of its responsibility for accounting, internal control and risks. It describes itself as 'a guide to the components of good board practice'. The discharge by a board of its collective responsibility depends on how it operates in practice. And, as with the performance of a team in sport, that in turn depends on the membership of the board and its leadership. That is why the Code lays a great deal of emphasis on the activities of the chairman and the composition of the board.

Whether or not there is a formal vote, the chairman needs, in the conduct of a meeting of the board, to get at the consensus view on every item of business. This is a singular and sometimes an awesome task. The chairman needs, himself, to understand every aspect of the issues raised by an item; he needs to be the master of the documents sent out to board members; he needs to bring in the director not disposed to push his view forward and to restrain the director inclined to speak at unnecessary length; he has to plan the order in which he will invite directors to speak, and to ration the time for (a) presentation by the executive directors, (b) comments and questions from the non-executive and (c) discussion, debate and decision. The skills required are considerable; and there must be a certain disinterestedness since his task is not to get his own way, nor to ensure that the executive team's proposal prevails, but to arrive at the collective will of the board as a whole.

The culture within a board and its style of operation are almost always determined by the chairman. On the one hand he can prevent glib, ritualistic presentations which gloss over underlying realities; on the other he can restrain carping, unconstructive challenge. As regards both the executives and non-executives he can ensure that both have done their homework before the meeting and neither wastes the other's time. Given that the key to good management of a business is understanding it, perhaps the core of a chairman's duty lies in ensuring that his board understands what the company is doing and addresses the significant issues. The very antithesis of good chairmanship is contempt for the intellectual grasp of the board as a whole and a determination to see the executive's intentions prevail.

The discharge of collective responsibility depends, necessarily, on the individuals making up the 'collective' and their performance and interaction. Both size and composition have a crucial bearing on how a board operates. As anyone who has sat on boards, councils or committees knows, the nature, quality and tone of presentation, persuasion, challenge and debate are affected by the numbers present. Large numbers tend

Notes

24 *Ibid.* at 489.
25 *Ibid.* at 486.
26 [2008] 1 BCLC 321. The case would doubtless have been decided the same way even if the expression 'corporate governance' had not passed into common parlance with respect to the conduct of boards of directors.
27 *Ibid.* at 326.
28 *Ibid.* at 374.

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to detract from the immediacy and directness of exchanges. Small numbers, on the other hand, can lead to cosiness, familiarity and a lack of rigour.

Because there must be understanding of a business for it to be well managed, it is axiomatic that the executives on the board should have the skills and experience to contribute to (and often lead) discussion of the principal activities undertaken by the company. Similarly there should, among the non-executives, be individuals with experience relevant to the main businesses of the company. Otherwise there will be nobody with knowledge and expertise derived otherwise than from the executives to lead the challenge to the executives on particular proposals, and to assist the non-executives as a group in their overall assessment on the executive's competence.

5. RBS and HBOS

Each of these banks published their accounts for the year to 31 December 2007 (the last full year before collapse in the second half of 2008) at the end of February 2008. The information in this section is taken from these accounts.

5.1. The size and composition of the board

RBS had seventeen directors (a chairman, six executives and ten non-executives), and HBOS sixteen (a chairman, seven executives and eight non-executives). Both these boards were plainly the other side of a long-recognised dividing line. On one side there is a gathering within which true debate and discussion is possible; mind can impact on mind and minds can be changed; a collective view can be one way at the outset and another at the conclusion. On the other is a series of formal presentations to an audience with constraint on questioning and contribution simply because there are too many people around the table.[29]

Both boards, of course, claimed that they had considered size and believed that they had got it right, having regard to the size and complexity of the business. Likewise, both boards claimed to have the right mix of expertise and experience. Of RBS's ten non-executives two had been investment bankers, two civil servants, two lawyers and the other four's careers had been in professional accountancy, US finance, airports management and insurance. The HBOS non-executive team had a distinct slant towards exposure to the consumer with two from catering and one from mobile phone selling. The other five came from the worlds of engineering, consultancy, finance, law and banking.

It is clear that serious questions arise as to how these boards were satisfied that they got size and skills right. What was the analysis and, in particular, what attention was paid to the topic addressed below, namely the board's understanding of the business for which it was responsible?

5.2. Chairmanship

The chairman's task is to enable the board to discharge its collective responsibility. He must ensure that the board addresses the issues which it should address, that it addresses them well (that is with adequate information, understanding, exploration and debate), and that the decisions reached truly represent the collective view. It is not for him to get his way or to help the chief executive get his way: it is to get at the sense of the meeting of all the directors. For each of the directors has his individual duty to discharge, all of them together have their collective responsibility, and each has one vote equal in weight to the vote of every other.

Because chairmanship essentially involves human relationships in and around the boardroom, it is impossible for anyone outside RBS and HBOS to assess whether good or bad chairmanship played any part in the boards' collective failings. Only a painstaking investigation of the facts, including interviews with all directors and an examination of all board papers, could enable such an assessment to be made.

5.3. Understanding

These were large and complex businesses. Both were involved in retail and corporate banking, general insurance, wealth management, structuring, distributing and trading in asset-backed securities, and the full range of treasury operations. HBOS was also in the life insurance and pensions business and invested by way of equity as well as loan in property, infrastructure and other activities.

The sums involved were huge. RBS's total assets were GBP 1,900 billion, and its liabilities GBP 1,809 billion, making its equity some GBP 91 billion. However, that margin needs to be seen alongside debt securities of GBP 276 billion (including GBP 23 billion of mortgage-backed securities) and a derivatives involvement of some GBP 337 billion. HBOS's total assets were GBP 666 billion, and its liabilities GBP 644 billion.

Notes

29 At paragraph 3.1 of his first report (note 3 above), Sir David Walker refers to '… a widely-held view that the overall effectiveness of the board, outside a quite narrow range, tends to vary inversely with its size.' According to Sir David, '[t]hat view would tend to converge around an "ideal" size of 10-12 members …' . His second report however contained no final recommendation as to optimum board size.

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Therefore its equity was GBP 22 billion, which needs to be compared with financial assets held for trading of GBP 54 billion and investment securities of GBP 128 billion.

Company law requires directors to inform themselves about the business for which they are responsible and to develop an understanding of it. What this means in practice will depend on the facts and circumstances of each case. When a board is responsible for a number of businesses the burden of understanding is increased. The boards of both RBS and HBOS had, in any event, a formidable task in understanding the various businesses of the respective groups. But it must have been the relatively new businesses of derivatives and securitisation that constituted the most severe test of the boards' capacity to understand.

As the cases coming before the courts have shown, the underlying financial instruments have become ever more elaborate and sophisticated.[30] What reached the courts probably gives only a very brief glimpse of the vast labyrinth of securities and derivatives involved in the businesses of RBS and HBOS. But was that labyrinth ever visited, with or without guidance, by any of the directors, executive or non-executive? Was there an understanding – the first requirement for a discharge of responsibility – or not?

No one outside RBS and HBOS can know what the directors' understanding was. Again, only a detailed investigation could get at the truth.

5.4. Corporate governance and risk

The RBS Annual Report is 248 pages long and devotes 20 pages to risk and 5 to corporate governance. HBOS's Report is 224 pages and has 19 pages on risk and 10 on corporate governance. Both reports evince meticulous care in the observance of the many prescriptions of the Combined Code as regards governance, internal controls and risk. And yet both banks failed, and both boards failed in that most basic of collective obligations – to ensure the bank's continued solvency.

There are clearly some singularly important lessons to be learned. Perhaps the sheer volume of the compliance detail of the Combined Code and the multiplicity of the technically complex assessments of risk led to a lack of understanding and a disinclination to ask fundamental questions. Only an investigation can give an answer to this.

Corporate governance is about process, procedure and disclosure. It does not bear on the quality and character of directors' discharge of their collective responsibilities. That turns on the actual dynamic of the interaction of mind on mind within the board in addressing issues and determining them. That dynamic starts with each director's sense of his or her own responsibilities. And that sense is built up in part from the law and from precedent. For this purpose, precedent includes judgments not just in claims for damages and disqualification cases but also in reports of Companies Act inspections after full investigations. Many company law practitioners have had occasion to advise: 'This may not expose you to personal liability or disqualification but it will certainly invite stinging criticism in a report by inspectors.'

It is possible that a considered judgement of the failed banks' directors' behaviour after a full investigation could be along the following lines:

> 'There was a failure by the directors to discharge their collective responsibility but it is impossible to allocate specific blame to one or more individual directors and to exempt others. Each had a share of the collective failure: no one, otherwise, had a specific individual responsibility for what went wrong.'

Such a judgement, even though not pointing to the commencement of disqualification proceedings, would be of importance in the public interest and would be a lesson for future boards.

6. The regulator

It can never avail the directors of a bank to say: 'We were completely open with the regulator which knew all it wanted to know and expressed itself content', whether generally or in relation to any specific issue, such as the adequacy of capital. Directors should always exercise independent judgement: that is their duty; and they are often better placed than the regulator to take an informed view.

Nevertheless, the exchanges between a bank and the regulator would be highly relevant to any consideration of the conduct of the directors of a failed bank. This includes not simply the accuracy and completeness of the information provided to the regulator and the nature of the regulator's response, but also the understanding within the boardroom of the attitude of the regulator and the nuances of the regulator's approach to the different businesses within each bank (to the extent that these matters are reported to the board). Finally, the extent of the boards' reliance on any reports produced by the regulator would also be a relevant factor for consideration in an investigation.

Although directors' disqualification proceedings can, as explained above, be launched on the basis of

Notes

30 See, e.g., *Hazell v London Borough of Hammersmith & Fulham* [1990] 2 WLR 17 ('the swaps case'); the Barings case, note 22 above; *Citibank NA v QVT Financial LP* [2008] 1 BCLC 376; and *UBS AG and UBS Securities LLC v HSH Nordbank AG* (Unreported) [2009] EWCA Civ 585.

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material in a report following an investigation instigated by the regulator, a Companies Act investigation would be a far better way forward. Since the conduct of the regulator itself is intertwined with the conduct of the board, the regulator's interest in an investigation should be regarded as a special, sectional interest distinct from the public interest in 'what went wrong.' Moreover, a report following a regulator's investigation would not be published.[31]

Conclusions

(A) It could be the case as regards any one or more of the directors of the failed banks that their conduct as directors has rendered them 'unfit to be concerned in the management of a company.'[32] Countless directors of relatively small companies which have become insolvent have been disqualified, and disqualification in the absence of dishonesty has been common. Disqualification has also occurred where there has been no specific breach of duty. 'Unfitness' raises what is called a 'jury question'[33]: it is not a technical legal concept.

The fact that the banks were so significant to the national economy that HM Government had to save them should not exempt their directors from the ordinary personal consequences of insolvency, which would have included meticulous examination of their conduct, jeopardy of disqualification, and potentially even a finding of unfitness. In the event the only satisfactory available procedure which could, should they be warranted, lead to disqualification proceedings, is a Companies Act investigation.

(B) While the collective responsibility of the directors lies at the heart of company law, the only direct remedies or sanctions available are against directors individually. In an abstract sense, of course, the respective boards of each of the five banks failed because the bank failed. But there may have been serious derelictions of the collective duty – derelictions which might be established notwithstanding an impossibility of allocating individual blame among individuals. The summation might be that the board as a whole failed, even though no one director was in breach of his individual duty or unfit to be a director of a company. An exploration of the board's exercise of its power and responsibility would be worthwhile and in the public interest, even if the publication of the report was the final step, leaving no more to be done. The public would know the answer to the question: what went wrong within the boardroom?

(C) Sir David Walker's second Report with its final recommendations was closely followed at the beginning of December 2009 by two publications from the Financial Reporting Council.[34] In sum these documents give both the Combined Code on Corporate Governance, and more generally the current legal structure for board responsibility, a clean bill of health as 'fit for purpose' and therefore not in need of radical reform. Much, however, is made of the need for behavioural change with an emphasis on the culture within the boardroom and the importance of constructive challenge of the management. There are many sensible proposals concerning the role of the chairman; the induction, training and development of the non-executive directors; and the periodic evaluation of the board's effectiveness. Also, both reports recognise the importance of learning lessons[35] from the collapse of the banks, while at the same time acknowledging the lack of evidence currently available as to the overall effectiveness of non-executive directors on boards.[36] Nevertheless, the Walker Report makes assertions about the inadequacy of banks' boards[37] without any evaluation of the specific facts and circumstances involved at the individual firm level. Further, the recommendations support the traditional formula of prescriptions in the Combined Code as to principle, guidance and disclosure.

In the short term, there was arguably no other regulatory option realistically available. Nevertheless, there remain legitimate questions as to what else can be done in order to uncover the nature and extent of any corporate governance lapses in the failed banks. The case law

Notes

31 Much of the information collected by the Financial Services Authority or by the persons appointed by it would be confidential information within s. 348 of the 2000 Act, and thus subject to restrictions on disclosure. Contrast s. 437 of the Companies Act 1985, which authorises the Secretary of State to '... cause any ... report to be printed and published.'

32 The test in s. 6 of the Company Directors Disqualification Act 1986.

33 *Re Sevenoaks Stationers (Retail) Ltd* [1991] BCLC 325 at 330.

34 Financial Reporting Council, *2009 Review of the Combined Code: Final Report* and the *Consultation Document on the Revised UK Corporate Governance Code* (1 December 2009).

35 See the second Walker Report (note 3 above) at para. 2.13: '... the most relevant question is how to identify and draw lessons from recent experience so that best practice is more widely and dependably attained.'

36 See the second Walker Report (note 3 above) at para. 2.12: 'Advice to this Review on available economic and business school research on the impact of NEDs in the decision-taking of boards (and the resulting added value to the entity) is that such research gives little evidence-based guidance.' Likewise, the FRC's *2009 Review of the Combined Code: Final Report* (note 34 above) contains a number of references to 'anecdotal evidence'.

37 See, e.g., the second Walker Report (note 3 above) at para. 4.1: '... a key purpose of this Review is how to ensure that the contribution of NEDs on a BOFI board achieves maximum effectiveness. That contribution appears to have been seriously inadequate in many recent situations.'

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approach of the common law – building from precedent to precedent with the facts examined first and then the principle extracted – attests to the fundamental truth that a story well and fully told is more memorable and more persuasive than naked precept. Each board's conduct in the run-up to the collapse of the banks should be investigated and the story told. That is the best way for the necessary lessons to be learnt.

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