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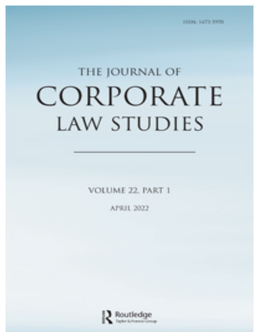

Journal of Corporate Law Studies

ISSN: (Print) (Online) Journal homepage: https://www.tandfonline.com/loi/rcls20

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**To cite this article:** Iain Frame (2023): The ends and means of banking: the Royal Bank of Scotland after the 2008 crisis, Journal of Corporate Law Studies, DOI: 10.1080/14735970.2023.2206212

**To link to this article:** https://doi.org/10.1080/14735970.2023.2206212

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JOURNAL OF CORPORATE LAW STUDIES
https://doi.org/10.1080/14735970.2023.2206212

# The ends and means of banking: the Royal Bank of Scotland after the 2008 crisis

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**ABSTRACT**

The distress wreaked on small businesses by the Royal Bank of Scotland's turnaround division, the Global Restructuring Group, is one of the most egregious examples of bank misconduct in recent decades. Such misconduct invites reflection on the role of commercial banks in the creation and use of money. To what ends and by what means do commercial banks perform this role? This article considers ends in the sense of whose interests banks ought to serve; and it considers means in the sense of the allocation of decision-making authority. It then turns to the drama of RBS after 2008 to document how allocations of decision-making authority by corporate law and secured transactions law benefited short-term financial interests to the detriment of RBS's small business customers. It concludes by suggesting an alternative distribution of decision-making authority to counteract such short-term financial interests.

**ARTICLE HISTORY** Received 13 July 2022; Accepted 20 April 2023

**KEYWORDS** Money; banking; corporate law; secured transactions law; Royal Bank of Scotland

## Introduction

A software development company in Oxfordshire; an architecture firm in Norwich; a hotel group in East Anglia; a care home in Bournemouth; a private school in Sheffield; a music producer in Glasgow; a barn conversion company in Aberdeen. These seven businesses banked with the Royal Bank of Scotland (RBS).[1] The financial crisis of 2007–08 left them financially distressed but viable. RBS responded by referring these and thousands of

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[1]See T. Warren, J. Bradley, R. Holmes and H. Blake, 'Meet the People Who Say Their Firms Were Destroyed by RBS' 12 October 2016 *BuzzFeed.News* at https://www.buzzfeed.com/tomwarren/the-great-white-sharks-of-rbs; I. Fraser, 'RBS "Dash for Cash" Scandal: 500 firms suing bank turn anger on regulator' 17 October 2016 *The Herald*; 'RBS: The Hillsborough of British Business' 7 April 2018 *Renegade Inc.* at https://renegadeinc.com/rbs-hillsborough-british-business/.

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other small and medium sized enterprises (SMEs) to its specialist turnaround division, the Global Restructuring Group (GRG). But instead of operating as 'an intensive care unit',[2] 'as an altruistic operation, bending over backwards to prefer the interests of the bank's customers',[3] GRG operated as 'the "heavy squad" designed to squeeze customers',[4] as an 'abattoir, where [SME customers] were stripped and taken apart'.[5]

GRG typically hit struggling SMEs with fines, fees and interest rate hikes – it demanded that one SME pay a £400 per month 'review fee', a £150,000 per year 'risk fee', and a one off £7,000 'security fee'.[6] In addition or alternatively, GRG would threaten to withdraw support from a struggling SME unless the SME agreed to new lending terms advantageous to the bank – desperate, many agreed; those who did not often ended up in liquidation.[7] One report on GRG concluded, 'in a significant proportion of cases' GRG's treatment of SMEs 'caused material financial distress'[8] to these businesses because GRG 'saw delivery of its own narrow commercial objectives as paramount'.[9] One member of parliament described GRG's conduct as 'the largest theft anywhere, ever'.[10] SME owners use similarly blunt language: 'I think the purpose of the restructuring unit is basically to get as much money out of a [SME] as they possibly can before they put it into administration and take all their assets off them'; 'They [GRG] weren't interested in helping our business, just making money from it'; 'GRG in particular seemed to take pleasure in really turning the screw'.[11]

RBS's GRG is not alone in facing SMEs alleging mistreatment.[12] And the practices of turnaround divisions like GRG are only part of the 'wider allegations of malpractice in financial services and related industries':[13] note the mis-selling of interest rate hedging products to SMEs;[14] the mis-selling of payment protection insurance to homeowners;[15] and the fraudulent

[2]C. Lewis, HC Deb vol 634 col 1083 18 January 2018.
[3]*Morley* v *Royal Bank of Scotland*, EWHC 270 (Ch), 31 January 2019 at [18].
[4]ibid.
[5]Lewis, n 2 above. For similar language, see B. Esterson, HC Deb vol 634 col 1122 18 January 2018.
[6]The example is from A. Nesvetailova and R. Palan, *Sabotage: The Business of Finance* (London: Penguin Books, 2020) 73.
[7]See the examples discussed in the sources referred to at n 1 above.
[8]Promontory Financial Group, *RBS Group's Treatment of SME Customers Referred to the Global Restructuring Group: a report under section 166 of the Financial Services and Markets Act 2000* (September 2016) at [x]. See also HC Deb vol 634 18 January 2018; and M. Arnold, 'Failing of RBS small business unit laid bare' 13 February 2018 *Financial Times*.
[9]Promontory Review, n 8 above at [xi].
[10]Lewis, n 2 above, col 1086.
[11]All three quotations are from Warren, Bradley, Holmes and Blake n 1 above.
[12]See HC Deb vol 634 18 January 2018; HC Deb vol 640 10 May 2018; on the infamous HBOS Reading fraud, see R. Cranston, 'The Cranston Review' (December 2019) at http://cranstonreview.com/; on the Clydesdale Bank, see B. Wylie, *Bandit Capitalism: Carillion and the Corruption of the British State* (Edinburgh: Birlinn, 2020) 193–208.
[13]Lewis, n 2 above, col 1082.
[14]https://www.fca.org.uk/consumers/interest-rate-hedging-products
[15]https://www.fca.org.uk/ppi/ppi-explained

manipulation of LIBOR, the influential wholesale money market interest rate.[16] Yet what makes these allegations of malpractice all the more controversial is the public support received by financial institutions in 2008. As the UK's largest bank at that time, RBS received more support than most: the UK Treasury invested £20 billion of capital and insured assets worth £282 billion.[17] To justify that support, the Chancellor of the Exchequer, Alistair Darling, explained, 'if you don't have a banking system that provides credit for businesses, then you will make the recovery and prosperity after that much, much more difficult'.[18] Darling's view is widely shared: 'when banks fail, the economy fails too'[19] is a common refrain, since financial instability would 'significantly impair the supply of credit'.[20] Yet today, when 'the dark clouds of past misconduct still hang heavy over the SME finance market',[21] and amidst numerous other misconduct allegations, that justification is at variance with 'the core dysfunctions of today's financial system',[22] including that banks like RBS are 'too big to fail' while other businesses are not.

Marginalised and mistreated customers; mistrusted financial institutions; a dysfunctional financial system. What do these controversies reveal about the ends and means of banking? To explore this question, this article considers ends in the sense identified by Stephen Bainbridge when he asks: whose interests should prevail? Bainbridge distinguishes that question from a related one about means. Thinking about means, Bainbridge suggests, invites the question: who holds decision-making authority?[23] And asking that question in turn elicits what Geoffrey Ingham calls '*the* money question: who should control its creation and how it should be used'.[24]

Money is today created and put to use by '[o]ne of capitalism's distinctive characteristics … a franchised and regulated banking system'.[25] Like Ingham,

[16]M. Wheatley, *The Wheatley Review of LIBOR: final report* (September 2012) at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191762/wheatley_review_libor_finalreport_280912.pdf

[17]For an overview of the Treasury's injections of capital into RBS, see National Audit Office, *HM Treasury: the Asset Protection Scheme* HC 567 (2010–11) 4.

[18]Alistair Darling, quoted in M. White and H. McDonald, 'Darling Criticism puts Banks on Defensive' 26 July 2009 *The Guardian*.

[19]R. Barwell, *Macroprudential Policy after the Crash* (Palgrave Macmillan, 2017) 214.

[20]E. Rosengren, quoted in ibid, 214.

[21]Treasury Committee, *SME Finance* HC 805 (2017–2019) (24 October 2018) at [2].

[22]S.T. Omarova, 'The "Too Big to Fail" Problem' (2019) 103 *Minnesota Law Review* 2497, 2500.

[23]S.M. Bainbridge, 'Director Primacy: the Means and Ends of Corporate Governance' (2003) 97(2) *Northwestern University Law Review* 547, 549–50. See also Zhong Xing Tan, 'Stewardship in the Interests of Systemic Stakeholders: Re-conceptualizing the Means and Ends of Anglo-American Corporate Governance in the Wake of the Global Financial Crisis' (2014) 9(2) *Journal of Business & Technology Law* 169.

[24]G. Ingham, *Money: What is Political Economy?* (Polity, 2020) 15. Emphasis in original.

[25]ibid, 61. For the history of English and then British money, including the emergence of bank created private credit money, see C. Desan, *Making Money: Coin, Currency, and the Coming of Capitalism* (Oxford University Press, 2014).

Robert Hockett and Saule Omarova's 'paradigm-shifting work'[26] also deploys the term 'franchise', characterising the state-bank relationship as a 'finance franchise', through which the public authorities, as franchisor, delegate to commercial banks, as franchisees, decision-making authority over who gets access to credit and on what terms.[27] Other commentators vary the metaphor, casting the state-bank relationship as a 'social contract'[28] or as an 'outsourcing arrangement',[29] or by casting banks as 'public utilities'[30] or as operating under a 'social licence'.[31] But however phrased all point to a similar dynamic of ends and means: financial '[m]arkets are not ends in themselves, but powerful means for prosperity and security for all';[32] bank profitability ought to be 'a means to an end and not as an end itself';[33] banks ought to be 'structures for deploying public wealth in service of human development and economic justice, rather than as the instruments of inequality and accumulation they have become'.[34] As Hockett and Omarova themselves express the dynamic, banks ought to engender 'inclusive and stable economic development',[35] yet 'private actors driven primarily … to satisfy increasingly short-term market expectations'[36] have generated a 'dysfunctional mode of interaction between the financial system and the real (i.e. non-financial) economy'.[37]

Since much of this commentary tends 'to be pitched at a quite high level of abstraction',[38] this article builds on it by analysing a case study of the state-bank relationship: the drama of RBS after 2008. This case study allows us to explore why and how banks prioritise short-term financial interests over the aspiration of 'inclusive and stable economic development'.[39] It analyses RBS for three reasons. First, the drama of RBS sets out the relations comprising our franchised and regulated banking system: the state and commercial

[26]W. Bateman and J. Allen, 'The Law of Central Bank Reserve Creation' (2022) 85(2) *The Modern Law Review* 401, 423.

[27]R.C. Hockett and S.T. Omarova, 'The Finance Franchise,' 102 *Cornell Law Review* (2017) 1143, 1147. Victoria Chick and Sheila Dow use the term 'franchise' to describe the state-bank relationship in the UK in their article 'Financial Institutions and the State: a Re-examination' (2011), available at: https://dspace.stir.ac.uk/bitstream/1893/22628/1/2013%20Chick%20Dow%20parguez%20vol%20final%20.pd

[28]M. Baradaran, 'Banking and the Social Contract' (2014) 89 *Notre Dame Law Review* 1283. The state-bank relationship as a 'social contract' also appears in, for example, P. Tucker, 'Regimes for Handling Bank Failures: Redrawing the Banking Social Contract' (2009), available at http://www.bankofengland.co.uk/publications/speeches/2009/speech396.pdf

[29]M. Ricks, 'Money as Infrastructure' (2018) *Columbia Business Law Review* 757, 801; D. Awrey, 'Bad Money' (2020) 106 *Cornell Law Review* 1, 3.

[30]A.M. White, 'Banks as Utilities' (2016) 90 *Tulane Law Review* 1241. See also, P. Molyneux, 'Are banks public utilities? Evidence from Europe' (2017) 20(3) *Journal of Economic Policy Reform* 199.

[31]D. Rouch, *The Social Licence for Financial Markets: Reaching for the End and Why It Counts* (Palgrave Macmillan, 2020).

[32]Mark Carney, quoted in ibid, 134.

[33]Baradaran, n 28 above, 1284.

[34]White, n 30 above, 1244.

[35]Hockett and Omarova, n 27 above, 1218.

[36]ibid, 1215.

[37]ibid, 1213.

[38]Ricks, n 29 above, 770.

[39]Hockett and Omarova, n 27 above, 1218.

banking; commercial banking and those to whom banks lend; and how the former affects the latter and with what consequences. Second, and in keeping with Bainbridge's definition of ends, the drama of RBS is a drama of interests in tension with each other: the interests of the Treasury as RBS's largest shareholder clashed with RBS's lending commitments to households and businesses; and the interests of RBS as a secured creditor clashed with the needs of viable SMEs in temporary financial difficulty. Third, and in keeping with Bainbridge's definition of means, the drama of RBS illustrates how allocations of decision-making authority determine whose interests prevail when interests conflict.

The structures of private law, such as corporate law and secured transactions law, set out the terms and mark out the pathways through which banks determine who gets access to credit and on what terms. In what follows we identify the allocations of decision-making authority by corporate law and secured transactions law that saw short-term financial interests prevail ahead of inclusive and stable economic development. And we conclude that to reform our franchised and regulated banking system, we may need to encourage public alternatives to credit allocation by shareholder-driven banks.

This article divides as follows. Section one situates private law within our franchised and regulated banking system before introducing corporate law and secured transactions law. Section two considers the role of corporate law in RBS's recapitalisation in 2008-09; section three considers how that recapitalisation interacted with the lending agreement between RBS and its SME customers to the detriment of these customers. Sections four and five extend insights from the analysis of RBS to the COVID-19 crisis – the second major financial and economic crisis in two decades. Section six concludes by suggesting an alternative distribution of decision-making authority.

## The ends and means of banking

### *A franchised and regulated banking system*

In Hockett and Omarova's account of the franchised and regulated banking system, the state takes on each commercial bank's 'privately-issued debt liability as a liability of its own'.[40] That accommodation 'monetizes a private liability',[41] guaranteeing the 'spendability'[42] of bank liabilities as money. And it marks out commercial banks as 'privileged purveyors' of the state's currency.[43] As such, commercial banks profit from channelling credit to households and businesses, a role the 'facilitative structures' of private law

[40]ibid, 1148.
[41]ibid.
[42]ibid, 1155.
[43]ibid, 1164.

enable,[44] and one which is justified by the assumption that commercial banks have 'superior ability to gather and process vital market information at the micro level faster and more efficiently than any one agent such as the state is able to do'.[45]

Central bank liquidity support, deposit insurance, and, if need be, government capital injections and asset guarantees maintain the equivalence between bank private credit money and state money. To discourage excessive credit creation, the central bank – responsible for 'maintaining appropriate *aggregates* of credit'[46] – deploys monetary policy, varying its interest rate in response to the rate of inflation and level of employment. And regulatory authorities provide and enforce the 'quality control'[47] standards familiar to actual franchise arrangements: in the UK, the Prudential Regulation Authority supervises the financial resilience of banks, while the Financial Conduct Authority regulates how financial institutions sell products or services to customers.

Private law structures like corporate law and secured transactions law set out the terms and mark out the pathways through which private financial institutions allocate credit. The insights of the American legal realist and institutional economist, Robert Lee Hale, help to delineate how they do so. Hale builds on the work of Wesley Hohfeld.[48] In Hohfeld's framework, legal entitlements for some correspond to disentitlements for others: the right of one party must correspond to another's duty, just as a privilege must correspond to the absence of a legal remedy. Hale follows Hohfeld by demonstrating how one party's freedom will be experienced as coercive when viewed from the perspective of the other party.[49] Property law gives the better endowed party the capacity to withhold that which the other side needs; to the extent that they can withhold, the law of contract will put them in a position to set terms of access. The process is coercive in the sense that the less

[44] J. Black, 'Reconceiving Financial Markets – From the Economic to the Social' (2013) 13 *Journal of Corporate Law Studies* 401, 413. For a broad ranging overview of law's role in constituting money, including but not limited to private law, and including but not limited to bank private credit money, see C. Desan, 'Money as a Legal Institution', in D. Fox and W. Ernst (eds) *Money in the Western Legal Tradition: Middle Ages to Bretton Woods* (Oxford University Press, 2016) 16.

[45] Hockett and Omarova, n 27 above, 1213.

[46] ibid. Emphasis in original.

[47] R.C. Hockett, 'Finance without Financiers' (2019) 47(4) *Politics & Society* 491, 498. See also L. Menand, 'Why Supervise Banks? The Foundations of the American Monetary Settlement' (2021) 74(4) *Vanderbilt Law Review* 951.

[48] W. Hohfeld, 'Some Fundamental Legal Conceptions as Applied in Legal Reasoning' (1913) 23 *Yale Law Journal* 16. For an insightful discussion of Hohfeld, see A. di Robilant and T. Syed, 'Property's Building Blocks: Hohfeld in Europe and Beyond' in Henry Smith and others (eds) *The Legacy of Wesley Hohfeld* (2020), available here: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3710102

[49] R.L. Hale, 'Coercion and Distribution in a Supposedly Non-Coercive State' (1923) 38 *Political Science Quarterly* 470. Barbara Fried discusses Hale's work in *The Progressive Assault on Laissez-Faire: Robert Hale and the First Law and Economics Movement* (Harvard University Press, 1998). See also W. Samuels, 'The Economy as a System of Power and its Legal Bases: The Legal Economics of Robert Lee Hale' (1973) 27 *University of Miami Law Review* 261.

endowed party may feel pressured or forced or required to accept these terms unless it wishes to forgo access to that which it needs.

The background rules of private law determine the choices open to the parties and the extent to which they can pressure each other. Building on Hale's analysis, Duncan Kennedy identifies two general categories of rules that determine the distribution of decision-making authority. Kennedy's first category are those 'rules governing the conduct of the parties during bargaining'; his second are those 'rules that structure the alternatives to remaining in the bargaining situation'.[50] In the narrative to follow, this article identifies rules in the first category by showing how corporate law and secured transactions law distributed decision-making authority in ways favourable to the short-term financial interests of shareholders and secured lenders but detrimental to small businesses. Along the way, this article identifies moments where limits to the availability of alternatives under the second category of rules re-enforced the authority allocated by the first category. The article concludes by suggesting that, to empower small businesses in response to bank misconduct, reforms should create alternatives to bargaining with commercial banks. For now, the next subsection considers corporate law, the subsection after secured transactions law.

### *Corporate law*

Financial regulators believe that banks financed by more equity and less debt – as required under Basel III[51] – are best placed to absorb losses, and that (in theory at least) makes such banks safe and sound compared to highly leveraged banks. Common equity's loss absorbing capacity distinguishes it from debt and affords it prominence in the Basel Accords. It also distinguishes shareholders from other corporate constituencies, both with respect to banks and more generally. Corporate constituencies such as investment creditors and employees contract for predetermined payments from the company.[52] Shareholders, by contrast, do not have a fixed claim against the company that affords them a predetermined share of the company's surplus; instead, they receive income from the company only after the company has honoured its contractual commitments and only if the board of directors decide to declare a dividend. That affords the company flexibility

[50] D. Kennedy, 'The Stakes of Law, or Hale and Foucault!' (1991) 15 *Legal Studies Forum* 327, 330.

[51] In 2009, Basel III tightened what counts as 'Tier 1' capital to common equity and retained earnings only, and mandated that a larger proportion of the 8 percent capital-to-assets ratio take the form of Tier 1 capital. Basel III complements these capital adequacy requirements with measures which reflect more fully the so-called 'macroprudential turn' in financial regulation, such as a 'capital conservation buffer' and a 'countercyclical capital buffer'. On Basel III, see Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for more Resilient Banks and Banking System* (rev. 2011). On macroprudential regulation, see Barwell, n 19 above; and A. Baker, 'The Gradual Transformation? The Incremental Dynamics of Macroprudential Regulation' (2013) 7 *Regulation & Governance* 414.

[52] A. Kokkinis, *Corporate Law and Financial Instability* (London: Routledge, 2018), 143.

in the allocation of its resources, including scope to write-off losses. And, some scholars argue, it also gives shareholders reason to hold management to account, for it is only if management maximises the company's surplus that shareholders stand a chance of receiving a return on their investment.[53]

In the UK, management decision-making authority over resource allocation both generally and in the context of banking is subject to accountability to shareholders, accountability which a range of corporate law (as well as capital markets law) mechanisms help to facilitate:[54] investors benefit from disclosure rules that require the company issuing shares to provide information about its activities;[55] once the investor becomes a shareholder, she is entitled to sell her shares,[56] to influence management strategy by appointing[57] and by removing directors,[58] and, in some circumstances, to approve corporate transactions;[59] and she is entitled to expect company directors to promote the success of the company 'for the benefit of its [shareholders] as a whole';[60] if the directors fail to do so, she and her fellow shareholders may in some circumstances litigate on behalf of the company against the company's directors.[61]

## *Secured transactions law*

Whereas shareholders both generally and in the context of banking may use the entitlements assigned to them by corporate law to challenge and steer management, other corporate constituencies excluded from corporate law protect their interests by bargaining over the terms of their contract with the company. And it is one such contract, in the context of banking that between the bank and those to whom the bank lends, that takes us to

[53]ibid, 146.

[54]See, generally, J. Armour, 'Shareholder Rights' (2020) 36(2) *Oxford Review of Economic Policy* 314.

[55]For example, UK listed companies must produce a half-yearly financial report. See Financial Conduct Authority, Disclosure Guidance and Transparency Rules 4.2.

[56]The shareholders' entitlement to sell her shares comes to the fore when there is a hostile takeover. The UK regime allows the target company's shareholders to decide whether to accept or reject the bid, and it does so by preventing the target company's management from frustrating the bid. See The Panel on Takeovers and Mergers, *The City Code on Takeovers and Mergers* (13th edn, 2021), General Principle 3. For a discussion of UK takeover regulation and the primacy it gives to shareholder interests, see D. Kershaw, *Principles of Takeover Regulation* (Oxford: OUP, 2016), Chapter XI, 'Hostile Takeovers and the Non-Frustration Rule'. On the role of the UK's Takeover Code pre-crisis, see A. Dignam, 'The Future of Shareholder Democracy in the Shadow of the Financial Crisis' (2013) 36 *Seattle University Law Review* 639, 645.

[57]Model Articles for Public Companies, Companies (Model Articles) Regulations 2008 No.3229, Art. 20, Sched 3.

[58]Companies Act 2006, s 168 and s 303.

[59]Dividend distributions require the approval of the general meeting as do other transactions where the size of the transaction exceeds a threshold. On the former, see Model Articles for Public Companies, Companies (Model Articles) Regulations 2008 No.3229, Art. 70, Sched 3; on the latter, see UK Listing Rules LR 10.

[60]Companies Act 2006, s 172(1).

[61]Companies Act 2006, ss 260–63.

secured transactions law. We turn to that area of law in a moment. Before doing so, consider first the shadow cast over it by insolvency law.

Before the Enterprise Act 2002, in the UK the right of secured creditors to appoint an administrative receiver in the event of the debtor breaching the lending agreement allowed the secured creditor to control formal insolvency procedures.[62] The receiver would take control of the debtor's business and had the power to sell its assets; their objective was to maximise the value of these assets for the benefit of the secured creditor alone. The Enterprise Act largely abolishes receivership.[63] In its place, the Act channels formal insolvency proceedings towards administration, a procedure controlled by an administrator who must pursue a hierarchy of objectives: to save the company if that is possible; if it is not possible, to achieve a better outcome for creditors as a whole than the outcome of liquidation; and, if that is not possible, to sell the secured assets for the benefit of secured and preferential creditors.[64] From a secured creditor perspective, then, administration is not necessarily advantageous because the administrator (not the secured creditor) runs the rescue operation and must consider the interests of all creditors (and not only secured creditors).[65]

But formal insolvency is not the only option at the disposal of secured creditors such as banks in response to financially distressed debtors, and it is possible that the changes to formal insolvency procedures noted above may have encouraged banks to place greater emphasis on pre-insolvency options.[66] Such options – including the option of informal business rescue – follow from secured transactions law. When the bank registers a valid security interest in an asset of equivalent value to the loan, doing so gives it two advantages: priority of payment and influence over what the borrower may do with the asset that is used to secure the loan.[67] With respect to the latter, for example, the bank may prevent the borrower from selling the asset, an advantage reinforced by terms the bank may add to the lending agreement to further control and monitor the borrower.[68] And 'events of

[62]A.J. Walters, 'Statutory Erosion of Secured Creditors' Rights: Some Insights from the United Kingdom' (2015) *University of Illinois Law Review* 543, 560–61. See also J. Armour, A. Hsu and A. Walters, 'Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002' (2008) *European Company and Financial Law Review* 148. For the rest of this paragraph, the terms 'administrative receiver' and 'administrative receivership' will be shortened to 'receiver' and 'receivership'.

[63]But see Walters n 62 above, at 564–65, where Walters notes that a secured creditor may still appoint a receiver if the charge was created before 15 September 2003.

[64]Insolvency Act 1986, Sched B1, para 3(1).

[65]Note, however, that secured creditors do have the power to appoint the administrator – see ibid, Sched B1, s 14(1), (2). And secured creditors may veto the choice of administrator where the appointment is made by the debtor – see ibid, Sched B1, ss 26(1) and 36. See Walters n 62 above, 565.

[66]See Walters n 62 above, 565–68; Armour, Hsu and Walters, n 62 above, 156–57.

[67]J. Armour, 'The Law and Economics Debate About Secured Lending: Lessons For European Lawmaking?' (2008) 5 *European Company and Financial Law Review* 3, 4–5.

[68]ibid, 7–9. See also R.E. Scott, 'A Relational Theory of Secured Financing' (1986) 86 *Columbia Law Review* 901, 916 and 946; and J. Day and P. Taylor, 'The Role of Debt Contracts in UK Corporate Governance' (1998) 2 *Journal of Management and Governance* 171, 174–5.

default' as set out in the lending agreement's default clause – for example, if the borrower fails to keep up with repayment commitments or breaches covenants – reveal the full extent of the lender's options. In these circumstances the bank may accelerate repayment of the loan; or, if it has a fixed charge, it may enforce its security interest by realising the value of charged property; or, if permitted to do so by the terms of the lending agreement, the bank may charge additional interest or levy extra fees; and it may in addition to these charges, or as an alternative to them, refer the distressed borrower to its turnaround division, a form of informal business rescue that we explore later.

Common equity absorbs, and secured lending protects against, financial loss. Corporate law and secured transactions law buttress these pillars of financial support by allocating decision-making authority to shareholders and to lenders. Notice, however, the Hohfeldian insight: that these allocations of authority correspond to the absence of, or limits to, the choices available to others. A lending agreement favourable to the lender allows it to benefit from terms and conditions which curtail the extent to which the borrower may use the money lent as she sees fit; similarly, when shareholders buy shares they acquire legal entitlements – to elect or to remove directors, for example – that check the scope of corporate management to use the company's assets as they see fit. Given these advantages and corresponding disadvantages, what is to stop the empowered party – shareholders, secured lenders – from using their advantages to withhold and to set terms of access that further their own interests at the expense of the less empowered party?

That question matters even more when interests conflict. As we now document, the example of RBS after 2008 saw a range of interests in tension with each other: the interests of the Treasury as RBS's largest shareholder clashed with RBS's lending commitments to households and businesses; and the interests of RBS as a secured creditor clashed with the needs of viable SMEs in temporary financial difficulty. As the next two sections show, the allocations of decision-making authority by corporate law and secured transactions law steered these conflicts in ways favourable to the short-term financial interests of shareholders and creditors yet detrimental to small businesses and inclusive, stable economic development.

## The Recapitalisation of RBS

### *The 'fundamental tension' and the government's priorities*

In its 2007 annual report RBS boasted about its 'Global Bank of the Year 2007' award.[69] Following its acquisition of the Dutch bank, AMN AMBRO, it was one

[69]RBS, *Annual Report 2007* (2007) 4. The award was made by *The Banker* magazine.

of the largest banks in the world by market capitalisation.[70] Global Banking & Markets, RBS's investment banking division, led the bank's growth in the years up to 2007.[71] Like other banks before the crisis, Global Banking & Markets prioritised 'securitised' credit, the collateralised debt obligations and credit default swaps later made infamous by the crisis.[72] The former were structured out of US mortgages. When the US housing market collapsed and borrowers could not make mortgage payments, RBS held collateralised debt obligations that might be worth little or nothing.[73] Other banks were similarly situated.[74]

In these circumstances, the UK government worried about 'the risk of one bank collapsing and taking all the others';[75] Alisdair Darling, the Chancellor of the Exchequer, feared that such an event would cause 'terrible collateral damage … to our economy';[76] to avoid that damage, Darling considered it 'vital … to prevent a complete collapse of the financial system'.[77] To avert that outcome, the government's Bank Recapitalisation Scheme invested £37 billion into the UK banking sector. RBS received £20 billion in return for which the Treasury acquired a 58 per cent shareholding. In the worsening economic situation of the months which followed, the Treasury injected further capital into RBS taking its shareholding to 84 per cent. Full nationalisation might have followed but for the introduction of the Asset Protection Scheme (APS), under which the Treasury protected RBS against further losses by insuring £282 billion worth of assets.[78]

These numbers are eye-popping. In response, during 2008–09 the government tried to 'provide assurances to the public that the banks face a quid pro quo in return for Government money'.[79] For example: the government insisted on the departure of RBS's chief executive and other top officials;[80] the APS placed some of the losses solely with the recipient banks and imposed on these banks tens of millions of pounds worth of mortgage and business lending commitments;[81] the European Commission approved this state aid on the condition that banks like RBS reduce their size and market

[70]Ian Fraser, *Shredded, Inside RBS* (Edinburgh: Berlinn, 2014) xv.
[71]Financial Services Authority, *Report on the Failure of RBS* (December 2011) at [13] and [18].
[72]ibid at [269–280].
[73]ibid at [245] and [250].
[74]See A. Turner, *The Turner Review: A regulatory response to the global banking crisis* (March 2009). For a full discussion of the lead up to the crisis, see A. Tooze, *Crashed* (Penguin Books, 2018), 42–90.
[75]A. Darling, *Back From the Brink* (London: Atlantic Books, 2011) 142.
[76]ibid, 119.
[77]ibid, 142.
[78]See National Audit Office, n 17 above. For information on changes to the number of RBS shares held by the Treasury, see National Audit Office, *Maintaining Financial Stability Across the UK's Banking System* HC 91 (2009–10) 22 and 37.
[79]Treasury Committee, *Banking Crisis: Dealing with Failure of UK Banks* HC 416 (2008–09) at [154].
[80]See Royal Bank of Scotland plc, 'Raising Capital', press release, 13 October 2008. Available at https://investors.rbs.com/~/media/Files/R/RBS-IR/corporate-actions/placing-and-open-offer-october-2008/rbs-news-2008-10-13-general-announcements.pdf
[81]National Audit Office, n 17 above.

share;[82] and the government applied a bonus tax and a bank levy to all banks.[83] So it would be unfair to follow one MP's assessment of the Treasury as 'squeamish and sensitive about the banks; you touch them with a feather duster'.[84] But although the Treasury did not touch banks like RBS with a 'feather duster', its approach was tempered by what one prominent Treasury official referred to as 'a fundamental tension'.[85]

Tempering the severity of the conditions imposed by the government was the government's simultaneous desire that RBS 'build [its] capital base up',[86] to 'conserve … protect … strengthen [its] capital and improve [its] balances sheets',[87] because otherwise it was unlikely that the Treasury would 'get our money back from the banks'.[88] The details of the government's support package in October 2008 made it clear that '[t]he government is not a permanent investor in UK banks'.[89] In early 2009, Alistair Darling reaffirmed that objective, yet also publicly recognised the need to get the banks lending again.[90] Observing these conflicting pressures in 2009, the Treasury Select Committee expressed concern 'about the contradictions of the Government's objectives for the banking sector' because, the Committee continued, 'there is an inherent conflict between ensuring that the banks maintain high capital ratios, protecting the taxpayer interest and wanting the banks to increase lending levels'.[91] To address these contradictions, the Committee recommended that the government 'clarify its strategic objectives and priorities'.[92] So, what end did the government prioritise?

## *UK Financial Investments Ltd*

The government's priority emerges from the arrangements through which it implemented its support package. As we saw a moment ago, RBS was

[82] See HM Treasury, *RBS and the Case for a Bad Bank: the Government's Review* (November 2013) 131–33.

[83] The bonus tax was introduced in December 2009 by then Chancellor of the Exchequer, Alistair Darling. It was a one-off tax and applied to individual discretionary bonuses above £25,000. The bank levy was introduced by the Coalition Government in 2011 and remains in place today. For more information on both the bonus tax and the bank levy, see A. Seeley, 'Taxation of Banking', House of Commons Library, Briefing Paper No. 05251 (5 January 2018).

[84] A. Mitchell, Committee of Public Accounts, *HM Treasury*: *the Asset Protection Scheme* HC 785 (2010–12) Q 85.

[85] Evidence of N. Macpherson (Permanent Secretary, HM Treasury), Committee of Public Accounts, *HM Treasury*: *the Asset Protection Scheme* HC 785 (2010–12) Q 57.

[86] S. Barclay, Committee of Public Accounts, *HM Treasury: the Asset Protection Scheme* HC 785 (2010–12) Q 126.

[87] R. Bacon, Committee of Public Accounts, *HM Treasury: the Asset Protection Scheme* HC 785 (2010–12) Q 162.

[88] Evidence of Macpherson, n 85 above, Q 57.

[89] Treasury press release, 13 October 2008: https://www.theguardian.com/business/2008/oct/13/creditcrunch-banking

[90] Evidence of A. Darling (Chancellor of the Exchequer), Treasury Committee, *Banking Crisis* HC 144-I (2007–08) Q 2844.

[91] Treasury Committee, *Banking Crisis: dealing with failure of UK banks* HC 416 (2008–09) at [155].

[92] ibid.

recapitalised rather than nationalised. The government had opted for the latter alternative after the collapse of Northern Rock and Bradford & Bingley. Yet in the case of RBS it opted against nationalisation – and, in the years after 2008, a range of other alternatives[93] – because, as a senior government official observed, 'there are serious advantages in having other shareholders'.[94] Having other shareholders, the official explained, 'helps with the commercial management of the bank'; nationalisation, by contrast, would make 'exit … significantly more difficult and significantly more prolonged'.[95]

One consequence of the government's decision to favour recapitalisation was that RBS remained subject to corporate law.[96] As we have seen, UK corporate law makes management accountable to shareholders, its rules and procedures designed to align director decision-making with shareholder interests, its objectives furthered by shareholders monitoring directors. Post-crisis, commentators assumed that the failure of banks like RBS 'would have been tackled more effectively had there been more vigorous scrutiny and engagement by major investors'.[97] The logic of that position supposes that, if shareholders ought to monitor corporate boards, and if corporate boards have failed, then the solution to this problem of corporate governance is greater shareholder engagement.[98] Now, it may be that in general asking

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[93]The government could have: behaved as an active owner to transform RBS into a sustainable bank, N. Silver, 'Towards a Royal Bank of Sustainability: protecting taxpayers' interests; cutting carbon risk' (2009) *Platform London*; reformed RBS into a Green Investment Bank, J. Leaton, 'A Bank for the Future: Maximising public investment in a low-carbon economy' (2010) *Global Justice Now*; converted RBS into a small business lender (an option suggested by the Business Secretary, Vince Cable), G. Parker, E. Rigby, C. Giles and S. Goff, 'Cable calls for RBS break-up to boost business lending' 7 March 2012 *Financial Times*; given its shares in RBS to the public for free (an option also suggested by Cable), P. Jenkins and G. Parker, 'Cable revives RBS privatisation plan' 6 February 2013 *Financial Times*; turned RBS into a network of 130 local banks, L. Macfarlane, 'Taking control of RBS: People-Powered Banking that puts Community's First' (2016) *New Economics Foundation*. On the last option, see also Christine Berry, 'Towards a People's Banking System' in L. Macfarlane (ed.) *New Thinking for the British Economy* (openDemocracy, 2018) 100.

[94]Evidence of J. Kingman (Chief Executive, UKFI), Treasury Committee, *Banking Crisis* HC 144-I (2007–08) Q 2603.

[95]ibid.

[96]P. Langley, *Liquidity Lost: The Governance of the Global Financial Crisis* (Oxford: OUP, 2015) 93. For general discussion of the consequences for minority shareholders when the state is the controlling shareholder, see E.W.K Lim, 'Concentrated Ownership, State-Owned Enterprises and Corporate Governance' (2021) 41(3) *Oxford Journal of Legal Studies* 663. For discussion of corporate law in relation to the state as controlling shareholder in the context of the US response to the 2008 crisis, see S.M Davidoff, 'Uncomfortable Embrace: Federal Corporate Ownership in the Midst of the Financial Crisis' (2011) 95 *Minnesota Law Review* 1733; and J.W. Verret, 'Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice' (2010) 27 *Yale Journal on Regulation* 283.

[97]D. Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: final recommendations* (2009) at [5.11].

[98]C.M. Bruner, 'Corporate Governance Reform in a Time of Crisis' (2011) 36(2) *The Journal of Corporation Law* 309, 320. As Bruner discusses from 329, the Stewardship Code encouraged shareholders to provide that oversight. The Financial Reporting Council introduced the first version of the Stewardship Code in 2010 and then a revised version in 2012. These early versions of the Code have been widely criticised for failing to increase levels of shareholder engagement. See, for example, A. Reisberg, 'The UK Stewardship Code: On the Road to Nowhere?' (2015) 15(2) *Journal of Corporate Law Studies* 217. Following the Kingman Review, the Financial Reporting Council introduced a significantly altered Code in 2020. For a discussion of the different versions of the Code, see P. Davies, 'The UK Stewardship Code 2010–

shareholders to serve as 'stewards' was and is asking the impossible.[99] But some shareholders do engage. What follows from that engagement?

One possibility is illustrated by UK Financial Investments (UKFI), the company created by the Treasury in late 2008 to hold its shares in RBS.[100] Treasury officials expected UKFI to act 'as an engaged, informed, responsible shareholder'.[101] But engagement to what end? According to its mandate, UKFI's objective was to manage the government's investments 'commercially, and with a view to achieving an exit'.[102] UKFI could achieve exit and discharge its mandate only if investors decided to buy RBS's shares, and investors would do that only if they valued RBS's shares as a worthwhile investment, as an investment with an expected rate of return more attractive than the alternatives.[103]

From the perspective of investment analysts, judging expected rates of return and levels of profitability calls for '[t]hinking as an investor'.[104] So thinking cultivates 'the investor's gaze',[105] a gaze felt by RBS's mangement since to influence the attractiveness of RBS's shares they had 'to generate returns on equity that will ultimately lead to dividends for shareholders'.[106] In other words, RBS's management had to confront the bargaining power of prospective investors. In Robert Hale's terminology, these investors had the capacity to withhold: they could refuse to buy RBS's shares – and keep

2020: From Saving the Company to Saving the Planet? (2020) European Corporate Governance Institute, Law Working Paper No 506/2020 at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3553493

[99]See P. Ireland, 'From Lonrho to BHS: The Changing Character of Corporate Governance in Contemporary Capitalism' (2018) 29(1) *King's Law Journal* 3, 34. See also L. Talbot, 'Why Shareholders Shouldn't Vote: A Marxist/Progressive Critique of Shareholder Empowerment' (2013) 76(5) *The Modern Law Review* 791.

[100]For an early discussion of UKFI that situates it within the government's overall response to the crisis and in relation to the constitution, see J. Black, 'Managing the Financial Crisis – The Constitutional Dimension' (2010) *LSE Law, Society and Economy Working Papers* 12/2010 at https://eprints.lse.ac.uk/32895/1/WPS2010-12_Black.pdf. Other scholarly discussions of UKFI include: E. Engelen et al, *After the Great Complacence: Financial Crisis and the Politics of Reform* (Oxford: OUP, 2011) 192–97; J. Froud, M. Moran, A. Nilsson and K. Williams, 'Wasting a Crisis? Democracy and Markets in Britain after 2007' (2010) *The Political Quarterly* 25, 32–34; J. Glynos, R. Klimeck and H. Willmott, 'Cooling Out the Marks: the Ideology and Politics of the Financial Crisis' (2012) 5(3) *Journal of Cultural Economy* 297, 308–11; and M. Kahan & E.B. Rock, 'When the Government Is the Controlling Shareholder' (2011) 89 *Texas Law Review* 1293, 1354–58.

[101]Evidence of Lord Myners (Financial Services Secretary to the Treasury), Treasury Select Committee, *Banking Crisis* HC 144-I (2008–09) Q 2725.

[102]UK Financial Investments Ltd, *An Introduction: Who we are, what we do, and the framework document which governs the relationship between UKFI and HM Treasury* (2009) 11.

[103]Glynos, Klimeck and Willmott, n 100 above, 297.

[104]F. Muniesa and others, *Capitalization: A Cultural Guide* (Paris: Presses des Mines, 2017), 12. For an example of such thinking, see Association of British Insurers, *Investability of UK Banks* (2012) at https://www.ivis.co.uk/media/5914/ABI-Investibility-of-banks-report-Dec-2012.pdf.

[105]Muniesa, n 104 above, 73.

[106]Evidence of R. Buxton (Head of Equities, Schroders), Treasury Committee, *Disposal of Government Stakes in Lloyds Banking Group and Royal Bank of Scotland* HC 73 (2012) Q 91. According to Ismail Erturk, 'return on equity has become the universal metric to measure financial performance in all publicly listed banks … ', I. Erturk, 'Financialization, Bank Business Models and the Limits of Post-crisis Bank Regulation' (2016) 17 *Journal of Banking Regulation* 60, 63.

RBS's share price depressed – unless RBS's management embraced the investors' perspective and expectations. RBS's management would find that challenging, however, if the bank became a 'political football'.[107] As one investment analyst put it, 'Government ownership is a fact'.[108] It followed from that fact, another analyst explained, that '[t]here is a lot of public interest in what RBS does',[109] '[t]here is a lot of comment by Members of Parliament and by the media'.[110] 'To the extent that the politicisation of the activities of RBS starts to threaten' the bank's commercial best interests, the same analyst continued, 'I think that does pose a threat, which institutional investors are nervous about'.[111] Investors had grounds for feeling nervous. One MP, for example, pointed out to a UKFI official that 'you're our representatives. We own these banks now, and you're the people who make sure the board do things that we would wish'.[112] As the Chairman of the Treasury Select Committee observed, UKFI, on behalf of the government, was 'the cook with 84% … the head chef'.[113] So why not use that position of authority to direct RBS to increase its lending to SMEs or to restrict the size and terms of bonus payments to bankers?

As the 'head chef' with 84 percent of RBS's shares UKFI had the power, if it wished to use it, to control the election and removal of RBS's directors. In these circumstances, what scope is there for minority shareholders to use corporate law to check the majority shareholder? To probe this question, consider *People and Planet v HM Treasury*.

## *People and planet v HM treasury*

In 2009 People and Planet – a social and environmental justice pressure group[114] – sought judicial review of the UK government's investment in RBS on the basis that, as the largest shareholder in RBS, the government ought to mandate UKFI 'to persuade or require' RBS to change its lending practices.[115] According to People and Planet, RBS's lending practices were 'harmful to the environment' and 'insufficiently respectful of human rights'; as such, they contradicted the government's Green

[107]ibid. See also evidence of R. Talbut (Chairman, Association of British Insurers), evidence to Treasury Committee, *Disposal of Government Stakes in Lloyds Banking Group and Royal Bank of Scotland* HC 73 (2012) Q 89.

[108]Evidence of G. Webb (Director, Solid Solutions), Treasury Committee, *Disposal of Government Stakes in Lloyds Banking Group and Royal Bank of Scotland* HC 73 (2012) Q 27.

[109]Evidence of A. Young (Co-Head of Equity Capital Markets Advisory, Rothschild), Treasury Committee, *Disposal of Government Stakes in Lloyds Banking Group and Royal Bank of Scotland* HC 73 (2012) Q 25.

[110]ibid.

[111]ibid, Q 17.

[112]G. Mudie, question to R. Budenberg (Chief Executive, UKFI), Treasury Committee, *UK Financial Investments* HC 766 (2010–12) Q 84.

[113]J. McFall, question to J. Kingman (Chief Executive, UKFI), Treasury Committee, *UK Financial Investments* HC 1090-I (2009) Q 13.

[114]https://peopleandplanet.org/

[115]*People and Planet* v *HM Treasury* [2009] EWHC 3020 (Admin) at [5].

Book.[116] That document lays down the standards that central government must adhere to when making decisions, and requires that government departments have regard to the environmental impact and human rights implications of their decisions.[117] The Treasury had reasoned that RBS's board would weigh up environmental and human rights considerations when meeting their directors' duties under s.172 of the Companies Act, which requires the board of directors 'to promote the success of the company for the benefit of its [shareholders] as a whole, and in doing so to have regard (amongst other matters) to … (d) the impact of the company's operations on the community and the environment'.[118] Based on this reasoning, the Treasury could then claim that its own decision to defer to the RBS board met the requirements of the Green Book.[119]

People and Planet saw the Treasury's approach as too deferential to the board of RBS. It reasoned that, if the UK government wished to adhere to the Green Book, then it must alter UKFI's mandate, replacing UKFI's commercial approach with an interventionist approach to impose 'its own policy in relation to combating climate change and promoting human rights on the Board of RBS'.[120] But Sales J feared that such an approach 'would have a tendency to come into conflict with, and hence would cut across, the duties of the RBS Board as set out in s.172(1)'.[121] If under UKFI direction the directors of RBS promoted environmental and human rights considerations ahead of the interests of the bank's other shareholders, then, Sales J continued, there was the 'real risk of litigation by minority shareholders seeking to complain that the value of their shares had been detrimentally affected by the Government seeking to impose its policy on RBS'.[122]

*People and Planet v HM Treasury* is instructive in two respects. First, and as Lorraine Talbot has observed, Sales J interpreted s.172 instrumentally: directors may consider other interests but 'only insofar as they promote the interests of shareholders, not as independent governance goals'.[123] So reading s.172 reinforces the sense that, as RBS's own CEO put the point in January 2010, 'as with all boards, the Board of RBS has a legal duty under companies law to shareholders'.[124] And, by privileging the interests of shareholders, such a reading of s.172 curtails the extent to which company directors may prioritise other considerations ahead of the interests of the company's

[116]ibid at [5] and [9].
[117]https://www.gov.uk/government/collections/the-green-book-and-accompanying-guidance-and-documents
[118]Companies Act 2006, s 172(1).
[119]*People and Planet v HM Treasury*, n 115 above at [18].
[120]ibid at [34].
[121]ibid at [34].
[122]ibid.
[123]L. Talbot, *Progressive Corporate Governance* (Routledge, 2013) 170.
[124]Evidence of S. Hester (Chief Executive Officer, RBS), Treasury Committee, *Royal Bank of Scotland, Northern Rock and Lloyds Banking Group* HC 259-I (2010) Q 21.

shareholders, considerations such as those not mentioned in *People and Planet* but which nonetheless fed the 'fundamental tension'[125] over what to do with RBS, such as 'the likely consequences of any decision in the long term' or 'the need to foster the company's business relationships with suppliers, customers and others'.[126]

Second, Sales J emphasised the interests of minority shareholders and by so doing emphasised that directors must promote the success of the company for the benefit of shareholders as a whole.[127] It follows that directors must determine the collective interest of the company's shareholders even when controlling shareholders urge the company to prioritise other considerations. If directors fail to do so, then minority shareholders may have grounds to bring a derivative action on behalf of the company or to petition the courts for relief from 'unfair prejudice'.[128] As is well documented, the successful use of these remedies in the UK by shareholders in public companies is very rare.[129] Yet UKFI was RBS's dominant shareholder in the years after 2008. In this context, Sales J took the threat of litigation to be a 'real risk';[130] press reports indicate that government ministers shared that concern.[131] And perhaps these fears explain why UKFI did not give RBS's minority shareholders cause to litigate: not only did UKFI respect its mandate and 'the overall context set by the Companies Act that directors have a duty to promote the success of the company for the benefit of its shareholders as a whole';[132] it also regarded its 'investment mandate [as] king',[133] and so channelled its efforts into reassuring existing and attracting future investors. It is to these efforts that we now turn.

[125]Macpherson, n 85 above, Q 57.

[126]Companies Act 2006, s 172(1) (a) and (c).

[127]The *FT's* Andrew Hill put the same point more colourfully at around the same time: speaking of RBS's directors, he wrote, 'Their duty is to represent all shareholders, not just the ones with nuclear weapons'. A. Hill, 'RBS and the government: how to defuse the tension' 2 December 2009 *Financial Times*.

[128]For derivative actions, see Companies Act 2006, ss 260–63; for unfair prejudice petitions, see Companies Act 2006, ss 994–96.

[129]J. Armour, 'Enforcement Strategies in UK Corporate Governance: a roadmap and empirical assessment' in J. Armour and J. Payne (eds), *Rationality in Corporate Law: Essays in Honour of Dan Prentice* (Hart Publishing, 2009) 71.

[130]*People and Planet v HM Treasury*, n 95 above at [34].

[131]See K. Stacey and S. Goff, 'Ministers weigh up buying out RBS shares' 1 August 2012 *Financial Times*, claiming that '[s]ome at the top of government' had considered 'directing the bank to increase lending to companies' but feared that so doing 'would be open to legal challenge by the remaining shareholders'. Post-crisis, RBS shareholders did litigate in another context, doing so under securities law to allege that RBS misled investors when it issued new shares in the first half of 2008. See M. Moore, 'Redressing Risk Oversight Failure in UK and US Listed Companies: Lessons from the *RBS* and *Citigroup* Litigation' (2017) 18 *European Business Organization Law Review* 733. RBS reached a settlement with investors in June 2017.

[132]UK Financial Investments Ltd, n 102 above, 10.

[133]Evidence of G. Moreno (Acting Chairman, UKFI), Treasury Committee, *Banking Crisis* HC 144-I (2009) Q 2573.

### UKFI as a 'firebreak'

UKFI managed the shares it held in RBS on a commercial basis, and so did 'not intervene in day-to-day management decisions'[134] to give 'the Board [of RBS] the commercial freedom' to adhere to its business plan.[135] Its officials rejected the impression created by the size of its shareholding that it was like a private equity investor or a venture capitalist. These types of investors would insist on a seat at the board; and they might start to issue directions, 'Fire those people. Cut his pay. Close that office'.[136] UKFI's strategy, by contrast, was 'more like a very engaged shareholder',[137] which would have a 'polite, if intense, conversation'[138] with the board of RBS if necessary, but which would otherwise convey to current and prospective investors that it really did operate 'at arm's length from Government'.[139] In 2009 UKFI held 'more than 80 investor meetings'[140] at which it emphasised its independence from the government to 'help address any misunderstandings or fears about possible non-shareholder-oriented goals that we, as a Government-related entity, might be perceived to have'.[141] To further reassure investors, UKFI had a 'heavyweight board' composed of one Treasury official surrounded by 'senior City figures … with experience of delivering shareholder value'.[142] These efforts had impact: in 2012 one investment analyst described UKFI 'as a firebreak';[143] as such it served as a protective shield to take the heat out of contentious issues.

As an example of UKFI as a firebreak, consider the mortgage and business lending commitments undertaken by the banks participating in the Asset Protection Scheme.[144] RBS had agreed to £25 million of lending in the first

[134]UK Financial Investments Ltd, n 102 above, 15.
[135]ibid, 19.
[136]Evidence of Moreno, n 133 above, Q 2618. See also evidence of J. O'Neil (Chief Executive, UKFI), Treasury Committee, *UK Financial Investments Ltd Annual Report and Accounts 2011–12* HC 672 (2012) Q 72.
[137]Evidence of Moreno, n 133 above, Q 2618.
[138]ibid.
[139]UK Financial Investments Ltd, n 102 above, 9.
[140]Written evidence of UK Financial Investments Ltd, Treasury Committee, *UK Financial Investments Ltd* HC 1090-I (2009). See also evidence of J. Kingman (Chief Executive, UKFI), Treasury Committee, *UK Financial Investments Ltd* HC 1090-I (2009) Q 81.
[141]UK Financial Investments Ltd, *UKFI Strategy: Market Investments and Annual Report and Accounts 2008/09* (2009) 20.
[142]Engelen et al, n 100 above, 193. Consider the UKFI Board as of early 2009 and the past ties of each member to one or more financial institution: Glen Moreno (Citigroup and Fidelity); Peter Gibbs (Merrill Lynch); Michael Kirkwood (Citigroup and HSBC); Philip Remnant (Credit Suisse, BZW, and Kleinwort Benson); and Lucinda Riches (Chase Manhattan, Warburg, and UBS). The Board at that time included two Treasury officials, John Kingman and Louise Tulett. See UK Financial Investments Ltd, n 140 above, 3–6. Kingman served as UKFI's Chief Executive from 2008–2010. On leaving UKFI he worked for Rothschilds (2010–2012) and has been Chairman of Legal & General since 2016. Robin Budenberg replaced Kingman as UKFI's Chief Executive in 2010 and served in that role for two years and then as Chairman for two years. He had previously worked for UBS. In January 2021, he became Chairman of Lloyds Banking Group.
[143]Evidence of Young, n 109 above, Q 25.
[144]For a discussion of the government's efforts to encourage bank lending more generally post 2008, see H. Macartney, 'From Merlin to Oz: The Strange Case of Failed Lending Targets in the UK' (2014) 21(4) *Review of International Political Economy* 820.

year of the Scheme – the government's hope was that such lending would support the wider economy in the midst of a recession.[145] Yet RBS failed to meet its business lending commitment for 2009-10, receiving more in repayments than it contributed in new lending.[146] In response, the Treasury could have sanctioned RBS: it had various options at its disposal – ranging from fines and penalties to naming-and-shaming to more novel options[147] – but it decided against applying any of them because RBS 'had failed to meet the commitments due to a fall in demand, which was beyond their control'.[148] In public, UKFI downplayed its influence over these lending commitments, stressing that '[t]he conditions that are attached to the Asset Protection Scheme are entirely a matter for the Treasury'.[149] In the background, however, it did provide 'quite a lot of advice'[150] both to the participating banks and to the government: with senior management of the former it discussed 'on a regular basis … [how] to make sure that they're undertaking those commitments in a way that is consistent with shareholder value';[151] with the latter it discussed 'what would be the impact of various scenarios in the government's investment on the value of the shares the government held'.[152] In other words, if RBS met lending commitments by lending 'uncommercially', or if the government sanctioned RBS for missed lending commitments, then UKFI would respond by enquiring, 'With what consequences for share price?'

Asking that question, 'to speak up [for] … shareholder value',[153] did not always prevent government decisions from negatively affecting bank share prices – ring-fencing[154] and bonus payments[155] present two examples – but the view of UKFI officials, one they felt was 'supported by most market participants',[156] was that UKFI had 'a particular role' and was 'seen to play

[145]National Audit Office, n 17 above, 27–31.
[146]ibid, 29.
[147]ibid, 31. Other possible sanctions included: linking CEO remuneration to fulfilling lending commitments; requiring the bank to transfer its lending shortfall to another lender by, for example, transferring an existing capital investment fund; and prohibiting the bank from bidding for government contracts.
[148]ibid, 30.
[149]Evidence of J. Kingman (Chief Executive, UKFI), Treasury Committee, *Banking Crisis* HC 144-I (2009) Q 2569.
[150]Evidence of Kingman, n 140 above, Q 6.
[151]Evidence of R. Budenberg (Chief Executive, UKFI), Treasury Committee, *UK Financial Investments* HC 766 (2011) Q 38.
[152]Evidence of Kingman, n 140 above, Q 6.
[153]Evidence O'Neil, n 136 above, Q 25
[154]ibid. See also evidence of S. Hester (Chief Executive Officer, RBS), Parliamentary Commission on Banking Standards, *Changing Banking for Good* HC 175-III (2013–14) Q 4193.
[155]See, for example, evidence of Buxton, n 106 above, Q 91; evidence of J. O'Neil (Chief Executive, UKFI), Treasury Committee, *UK Financial Investments Ltd 2012* HC 1896 (2012) Q 120; A. Bolger, 'Hester bemoans "politicised" bonuses' 16 December 2009 *Financial Times*; M. Murphy and S. Goff, 'RBS pay-out faces intense scrutiny' 13 January 2012 *Financial Times*.
[156]Evidence of R. Budenberg (Chairman, UKFI) Treasury Committee, *UK Financial Investments Ltd Annual Report and Accounts 2011–12* HC 672 (2012) Q 5.

that role in the most effective way possible'.[157] Its absence would leave '[t]he biggest question mark … in the minds of other investors', namely, 'whether they would feel that the banks are going to be run based on their commercial best interests'.[158] If that question weighed on the minds of investors then, UKFI acknowledged, it would be hard for the government to find that 'whole range of new investors' it needed to sell its shares.[159] But in 2012 the perception amongst investment analysts was that UKFI had 'done a very, very good job out of a difficult situation',[160] for, as one analyst explained, 'if you look at the major strategic decisions that have been made by RBS over the course of the last few years … I think the market believes, correctly, that those were all strategic decisions that were taken because they were the right commercial thing to do for RBS management and for RBS shareholders'.[161]

## *RBS's 'strategic restructuring plan'*

As a successful firebreak UKFI created space for RBS to operate on a commercial basis. How then did RBS's board use that commercial freedom? In 2009 the bank's new CEO, Stephen Hester, observed that '[i]t is only if we restore shareholder value—crudely, getting the share price up and creating conditions where investors want to buy our shares—that … the government can sell its shares to willing investors at a profit'.[162] Hester later added 'we obviously won't consider our job at RBS to be successful until we're finally paying dividends again';[163] as the Treasury observed, paying a dividend again would 'over time make RBS shares more attractive to external investors and accelerate the bank's return to the private sector'.[164] Paying a dividend, Hester explained, depended on RBS's 'ability to A, generate profits, and B, stop spending them on the clean-up'.[165] The bank referred to its clean-up as its 'strategic restructuring plan'.[166] Given the scale of the financial crisis in 2008, in its aftermath many other banks around the world faced the same challenge of revaluing assets and absorbing losses. Their responses to that challenge are examples of what Brett Christophers describes as

[157]ibid.
[158]ibid, Q 11.
[159]ibid.
[160]Evidence of Young, n 109 above, Q 25.
[161]Evidence of M. Costello (Managing Partner, Banks Research, Autonomous), Treasury Committee, *Disposal of Government Stakes in Lloyds Banking Group and Royal Bank of Scotland* HC 73 (2012) Q 28.
[162]Evidence of Hester, n 124 above, Q 25. The view echoes that of Sir Philip Hampton, RBS's Chairman. See RBS, *Annual Results for the year ended 31 December 2011* (2011) iv.
[163]S. Hester (Chief Executive Officer, RBS), Analysts Presentation, 2012 Q1 IMS, 4 May 2012.
[164]HM Treasury, n 82 above, 3. See also RBS, *Annual Report and Accounts 2008* (2008) 2; and Association of British Insurers, *Investability of UK Banks* (2012) 11.
[165]Hester, n 163 above.
[166]RBS, n 164 above, 5.

'asset vigilance', of banks scanning their balance sheet in search of asset quality and asset margin.[167] How banks did this in the aftermath of 2008 prompted the consultancy firm, McKinsey, to publish in 2012 *Good riddance: Excellence in managing wind-down portfolios*.[168] The report draws on McKinsey's 'experience with several of these institutions and on interviews with leading executives to collect, develop, and validate the actions and principles that managers of wind-down portfolios are using today to find success'.[169] So, by what actions and principles did banks find success?

The bank first had to identify its 'weak assets',[170] what Hester referred to as RBS's 'unwanted assets'.[171] These were to be segregated from the rest of the bank's assets via structures named 'wind-down divisions', 'legacy assets', 'collection bank', 'value bank'; McKinsey's report preferred the term 'bad banks';[172] RBS settled on 'non-core division'.[173] Once the bank had identified these weak assets and segregated them, '[t]he essential question is whether to hold assets until maturity or sell them, and if they are to be sold, how quickly?'[174] Both a 'rapid wind-down' and a 'leisurely wind-down' had their advantages and disadvantages.[175] Whether a bank opted for one or the other was conditioned by the 'funding climate in which it operates', which was in turn conditioned by the willingness of private shareholders and government 'to shoulder additional borrowing for many years, … [and] support the funding of its bad banks over the long term'.[176] Neither the UK government nor RBS's board was willing to shoulder the burden of such support; instead, their interests converged on the government selling its shares in RBS as soon as possible, a consensus shared by investors[177] and one which steered RBS toward 'rapid wind-down'. RBS's strategic restructuring plan anticipated in 2008 that it would take three to five years 'to run off or dispose of' the 'unwanted assets' in its non-core division.[178]

[167]B. Christophers, *Rentier Capitalism: Who Owns the Economy, and Who Pays for It?* (London: Verso, 2020) 50.
[168]S. Aggarwal et al, 'Good riddance: Excellence in managing wind-down portfolios' (April 2012) McKinsey Working Papers on Risk, Number 3, at https://www.mckinsey.com/business-functions/risk-and-resilience/our-insights/good-riddance-excellence-in-managing-wind-down-portfolios
[169]ibid, 1.
[170]ibid.
[171]Evidence of Hester, n 124 above, Q 86.
[172]Aggarwal et al, n 168 above, 1.
[173]RBS, n 164 above, 5.
[174]Aggarwal et al, n 168 above, 5.
[175]ibid. A 'rapid wind-down' removes the assets from the bank's balance sheet but at the cost of accepting a discount on their price; a 'leisurely wind-down' avoids that discount but at the risk of the asset values declining further.
[176]ibid.
[177]According to one analyst '[t]he overhang or the presence of a single Government shareholder owning over 80% of the shares is an inhibiting factor on other commercial organisations wanting to own shares in the company', evidence of Talbut, n 107 above, Q 92.
[178]RBS, n 164 above, 5.

Once the bank had decided on its wind-down strategy, it could then allow its workout unit to begin renegotiating loan terms with borrowers. The McKinsey report singles out RBS's restructuring plan and its implementation, offering it as an example for others to follow, even interviewing Rory Cullinan, the head of RBS's non-core division.[179] In 2010 Stephen Hester, while acknowledging that RBS faced the 'biggest and most complex bank or company restructuring in history', added '[s]o far I have been incredibly pleased by how well it has gone'.[180] Two years later investment analysts reiterated that sentiment, one observing that '[t]he progress that [the board of RBS] have made on their strategic plan has been very impressive so far. I think there has been an enormous reduction in the non-core assets, which has been ahead of plan and within their guideline of losses expected'.[181] In his 2014 book, *Shredded, Inside RBS*, Ian Fraser noted that '[t]he shrinkage that occurred under Stephen Hester was impressive'. He then adds, 'but it came at a huge cost in terms of the destruction of whole swathes of the UK's small and medium sized enterprise base … '.[182] The next section turns to these huge costs and the SMEs who bore the burden of them.

## GRG's 'widespread inappropriate treatment' of SMEs

### *Turnaround objectives and commercial objectives*

The government's support package of 2008-09, including the recapitalisation of RBS, had the explicit objective of preventing banks from collapsing to maintain 'support for the real economy' and 'lending in the medium term'.[183] The size of SMEs limits their cash reserves and access to capital markets; to expand and to survive adversity they therefore turn to and are dependent on banks.[184] When the 2008 crisis turned into a recession, viable but financially distressed SMEs turned to their bank for that support. If there is an 'event of default' – if, say, the financially distressed SME fails to honour repayment commitments – the bank might decide to enforce its security by selling the charged property.[185] Alternatively, it might try to revive the fortunes of the struggling business, either through formal

[179]Aggarwal et al, n 168 above, 6.
[180]Evidence of Hester, n 124 above, Q 38.
[181]Evidence of Costello, n 161 above, Q 3.
[182]Fraser, n 70 above, xvii.
[183]See 8 October 2008 press release at https://www.theguardian.com/business/2008/oct/08/creditcrunch.banking1
[184]See R. Davis et al, *Micro, Small, and Medium Enterprise Insolvency: A Modular Approach* (Oxford University Press, 2018), Introduction and Chapter 6, 'The Role and Position of Other Key Stakeholders Interacting with or Affected by the Distressed MSME'.
[185]The lender will typically do so by appointing a Law of Property Act receiver or fixed charge receiver. The former is appointed under statutory powers (Law of Property Act 1925, ss 101(1), 103 and 109); the latter is appointed under an express power contained in the lending agreement.

procedures such as administration, or through informal processes.[186] Earlier we saw that from a bank's perspective administration is not necessarily advantageous because the administrator runs the rescue operation and must consider the interests of all creditors. By contrast, secured creditors such as banks dominate the informal rescue operations conducted within the bank by its turnaround division (or 'business support unit').[187]

Between 2008 and 2013 RBS referred just short of 6,000 SMEs to its turnaround division, the Global Restructuring Group.[188] As the UK's largest lender to SMEs at the time, RBS's referrals covered a broad sample of SMEs the length and breadth of the country. GRG's 'primary aim' was to help these businesses 'return to satisfactory', in other words, restore the troubled business to financial health and return it to the mainstream bank.[189] Yet GRG also had a second objective, described in its mandate as 'to improve [the bank's] position', elsewhere as 'to minimise losses for RBS and to execute effective asset management strategies that demonstrate value'.[190]

That these objectives may sometimes conflict became a matter of public concern in late 2013 when Lawrence Tomlinson, entrepreneur-in-residence at the Department of Business, Innovation and Skills, published a report alleging that GRG 'engineered' the default of SMEs in an attempt to 'make profits for the bank through the destruction of viable businesses'.[191] In response to these allegations, the Financial Conduct Authority appointed Promontory Financial Group to conduct an independent review of GRG.[192] The independent review concluded that, although there was no evidence of deliberately engineered defaults, 'there was widespread inappropriate treatment of customers by GRG';[193] that the vast majority of these businesses were viable and, with the right support, could have been turned around;[194] and 'that in a significant proportion of cases … that treatment appears likely to have caused

[186]Besides formal rescue (administration) and informal rescue (turnaround), Vanessa Finch notes a third possibility, which she labels 'quasi-formal rescue', such as pre-packaged administration. See V. Finch, 'Corporate Rescue: A Game of Three Halves' (2012) 32(2) *Legal Studies* 302.

[187]On 'turnaround' and the so-called 'rescue culture', see V. Finch and D. Milman, *Corporate Insolvency Law: Perspectives and Principles* (Oxford University Press, 3rd ed., 2017), chapter 5, 'Insolvency Practitioners and Turnaround Professionals' and chapter 6, 'Rescue'. See also J. Armour and S. Frisby, 'Rethinking Receivership' (2001) 21(1) *Oxford Journal of Legal Studies* 73, 91–95.

[188]T.T. Arvind, 'Too Big to Care?: Financial Contracts and the Problem of Transactional Asymmetry' (2021) 84(1) *Law and Contemporary Problems* 35, 42.

[189]According to GRG's mandate, it aimed to 'improve … the financial condition of the customer. One of the key metrics for measuring success of GRG is the return of customers [to the mainstream bank]'. Quoted in Clifford Chance LLP, *Independent Review of the Central Allegations Made by Dr Lawrence Tomlinson in Banks Lending Practices: Treatment of Businesses in Distress* (April 2014) at [4.6].

[190]See Financial Conduct Authority, *Report on the Financial Conduct Authority's further investigative steps in relation to RBS GRG* (2019) 22.

[191]L. Tomlinson, *Banks' Lending Practices: Treatment of Businesses in Distress* (November 2013) at http://www.tomlinsonreport.com/docs/tomlinsonReport.pdf. The quotation in the text is from evidence of L. Tomlinson, Treasury Committee, n 21 above, Q 96.

[192]Promontory Financial Group, n 8 above.

[193]ibid at [x].

[194]ibid at [6.2.53].

material financial distress'[195] to such an extent that in numerous cases it contributed to 'a journey towards administration, receivership and liquidation'.[196]

The independent review did not criticise GRG's commercial objective.[197] The problem, rather, was that there could be '[f]undamental conflicts between the underlying objectives of GRG':[198] as the independent review explains, 'in a turnaround context, where the customer is already exhibiting financial distress, such commercial considerations need to be balanced against the need to foster an environment that is conducive to the customer's return to health … '.[199] How, then, might GRG have managed the conflict between its two objectives? What would it have entailed for it to pay regard to the interests of its customers and to have treated them fairly?

### *Navigating turnaround*

If the bank judged the struggling SME viable,[200] as a next step the bank would think about a recovery plan.[201] Such a plan ought to contain 'appropriate objectives and milestones',[202] the achievement of which the bank could help to facilitate by the appropriate use of turnaround tools.[203] The independent review emphasises two such tools: forbearance and new credit. When the bank exercises forbearance it will forego the exercise of its legal entitlements: it might forgive debt, postpone debt payments, or waive additional interest charges or fees. The bank's exercise of forbearance would allow the SME a period of time to, for example, weather a temporary drop in income during a recession or implement changes to its business to return to profitability.[204] Similarly, as the independent review explains, additional credit from the bank would be appropriate 'for example to allow a development to be completed where the evidence indicated that this was the best way forward'.[205]

These turnaround tools serve as examples of the bank loosening what Perry Mehrling calls the borrower's 'settlement constraint', the SME's promise to repay the bank on a specified date.[206] Debt forgiveness waives

[195]ibid at [x].
[196]ibid at [6.2.86].
[197]ibid at [1.37].
[198]ibid at [1.30].
[199]ibid at [3.1.6].
[200]ibid at [4.2.20]. RBS told the independent review that 'the strategy for managing a distressed loan starts with a rigorous assessment of the viability of the business', at [4.2.22].
[201]ibid at [4.2.30-4.2.31].
[202]ibid at [4.2.41].
[203]ibid at [4.3.38-4.3.43].
[204]ibid.
[205]ibid at [4.3.42].
[206]P. Mehrling, 'Financialization and its Discontents' (2017) 3(1) *Finance and Society* 1, 4.

that obligation; postponement and additional credit move it into the future. But there are limits to the bank's capacity to adjust the discipline this constraint exercises on the borrower. The bank has its own payment obligations. Where the bank waives or moves the payment commitment into the future, the bank loses a cash inflow that would otherwise help it to meet cash outflows, such as honouring payments on behalf of depositors. Turnaround divisions must, then, navigate a tension: on the one hand, the essence of turnaround requires that the bank foster an environment conducive to returning SMEs to health, which in turn requires that the bank give the SME time to turn itself around by extending financial support to the SME; yet on the other hand, to extend such support the bank must sacrifice its short-term commercial interests, which in turn requires that the bank pull back from using its legal entitlements as a secured lender.

Whatever the bank decides that the decision lies with it indicates the extent of the bank's legal entitlements and the extent of the borrower's corresponding vulnerability. That power reflects concentration in the banking sector, described by one government minister as 'lots of Davids and four Goliaths'.[207] Most SMEs had little choice but to accept the bank's lending decision: as Robert Hale might have put it, the bank can withhold finance from the SME unless the SME accepts the bank's terms and conditions. That's true of thriving SMEs; 'SME customers facing financial hardship may have even more limited choices' because '[t]hey will often have little realistic prospect of changing their banking arrangements'.[208] Given that SMEs must bargain with the bank, to what extent do rules of law encourage courses of conduct which might check the bank's decision-making authority and guide it to prioritise turnaround?

### *The terms and conditions of the lending agreement*

GRG claimed due regard for the interests of its customers as part of its ethos.[209] To strengthen that claim, in 2010 RBS applied the financial regulator's Treating Customers Fairly (TCF) initiative to all its divisions, including GRG.[210] The regulator had introduced TCF in 2006[211] in an attempt to push financial firms to give greater weight to the fair treatment of retail customers by articulating expected outcomes such as: 'Customers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture'.[212] Since RBS's relationship with commercial borrowers

[207]Evidence of J. Glen (Economic Secretary to the Treasury), Treasury Committee, *SME Finance* HC 805 (2017–2019) Q 264.
[208]Promontory Financial Group, n 8 above, [7.15]
[209]ibid, [2.2.7].
[210]ibid from [4.6.3]. See also Financial Conduct Authority, n 190 above, 30.
[211]Financial Services Authority, *Treating Customers Fairly – Towards Fair Outcomes for Customers* (July 2006) at https://www.fca.org.uk/publication/archive/fsa-tcf-towards.pdf
[212]Financial Conduct Authority, n 190 above, 30.

was (and still is) an 'unregulated activity,' it was not legally required to adhere to TCF outcomes.[213] Yet RBS of its own accord applied TCF to GRG. In December 2010 GRG's Policies and Procedures were drafted accordingly, stating 'TCF is at the heart of how we do business at GRG … Typically, we are dealing with customers who are in distressed circumstances, therefore it is even more important that we deal with our customers fairly and sensitively, as our aim is to return such businesses back to the mainstream Bank'.[214] Such an ethos echoed the expectations of many SMEs, who reportedly 'trusted their bank to act in their interests'[215] on the assumption 'that the bank owed their business a duty of care or would act in good faith'.[216]

Yet because commercial lending falls outside the FCA's jurisdiction, the regulator will not act in response to a failure to meet these standards.[217] In the absence of regulatory oversight, the relationship between the turnaround division and its SME customers is 'mainly governed by the terms and conditions of the commercial contract between them',[218] which in turn entails that SMEs 'must rely … on the [] limited causes of action available under the general law'.[219] The law of contract, for example, might influence the content of the parties' obligations either by policing the substantive fairness of their agreement through implied terms, or by policing procedural fairness in the process of contract formation (or renegotiation) through doctrines like duress. *PAG v RBS*[220] examines the former, *Morley v RBS*[221] the latter; both cases illustrate the limited role of contract in policing the lender's control of the turnaround process.

### *Contractual discretion*

Between 2003 and 2007 PAG, a property development company, borrowed from RBS on the security of its property portfolio and, moreover, agreed to various interest rate derivatives (or 'swaps') from which PAG benefited financially when interest rates increased but incurred substantial costs when

[213]ibid.

[214]Promontory Financial Group, n 8 above at [4.6.9].

[215]C. Elmore, HC Deb vol 634 col 1115 18 January 2018.

[216]K. Hollinrake, 'Fair Business Banking for All', *Centre for Policy Studies* (July 2018) 27. See also Promontory Financial Group, n 8 above at [2.2.7]; and Arvind, n 168 above, 46.

[217]Financial Conduct Authority, n 190 above, 16–17; and Promontory Financial Group, n 8 above at [2.1.57]. From 15 February 2021, SMEs have the option of taking a complaint about a banking service to the Business Banking Resolution Service – provided the SME's bank is one of the seven participating banks (Barclays, Danske, HSBC, Lloyds, NatWest/RBS, Santander, and Virgin Money). A 'micro-enterprise' and (since April 2019) a 'small business' (annual turnover of less than £6.5 million) have the additional option of taking a complaint to the Financial Ombudsman Service. On these services, see http://www.fca.org/firms/how-complain-small-businesses

[218]Financial Conduct Authority, n 190 above, 21.

[219]Treasury Committee, n 21 above, 118.

[220]*Property Alliance Group Limited* v *The Royal Bank of Scotland Plc* [2018] EWCA Civ 355. Note that, in addition to the claims about implied terms, this case also considered the alleged misrepresentations made by RBS about LIBOR.

[221]*Oliver Dean Morley t/a Morley Estates* v *The Royal Bank of Scotland Plc* [2021] EWCA Civ 338.

interest rates decreased – as they did during and after 2007-08. These costs placed PAG under considerable financial pressure which in 2010 led RBS to transfer it to GRG. As it was entitled to do under the lending agreement, in 2013 GRG had the charged properties revalued. It did so because a loan-to-value ratio above 75 percent would constitute a breach of covenant; a breach of covenant would put PAG in default; and an 'event of default' would allow GRG to call in the loan or levy a range of fees and charges.

The issue in *PAG* was whether the revaluation provision allowed GRG to exercise an absolute contractual right or a contractual discretion. PAG argued that the valuation provision was a contractual discretion; as such it contained an implied term that the 'discretion be exercised honestly and in good faith [and] … must not be exercised arbitrarily, capriciously or unreasonably'.[222] The Court of Appeal observed that 'the power conferred by [the valuation provision] was not wholly unfettered'.[223] As such, the contract contained an implied term that GRG could not, for example, exercise that power to 'vex' the SME 'maliciously' by, say, 'requiring a valuation every week or even every day'.[224] Rather, GRG had to exercise the power 'in pursuit of legitimate commercial aims'.[225] Such aims were, however, defined broadly: GRG was 'free to act in its own interests … and was under no duty to attempt to balance its interests against those of [PAG]'.[226]

The Court of Appeal's judgment in *PAG* is instructive in three respects. First, it confirmed that the courts will add to the terms of the lending agreement by implying a term that fetters the exercise of contractual discretion. As explained by the Court of Appeal in *Socimer*, the 'concern is that the discretion should not be abused'.[227] That means the party exercising the discretion must act in good faith in the sense that their decision must be made honestly rather than maliciously, and that they must not exercise the power for an improper purpose or without a rational or factual justification.[228] But, second, asking the party with decision-making authority to act honestly and for a legitimate commercial purpose is a 'mild form of control'.[229] As

[222]Leggart LJ in *Dubai National Tanker Co* v *Product Star Shipping* [1993] 1 Lloyd's LR 397 at 404, cited in *Property Alliance Group Limited* v *The Royal Bank of Scotland Plc* [2016] EWHC 3342 (Ch) at [263]. PAG claimed that GRG had breached this implied term because, while GRG had claimed that the valuation was necessary to assess the merits of further lending, it had in fact decided to cease lending to PAG some months before; therefore, the valuation served no purpose and was ordered in bad faith. See ibid at [260].

[223]*Property Alliance Group* n 220 above at [169]. By contrast, Asplin J in the court below concluded that the valuation provision was an absolute contractual right and not a contractual discretion, with the consequence that RBS was 'entitled to take into account its own interests when exercising the valuation power provision'. See *Property Alliance Group*, n 222 above at [278].

[224]*Property Alliance Group*, n 220 above at [167–9].

[225]ibid.

[226]ibid.

[227]Rix LJ in *Socimer International Bank Ltd* v *Standard Bank London Ltd* [2008] EWCA Civ 116 at [66].

[228]S. Rowan, 'Abuse of Rights in English Contract Law' (2021) 84(5) *The Modern Law Review* 1066, 1072–3.

[229]P.S. Davies, 'Excluding Good Faith and Restricting Discretion' in P.S. Davies and M. Raczynska (eds), *Contents of Commercial Contracts: Terms Affecting Freedoms* (Oxford: Hart Publishing, 2020) 89. The

Solene Rowan explains, while judicial control of contractual discretions might counter the most egregious abuses of power, the courts have shown little interest in 'fulfilling wider ambitions of promoting positive standards of behaviour'.[230] And, third, this 'mild form of control' is limited to the exercise of contractual discretion. Where the bank has absolute contractual rights at its disposal – as for instance when an event of default allows the lender to call in its loan[231] – there is no suggestion that implied terms constrain the bank. Instead, English contract law's default position comes to the fore: that outside of piecemeal interventions such as the limited controls over contractual discretion, there is no general principle of good faith, and the parties may pursue their own commercial interests without regard for the interests of the other party.[232]

### Economic duress

If the courts are reluctant to add terms to the agreement, how willing are they to free parties from terms to which they have agreed? One doctrine that allows the courts to relieve a party from prior commitments is that of duress. *Morley v RBS* is instructive because it illustrates the height of the threshold for establishing duress. Like PAG, Morley's business developed commercial property and from 1999 to 2010 (apart from a break in 2005-06) banked with RBS. In late 2006, RBS agreed to a three-year £75 million loan to enable Morley to add additional properties to his property portfolio. The loan was secured by a charge over 21 properties owned by Morley. The events of 2008, however, left Morley unable to repay the loan and led to a fall in value of his property portfolio. That fall in value put Morley in breach of the lending agreement and prompted RBS to transfer his business to GRG. In 2010 GRG offered to release its security if Morley paid £20.5 million for five of the 21 properties; the remaining 16 properties were to be transferred to West Register, an RBS subsidiary established to manage the property of failed business customers. If Morley refused the offer, GRG threatened to appoint a LPA receiver, with the consequence that all 21 properties would be transferred to West Register.

quotation in the text is from page 20 of the version of the article available at https://discovery.ucl.ac.uk/id/eprint/10088548/3/Davies_6.Davies%20-%20Excluding%20Good%20Faith.pdf

[230]Rowan, n 228 above, 1081.

[231]See *Oliver Dean Morley t/a Morley Estates v The Royal Bank of Scotland Plc* [2020] EWHC 88 (Ch) at [149] and [151].

[232]But see Leggatt J (as he then was), writing in an extra-judicial capacity, about whether an innocent party can keep a contract alive when to do so would be unreasonable. Leggatt observes: 'What is relevant for today's purposes is … that this constraint on the power to keep the contract alive could be seen as analogous to the now well established constraints on the exercise of contractual discretions and a manifestation of a more general principle of good faith'. Justice Leggatt, 'Contractual duties of good faith' (18 October 2016) Lecture to the Commercial Bar Association, 17–18 at https://www.judiciary.uk/wp-content/uploads/2016/10/mr-justice-leggatt-lecture-contractual-duties-of-faith.pdf

Morley agreed to GRG's offer but later claimed to have done so under duress. Drawing on *DSND Subsea v Petroleum Geo-Services*,[233] Morley argued that GRG's threat to appoint a LPA receiver if he did not accept GRG's offer was 'illegitimate' because it amounted to pressure to enter the contract that left Morley without a practical alternative.[234] Kerr J accepted that the 'narrative, tone and demeanour', 'the evident disdainful insouciance' of GRG's representative placed GRG's offer 'in the category of a threat':[235] it instructed the claimant to do as we ask or else, and was 'intended to concentrate the minds' of the claimant's representatives.[236] But threats are not necessarily illegitimate conduct that amounts to economic duress; as Dyson J put it in *DSND Subsea*, the illegitimate threat must be 'distinguished from the rough and tumble of the pressures of normal commercial bargaining'.[237] And reaching the threshold for economic duress is even more daunting where the threat is to carry out a lawful act. Since Morley had breached the loan-to-value ratio under the lending agreement, GRG was entitled to enforce its security and to do so as part of a 'robust (and even aggressive) negotiation'.[238] Something more – something 'reprehensible' – was and is needed to turn the threat to enforce that security into an illegitimate threat that amounts to economic duress.[239] Morley could not reach that threshold. But the broader point is the willingness of the courts to allow banks to aggressively threaten their SME customers. The independent review refers to such threats as GRG's 'leverage':[240] if the SME had breached the lending agreement, GRG could use its 'extensive legal rights as lender'[241] to threaten to impose fees or to withhold credit facilities as a 'negotiating tactic to achieve its objectives'.[242] It is to this leverage and its contribution to RBS's objectives that we now turn.

## *GRG's objectives: exploiting leverage, generating income*

The independent review documents GRG's: inability or unwillingness to transparently value its customers' assets;[243] conflicts of interest when selling property to West Register;[244] 'opportunistic' use of 'upside

[233] [2000] BLR 530.
[234] *Oliver Dean Morley*, n 231 above at [206–07].
[235] ibid at [242].
[236] ibid at [243].
[237] Dyson J quoted in ibid at [268].
[238] *Oliver Dean Morley*, n 221 above at [54].
[239] *Pakistan International Airline Corporation (Respondent)* v *Times Travel (UK) Ltd (Appellant)* [2021] UKSC 40
[240] Promontory Financial Group, n 8 above at [4.4.73].
[241] ibid at [xiv].
[242] ibid at [4.4.74].
[243] ibid at [4.5.15] to [4.5.54].
[244] As noted earlier, West Register – an RBS subsidiary – managed the property of failed business customers on behalf of the RBS Group. See ibid from [5.1.1].

instruments';[245] hostility to so-called 'non-core' assets; and enthusiasm for fees, fines, and interest rate increases. Below we document the last two activities in greater detail.

Earlier we saw RBS establish a non-core division as part of its strategic restructuring plan to 'rebalance [its] risk exposure by exiting more capital intensive assets and assets no longer deemed core to RBS strategy'.[246] RBS classified as non-core about half the businesses referred to GRG.[247] GRG did not exercise forbearance or renew credit facilities for non-core SMEs, but instead tried to reduce the debt owed by these customers. Sometimes it did so by withdrawing credit facilities: the independent review observed one case where GRG gave an SME 28 days' notice that its invoice financing facility would be reduced from £2 m to £250,000.[248] At other times GRG required SMEs to use the proceeds of asset sales to pay down debt.[249] Frequently, GRG used the SME's breach of the lending agreement to impose charges and fees that had little justification beyond increasing the cost of banking with RBS; GRG hoped such costs would 'galvanise [the SME] into action'[250] to refinance with another lender.[251]

GRG's hostility to non-core assets demonstrates its role as a 'profit centre' for the bank,[252] its approach 'weighted towards prioritising "the contribution to RBS's bottom line".'[253] To further that end, GRG encouraged its employees to renegotiate the terms of credit facilities after 2008 to adjust pricing to

[245]RBS preferred upside instruments in circumstances where the SME lacked the cash flow to meet interest charges or fees. In these circumstances, RBS could allow the SME to defer payment by either linking the future payment to the future value of property or to the future value of the SME's shares. The former option took the form of a Property Participation Fee Agreement, the latter an Equity Participation Agreement. The independent review concluded that '[T]he pricing associated with these arrangements was … 'opportunistic' – that is it appeared to us to be assessed as much on the basis of what was the best deal [the bank] could negotiate', see ibid at [5.2.47].
[246]RBS quoted in ibid at [4.3.6].
[247]ibid at [4.3.7]. Not all these businesses were SMEs. See [4.3.7].
[248]ibid at [4.3.36].
[249]ibid. at [4.3.43].
[250]ibid. at [4.4.75].
[251]ibid at [4.4.76]. In one case GRG allowed the SME time to look for an alternative lender by granting it a three-month £125,000 overdraft; to galvanise the SME into action, GRG charged a £1,000 per month fee for the overdraft 'if the facilities were repaid within 10 weeks, but otherwise fees for the three months would be £6,000 (£2,000 a month)', at ibid.
[252]Before the Treasury Committee, *SME Lending* HC 1008 (2014), Chris Sullivan (RBS's Deputy Group Chief Executive) and Derek Sach (Head of GRG) testified 'That we [GRG] are not a profit centre' (Sach at Q 578). They repeated that claim in one form or another 27 times during their evidence (see H. Blake, J. Bradley, T. Warren and R. Holmes, 'The Dash for Cash: Leaked Files Reveal RBS Systematically Crushed British Businesses for Profit' 10 October 2016 *BuzzFeed.News* at https://www.buzzfeed.com/heidiblake/dash-for-cash?mod=article_inline). Their claim that GRG was not a profit centre contradicted the finding of the 'Large Review' (A. Large, 'RBS Independent Lending Review' (2013) at https://lexlaw.co.uk/wp-content/uploads/2014/01/Sir-Andrew-Large-RBS-Independent-Lending-Review-Report.pdf) which had found that 'GRG is run as an "internal profit centre"' (ibid, 52). In August 2014, RBS's chairman wrote to the Chair of the Treasury Committee to acknowledge that Sullivan and Sach had made 'an honest mistake' and that Andrew Large had been correct to characterise GRG as a profit centre (see Blake, Bradley, Warren and Holmes, 'The Dash for Cash').
[253]Promontory Financial Group, n 8 above at [3.1.55].

better reflect post-crisis perceptions of risk. And if the SME breached the lending agreement, then GRG could apply leverage as part of the renegotiation: it could increase interest payments to a higher rate, apply a range of fees, or threaten to withdraw credit facilities, all of which helped the bank extract revenue from the SME, and which sometimes helped GRG force through new terms advantageous to the bank. In one case GRG imposed on a financially distressed SME a loan restructure fee, numerous overdraft arrangement fees, and third party fees, in this instance legal fees and fees to pay for a valuation of the SME's assets.[254] In addition to these fees, GRG had at its disposal monthly fees and exit fees, risk fees and excess fees, waiver fees and commitment fees.[255] Transfer to GRG itself came with its own fee to compensate GRG for its turnaround expertise, which prompted one SME owner to respond: 'I feel aggrieved at the fact that you want to charge the company £1,000 per month for the privilege'.[256] The aggravated owner had a point and the independent review agreed: 'Simply demanding more money from already financially distressed businesses was often unrealistic'.[257] GRG's turnaround objective required that it act with care when imposing fees on SMEs in financial difficulty. In practice, however, the independent review concluded that 'some of the pricing that we observed was, in our view, inappropriate … or otherwise excessive … There was … a significant group of cases where pricing appeared to us to be questionable and sometimes opportunistic'.[258]

GRG failed to 'identify and manage'[259] the conflict between its objectives because its 'objectives were in practice not equal'.[260] In practice GRG's 'strategic focus'[261] merged with RBS's strategic restructuring plan and, for that reason, its 'focus was on the commercial objective and much less weight was attached to turnaround'.[262] GRG seldom conducted a viability assessment.[263] The independent review did not find a single turnaround plan.[264] And while the independent review did observe GRG exercising forbearance it also found that GRG missed opportunities for additional forbearance or additional credit.[265] GRG may have missed these opportunities because the lead author of the independent review and his team did not encounter GRG employees asking questions such as, 'How can we help this customer

[254]ibid at [4.4.56].
[255]Financial Conduct Authority, n 190 above, 54.
[256]Promontory Financial Group, n 8 above at [4.4.60].
[257]ibid.
[258]ibid at [4.4.69].
[259]ibid at [1.30].
[260]Financial Conduct Authority, n 190 above, 26.
[261]ibid, 23.
[262]Promontory Financial Group, n 8 above at [1.42].
[263]ibid at [4.2.54].
[264]ibid at [4.2.63].
[265]ibid at [4.3.41-4.3.42].

reformulate their business? How can we help them get back to a normal banking relationship?' Nor did they identify any evidence of 'pride in having successfully turned businesses around'.[266] What they saw instead was GRG instrumentalising turnaround as a means in the service of RBS's strategic restructuring plan.

## From villains to saviours?[267]

Stephen Hester was aware of the interests at stake: in the years prior to the 2008 crisis, 'too often people saw the customer as the thing from which you made money, and making money for your shareholders … as being the primary purpose'; the imperative post-crisis was 'to reverse that'.[268] In his evidence to the Parliamentary Commission on Banking Standards, Hester went on to suggest that giving primacy to the interests of customers did not mean that 'shareholders are unimportant';[269] rather the aim was 'simply to change the order of thought and behaviour … such that people understand that the route to long-term prosperity is serving customers well'.[270]

But Hester was also aware of 'the tensions that get in the way of all companies' as they endeavour 'to balance the interests of shareholders, customers, regulators and society at large'.[271] And so, while Hester talked up customer service and the government made a show of lending commitments, simultaneously RBS's board and UKFI set about making RBS attractive to prospective investors. When the interests of investors and customers clashed, the allocation of decision-making authority influenced whose interests prevailed. As the preceding two sections have shown, corporate law mechanisms that align managerial decisions with shareholder interests – in this instance s.172 combined with the threat of litigation – steered the RBS board and UKFI in an investor friendly direction. So steered, RBS used its decision-making authority under the lending agreement to prioritise its commercial interests by inflicting 'material financial distress' on its small business customers.

And yet besides failing its business customers, in the years since 2008 RBS also failed by the yardstick of these short-term financial interests. A decade after its capital injections saved RBS, the Treasury still owned 62.4 percent of RBS's shares;[272] the Treasury's sale in the summer of 2018 of 7.7 percent of its holding amounted to a loss of £2.1

[266]Evidence of T. Boorman (Promontory Financial Group), Treasury Committee, *RBS's Global Restructuring Group and its Treatment of SMEs* HC 737 (2017–2019) Q 7 and Q 60.
[267]M. Schillig, 'Banking and Finance after Covid-19' (2021) 32(1) *King's Law Journal* 49, 49.
[268]Evidence of S. Hester (Chief Executive Officer, RBS), Parliamentary Commission on Banking Standards, *Changing Banking for Good* HC 175-III (2013–14) Q 863.
[269]ibid.
[270]ibid.
[271]ibid.
[272]S. Jack, 'Government loses £2.1 billion on RBS stake sale' 5 June 2018 *BBC News* at https://www.bbc.com/news/business-44366731.amp

billion;[273] and despite apologising to business customers harmed by GRG in November 2016, such is RBS's shattered reputation in 2020 RBS Group formally changed its name, replacing RBS with its NatWest brand.[274]

In the aftermath of so many examples of bank misconduct, other banks also face the challenge of repairing their public image. The COVID-19 crisis – the second major financial and economic crisis in two decades – offered the sector 'a unique opportunity to restore its reputation, particularly with the SME community'.[275] But for banks to transform from 'villains to saviours'[276] and provide 'the necessary flexibility to preserve businesses, jobs and livelihoods during a severe, but temporary health crisis',[277] they would need to 'walk a fine line' to avoid 'calling into question the soundness' of the banking system.[278] As banks weighed these considerations, the Treasury navigated its own 'essential dilemma': 'On the one hand, there was a very urgent need for support to the economy. On the other hand, there was how to balance that against all the usual checks and controls'[279] to ensure the 'good use of public money'.[280] Could the Treasury and the banks navigate these tensions to produce an outcome this time favourable to small businesses and redemptive for the banks? The next section considers the COVID-19 crisis further and does so by focusing on lending to SMEs.[281]

## THE COVID-19 crisis

To encourage banks to support SMEs during the crisis, in March 2020 the government established the Coronavirus Business Interruption Loan Scheme (CBILS).[282] Orchestrated by the British Business Bank on behalf of the government, CBILS provided businesses with a turnover of up to £45 million with finance of up to £5 million through participating lenders.

[273]ibid. By the time of that sale, UKFI had ceased operating: in the spring of 2018 all its assets (including the shares of RBS) were transferred to UK Government Investments, a holding company that holds the shares in various public sector and state-owned enterprises on behalf of HM Treasury.

[274]RBS set aside £400 million to compensate SMEs harmed by GRG. On the complaints process, see: https://www.natwestgroup.com/grg-complaints-process.html. On the change of name, see J. Partridge, 'Royal Bank of Scotland changes name to NatWest' 22 July 2020 *The Guardian*.

[275]Evidence of S. Jones (CEO, UK Finance), Treasury Committee, *Economic Impact of Coronavirus* HC 271 (2020) Q 178.

[276]Schillig, n 267 above, 49.

[277]ibid, 54.

[278]D. Crow, S. Morris and L. Noonan, 'Will the coronavirus crisis rehabilitate the bank? 1 April 2020 *Financial Times*.

[279]Evidence of T. Scholar (Permanent Secretary, HM Treasury), Treasury Committee, *HM Treasury's Role in Combating Fraud* HC 1156 (2022) Q 130.

[280]Evidence of S. Munby (Permanent Secretary, Department for Business, Energy and Industrial Strategy), Public Accounts Committee, *Bounce Back Loans Scheme: Follow up* HC 951 (2022) Q 56.

[281]For a broad ranging overview of the UK's response to the COVID-19 economic and financial crisis, see I.H-Y Chiu, A. Kokkinis and A. Miglionico, 'Relief and Rescue: Suspension and Elasticity in Financial Regulation, and Lessons from the UK's Management of the COVID-19 Pandemic Crisis' (2021) 64 *Washington University Journal of Law & Policy* 64.

[282]https://www.gov.uk/guidance/apply-for-the-coronavirus-business-interruption-loan-scheme

The government guaranteed 80 percent of the loan, but resisted full guarantees because it feared 'lending to companies with no prospect of repaying the money'.[283] Since lenders took 20 percent of the risk, CBILS encourage lenders to make 'the credit checks and loan assessments that they would normally make on a commercial basis'.[284] Yet it was precisely these commercial lending checks that proved 'clunky'[285] and 'unwieldy'[286] and prevented 'very small businesses and new businesses from being able to access the lending'.[287] Many lenders wanted a personal guarantee from the borrower;[288] some businesses described the application process as 'Kafkaesque';[289] others grew frustrated as applications took weeks 'at a time when they were burning through cash'.[290] Businesses had to pay suppliers and employees, yet '[i]f you have only two weeks' money left and you have to wait 10 days to know if you are going to get your loan, it did not feel that helpful'.[291]

In May 2020 the government varied its approach. Under the Bounce Back Loans Scheme (BBLS) it again tasked the British Business Bank with orchestrating the scheme, but this time guaranteed the full amount of loans of up to £50,000 or 25 percent of annual turnover.[292] BBLS aimed to get money to borrowers within 24 to 48 h of applying. Prioritising speed deprioritised the checks that characterised CBILS. That 'was a deliberate part of the design'[293] because, although banks served as the 'transmission mechanism'[294] and had to conduct counter money laundering and fraud checks, BBLS took 'most of the decision-making out of the hands of the banks'.[295] It made banks 'more of an administrator of the system'[296] because 'Ministers

[283]D. Thomas and G. Parker, 'State-backed SME lending picks up pace too late for many' 15 April 2020, *Financial Times*.

[284]Evidence of T. Scholar (Permanent Secretary, HM Treasury), Public Accounts Committee, *Covid-19: Bounce Back Loans* HC 687 (2020) Q 15.

[285]Evidence of M. McTague (National Vice Chair Policy and Advocacy, Federation of Small Businesses), Business, Energy and Industrial Strategy Committee, *The Impact of Coronavirus on Businesses and Workers* HC 219 (2020) Q 66.

[286]Evidence of A. Goodacre (CEO, British Independent Retailers Consortium), Business, Energy and Industrial Strategy Committee, *The Impact of Coronavirus on Businesses and Workers* HC 219 (2020) Q 112.

[287]Evidence of K. Braddick (Director General, Financial Services, HM Treasury), Public Accounts Committee, *Covid-19: Bounce Back Loans* HC 687 (2020) Q 45. See also L. White, 'Lloyds Bank comes under fire for its "disappointing" efforts to help small businesses through coronavirus crisis' 27 April 2020 *This is Money*; A. Verity, 'Banks under fire for coronavirus loan tactics' 30 March 2020 *BBC News*; and J. Salmon, 'Firms are being denied lifeline loans by "cynical" banks' 30 March 2020, *The Daily Mail*. RBS made the largest number of loans under CBILS – see J. Warrington, 'RBS pays out 70 percent of government coronavirus loans' 12 April 2020 *City A.M.*

[288]H. Brennan, 'Small business owners asked to put homes on the line to get emergency coronavirus loans' 29 March 2020 *The Telegraph*.

[289]Letter to the editor, 'Kafkaesque applications for business loans' 15 May 2020 *Financial Times*.

[290]Thomas and Parker, n 283 above.

[291]Evidence of Braddick, n 287 above, Q 29.

[292]https://www.gov.uk/guidance/apply-for-a-coronavirus-bounce-back-loan

[293]Evidence of Braddick, n 287 above, Q 47.

[294]Evidence of Jones, n 275 above, Q 159 and 161; and evidence of C. Woolard (Interim CEO, Financial Conduct Authority), Treasury Committee, *Economic Impact of Coronavirus* HC 271 Q 191.

[295]Evidence of M. McTague, n 285 above, Q 66.

[296]ibid.

were clear that they did not want banks to be deciding who [is] a worthy recipient'.[297]

Removing credit-risk decision-making resulted in 270,000 loans in the first week of BBLS and around 800,000 in its first month.[298] Between May 2020 and March 2021 BBLS supported 1.5 million loans worth £47 billion.[299] But speed and scale carried trade-offs: a year after BBLS's launch the government estimated that 37 percent of loans would not be repaid, including an estimated 11 percent written off as fraudulent.[300] The Public Accounts Committee worried that the Treasury's 100 percent guarantee combined with the 'focus on the speed of delivery had exposed the taxpayer to potentially huge losses'.[301] Others imagined 'a giant bonfire of taxpayers' money … with banks just handing out the matches'.[302]

Given the Treasury's guarantee, do lenders have incentives to minimise a potentially 'eye-watering loss of public money'?[303] The terms of the guarantee agreement require lenders to undertake 'appropriate recovery processes'[304] before they claim the guarantee. After the lender has given the borrower a formal demand for payment, the lender has a 12 month window within which to recover the debt.[305] If the government becomes concerned that a lender is not doing 'their utmost to minimise taxpayer losses'[306] – for example, because a lender's recovery rate is lower than its peers[307] – and if it transpires that the lender did not follow the appropriate recovery process, then '[t]he ultimate penalty is that we [the government] refuse to respect the guarantee, or we can claw back'.[308]

That ultimate penalty ensures that '[t]here is money on the table here for lenders'[309] and that they pursue recoveries 'in line with their existing

[297]Evidence of Braddick, n 287 above, Q 48.

[298]British Business Bank, *Evaluation of the Bounce Back Loan Scheme, Coronavirus Business Interruption Loan Scheme, and Coronavirus Large Business Interruption Loan Scheme: Process evaluation and early impact assessment* (June 2022) 10.

[299]National Audit Office, *The Bounce Back Loan Scheme: an update* (December 2021) 8.

[300]ibid, 9.

[301]Public Accounts Committee, *Bounce Back Loans Scheme: Follow-up* HC 951 (2021–22) 3.

[302]D. Thomas and S. Morris, '"A giant bonfire of taxpayers' money": fraud and the UK pandemic loan scheme' 20 December 2020 *Financial Times*.

[303]D. Thomas, 'Taxpayers face losses of up to £26bn on loan scheme, says watchdog' 7 October 2020 *Financial Times*.

[304]National Audit Office, *Investigation into the Bounce Back Loan Scheme* HC 860 (October 2020) 11.

[305]ibid. The lender may make a claim on the government guarantee within this time-period provided they make the claim '"within a reasonable time period" following the first formal demand date, or sooner, if lenders believe "no further payment is likely"' (ibid).

[306]D. Thomas, 'UK banks need pushing to recover Covid business loans, say MPs' 27 April 2022 *Financial Times.*

[307]Evidence of P. Magee (Chief Commercial Officer, British Business Bank) Public Accounts Committee, *Bounce Back Loan Scheme: Follow up* HC 951 (2022) Q 27.

[308]Evidence of C. Lewis La Torre (Chief Executive, British Business Bank) Public Accounts Committee, *Bounce Back Loan Scheme: Follow up* HC 951 (2022) Q 26.

[309]Evidence of Munby, n 280 above, Q 24.

business-as-usual standards'.[310] Simultaneously, however, 'Treasury officials also want to avoid the sort of banking scandal that resulted from the last financial crash … '.[311] Others share that concern. One MP remarked, 'Many of us will remember GRG';[312] a Bank of England official added 'no one wants to see another GRG';[313] the *FT* advised banks to 'avoid pillaging weaker small businesses as a couple of lenders did last time … '.[314] Under the terms of the lending guarantee, if the banks do not comply with the FCA's approach to treating customers fairly then the government can refuse to pay out on the guarantee.[315] And therein lies the banks' dilemma: whether too harsh or too lenient, either way they risk losing access to the government guarantee.

Dilemmas such as this have been a theme of this article: should commercial banks prioritise their balance sheet or should they support borrowers in difficulty? Should the state assist productive businesses, or should it safeguard the public finances? A further theme has been the way authority is distributed to determine whose interests prevail when interests conflict. If the government had deferred to commercial banks on how to respond to the COVID-19 economic crisis, the banks would have lent too little too late. A different outcome – one with its own difficulties: the cost of BBLS remains controversial; the recovery process may yet become controversial – saw the state curtail the banks' authority to make credit risk assessments. In Hockett and Omarova's terms, an 'active franchisor'[316] directed credit allocation. Notice how it did so: it provided SMEs with an alternative source of finance to bargaining with their bank. Does that provide a model for a different type of banking?

## Conclusion

In March 2012 Vince Cable, the then business secretary, suggested to the rest of the government that it 'recognise that RBS will not return to the market in its current shape' and that it 'use [RBS's] time as ward of the state to carve out of it a British business bank with a clean balance sheet and a mandate to expand lending rapidly to sound business'.[317] When the Treasury opposed

[310]Public Accounts Committee, n 301 above, 11.
[311]D. Thomas, S. Morris and G. Parker, 'UK Treasury and banks in talks on coming wave of bad Covid debt' 26 July 2020 *Financial Times*.
[312]S. Baker, Treasury Committee, *Economic Impact of Coronavirus* HC 271 (2020) Q 178.
[313]Evidence of S. Woods (Deputy Governor Bank of England and CEO of the Prudential Regulation Authority) Treasury Committee, *Economic Impact of Coronavirus* HC 271 (2020) Q 216.
[314]Lex column, 'Bounce back loans/banks: having a ball' 5 October 2020 *Financial Times*.
[315]Evidence of S. Mills (Executive Director, Consumers and Competition, Financial Conduct Authority) Public Accounts Committee *Bounce Back Loan Scheme: Follow up* HC 951 (2022) Q 15; and evidence of Magee, n 307 above, Q 24.
[316]Hockett and Omarova, n 27 above, 1214.
[317]'Cable calls for RBS to be split up' 6 March 2012 *BBC News*, https://www.bbc.co.uk/news/business-17275884

that suggestion, Cable established the government-owned British Business Bank to 'increase the supply of finance available to smaller businesses where markets don't work well'.[318] As a public bank, the British Business Bank is instructive in four respects.[319]

First, the British Business Bank shows the state and commercial banks sharing responsibility for credit allocation. The British Business Bank does not lend or invest directly, but rather does so through commercial banks and other financial institutions.[320] Earlier we saw two examples of such an arrangement: the British Business Bank orchestrated CBILS and BBLS on behalf of the government, yet the lending was transmitted through commercial banks. By sharing responsibility for credit allocation, the British Business Bank helps to 'lever'[321] existing markets: it expands a market that would be less extensive but for public support, such as lending to viable SMEs who wish to access finance but cannot do so because banks will not lend. As some have argued, public banks could be, and sometimes are, more ambitious: freed from the need to collaborate with commercial banks, they can create and shape markets as well as fix 'market failures'. [322]

But – and this is the second point – why is a public bank necessary to achieve such ends? Policymakers conventionally respond to bank misconduct or to inadequate levels of SME finance by encouraging competition in banking.[323] Notice, however, the UK's 'merry-go-round'[324] of competition

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[318]British Business Bank, 'Our Objectives', https://www.british-business-bank.co.uk/what-the-british-business-bank-does/

[319]For an overview of the British Business Bank, see D. van der Schans, 'The British Business Bank's role in facilitating economic growth by addressing imperfections in SME finance markets' (2015) 17 *Venture Capital* 1. In summer 2021 the British Business Bank was joined by a second UK government-owned bank, the UK Infrastructure Bank, which has the dual objectives of financing infrastructure projects that support net zero and investing in regional and local economies to support growth. See HM Treasury, *UK Infrastructure Bank: Policy Design* (2021). The Welsh Development Bank was established in 2001 and is owned by the Welsh government. It offers financial support to businesses based in Wales. The Scottish National Development Bank was established in 2020 and is owned by the Scottish government. It invests in Scottish businesses 'where the private sector is not providing sufficient investment' or in 'projects that support the development' of Scotland's economy. See https://www.thebank.scot/about

[320]British Business Bank, n 318 above.

[321]See R.C Hockett and S.T. Omarova, 'Public Actors in Private Markets: Towards a Developmental Finance State' (2015) 93(1) *Washington University Law Review* 103, 122–37. See also R.C Hockett and S.T Omarova, 'Private Means to Public Ends: Governments as Market Actors' (2014) 15 *Theoretical Inquiries in Law* 53, 57–72.

[322]See M. Mazzucato and C.C.R. Penna, 'Beyond market failures: the market creating and shaping roles of state investment banks' (2016) 19(4) *Journal of Economic Policy Reform* 305, which builds on M. Mazzucato, *The Entrepreneurial State: Debunking Public vs. Private Sector Myths* (Anthem Press, 2013). The Labour Party has proposed expanding the British Business Bank's mandate 'to promote regional economic equality in access to investment capital'. See *A New Britain: Renewing Our Democracy and Rebuilding Our Economy* (2022) 12. Others explore ways of democratising finance, including but not limited to the role of public investment banks. See M.A. McCarthy, 'The Politics of Democratizing Finance: A Radical View' (2019) 47(4) *Politics & Society* 611.

[323]See, for example, Don Cruickshank, *Competition in UK Banking: A Report to the Chancellor of the Exchequer* (2000); and Independent Commission on Banking, *Final Report: Recommendations* (2011).

[324]J. Froud, D. Tischer, K. Williams, 'It is the business model … Reframing the problem of UK retail banking' (2017) 42 *Critical Perspectives on Accounting* (2017) 1, 7.

cycles and policy failures. 'Taking a twenty year horizon', one article observes, 'UK governments and regulators appear to be stuck in a closed-loop process of repeated narrative about more competition and failed reforms'.[325] Concentration in banking, then, may not fully account for the problems of bank misconduct and subdued lending to SMEs; what may also contribute to these problems is 'the monoculture of shareholder-owned banks', which 'encourages mimetic behaviours intended to improve return on equity', leaving 'relatively little to distinguish between [banks]' and making 'little difference to customers'.[326]

Third, public banks like the British Business Bank break that monoculture. That they do so helps to distinguish them as a reform option from other legal reforms to banking. Reform of s.172 might require bank directors to put customers first and shareholders second;[327] reform of control rights might allocate to the government a 'golden share' in the largest banks and allow it to voice the public interest when banks determine strategy;[328] reform of the FCA's regulatory perimeter might offer businesses defined as 'small and medium' some protection against egregious bank conduct;[329] reform that introduces a duty of good faith to lending agreements would offer minimum protection to all businesses.[330] These reforms shift the rules governing the conduct of the parties during bargaining: the first two modify corporate law to limit the bargaining power of shareholders; the latter two modify contract law to limit the bargaining power of secured lenders. But none of these options offer borrowers an alternative to remaining in a bargaining situation dominated by 'the monoculture of shareholder-owned banks'.[331] Public banks offer that alternative: if bank lending to creditworthy projects is insufficient, then a public competitor could expand that lending by offering straightforward business banking services to the public, setting standards for price and service in the process.[332] A reformed British Business Bank could perform this role.

[325] ibid.

[326] ibid, 15.

[327] An option implied by David Kershaw's evidence to the Parliamentary Commission on Banking Standards, *Changing Banking for Good* HC 175-III (2013–14) Q 2678. Reforms to s.172 in the context of banking typically focus on financial stability by requiring directors to, for example, 'ensure the financial safety and soundness of the company ahead of the interests of its members'. Parliamentary Commission on Banking Standards, *Changing Banking for Good* HL 27-I, HC 175-I (2013–14) [124].

[328] S.T. Omarova, 'Bank Governance and Systemic Stability: The "Golden Share" Approach' (2016) 68(4) *Alabama Law Review* 1029. As envisaged by Omarova, the government would be a passive shareholder, not exercising control rights, until a specific event – for example, a threat to financial stability – activates the government's control rights. The government would then influence how the bank allocates credit but would do so to maintain financial stability rather than to direct credit for other reasons.

[329] A. Keller, 'Vulnerability in Financial Regulation: The Case of SMEs' (2022) 33(5) *European Business Law Review* 695.

[330] See, for example, H. Collins, 'Implied Terms: The Foundation in Good Faith and Fair Dealing' (2014) 67 (1) *Current Legal Problems* 297–331.

[331] Froud et al, n 324 above, 15.

[332] K.S. Rahman, 'The New Utilities: Private Power, Social Infrastructure, and the Revival of the Public Utility Concept' (2018) 39 *Cardozo Law Review* 1621, 1656–65.

Fourth, notice that the British Business Bank is incorporated under the Companies Act 2006. Its sole shareholder is the business secretary, on whose behalf UK Government Investments, the successor to UKFI, acts as a 'shareholder representative'.[333] In contrast to UKFI, UK Government Investments does not have a mandate to promote the sale of the government's holding to outside investors.[334] The absence of outside investors and their expectations frees the British Business Bank from navigating conflicts between the interests of investors and the purpose of the bank. But it must still confront a tension: those who run it must weigh the bank's capacity to channel credit against ensuring accountability for those decisions.[335] With that tension in mind, the government's decision to establish the British Business Bank under the Companies Acts rather than as a statutory corporation is significant, for the former allows for 'the avoidance of legislative influence and control',[336] so that 'the Secretary of State, as "owner" … can exercise comprehensive control … [and] Parliament is … left without an effective voice'.[337]

That allocation of decision-making authority matters because it raises again '*the* money question: who should control its creation and how it should be used'.[338] Company structures place control of money creation and its use under the influence of bank shareholders, whether external investors or, in the case of public banks incorporated under the Companies Acts, the government. Given what we now know about GRG's misconduct, Vince Cable may have been astute in 2012 when he suggested that the government ought to have converted RBS into a public bank. But the history of public banks has its own stories to tell of dysfunctional finance – of incompetent management, interest group capture, and wasted resources. The drama of RBS during and after 2008 suggests that shareholder driven banks cannot be the only or even the dominant form of banking. Might public banking serve as an alternative, to aid rather than hinder the normative aspiration of 'inclusive and stable economic development'?[339]

## Acknowledgements

For comments and advice on a draft of this paper that I shared with the KLS Obligations Discussion Group, I thank Tobias Barkley, Amanda Hoły, Nick Piška, Geoffrey

[333] British Business Bank Plc, *Shareholder Relationship Framework Document* (2022) [1.2].
[334] Instead, its task is to 'promote appropriate governance structures', ibid.
[335] For example, the British Business Bank has been criticised over its role in the government's response to the COVID-19 crisis for failing to do enough to counter fraudulent loans, for deferring to lenders on recoveries, and for the way it approved participating lenders. On the first two criticisms, see Public Accounts Committee, n 301 above; on the third criticism, see T. Rees and L. Burton, 'British Business Bank faces pressure for reform over stumbling loan schemes' 9 May 2020 *The Telegraph*.
[336] T. Daintith, 'Government Companies as Regulators' (2019) 82(3) *Modern Law Review* 397, 423.
[337] ibid.
[338] Ingham, n 24 above.
[339] Hockett and Omarova, n 27 above, 1218.

Samuel, John Wightman and Clare Williams. Many thanks also to the two anonymous reviewers. All errors remain my own.

## Disclosure statement

No potential conflict of interest was reported by the author(s).

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