Explaining Financial Scandals

Explaining Financial Scandals: Corporate Governance, Structured Finance and the Enlightened Sovereign Control Paradigm

By

Vincenzo Bavoso

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This work is dedicated to my family.
For having taught me to think out of the box.

TABLE OF CONTENTS

Part II – The legal Issues

Part III – The Case Studies

LIST OF CASES

Australia

Australian Securities and Investments Commission v. Healey [2011] FCA 717
Australian Securities and Investments Commission v. Rich [2003] NSWSC 85
Commonwealth Bank of Australia v. Friedrich (1991) 9 A.C.L.C 946

New Zealand

Fletcher v. National Mutual Life Nominees Ltd [1990] 3 NZLR97

UK

Aberdeen Railway Co v. Blaikie Brothers (1854) 1 Macq 461
Arneson v. Arneson [1977] App. Cas. 405 (1975)
Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cuninghame [1906] 2 Ch. 42 (C.A.)
Bligh v. Brent (1836) 2 Y. & C. 268
Bristol and West Building Society v. Mothew (1998) Ch 1, CA, 18
Borland's Trustees v. Steel Brothers & Co. Ltd [1901] 1 Ch. 279, 288
Caparo Industries v. Dickman [1989] 1 QB 653 (CA 1988)
Dorchester Finance Co. Ltd v. Stebbing [1989] BCLC 498
Imperial Hydropathic Hotel Co., Blackpool v. Hampson (1882) 23 ChD 1
Marquis of Bute's Case [1892] 2 Ch 100
Myers v. Perigal (1852) 2 De G.M. & G. 599
Norman v. Theodore Goddard [1992] BCC 14
Overend & Gurney v. Gibb (1872) LR 5 HL 480
Re Barings Plc (No5) [2000] 1BCLC 523, CA
Re Brazilian Rubber Plantation and Estates Ltd [1911] 1 Ch 425
Re City Equitable Ltd [1925] Ch 407
Re D'Jan of London Ltd [1993] BCC 646
Regal (Hastings) Ltd v. Gulliver [1967] 2 AC 134 (HL)
Regentcrest plc v. Cohen [2001] 2 BCLC 80

Re Southern Counties Fresh Foods Ltd, [2008] EWHC 2810
Salmon v. Quin & Axtens Ltd [1909] 1 Ch. 311 (C.A.)
Salomon v. Salomon & Co. Ltd [1897], A.C. 22
Scottish Co-operative Wholesale Society Ltd v. Meyer [1959] AC 324
Shaw & Sons (Salford) Ltd v. Shaw [1935] 2KB 113 CA
Short v. Treasury Commissioners [1948] 1 K.B. 122
Westdeutshche Landesbank Girozentrale v. Islington London Borough Council, 1996, 1 AC 669

USA

Central Hudson Gas & Electric Corp. v. Public Service Commission, 447 US 557 (1980)
County of Orange v. McGraw-Hill Cos., 245 BR 151, 157 (CD Cal. 1999)
DiLeo v. Ernst & Young 901 F.2d 624 (7th Cir. 1990)
Dun & Bradstreet Inc. v. Greenmoss Builders Inc., 472 US 749 (1985)
Francis v. United Jersey Bank 432 A(2d) 814 (1981)
Irwin v. Williar, 110 US 499 (1884)
Lowe v. SEC, 472 US 181,210 n.58 (1985)
Newby v. Enron Corp., 2005 US Dist. LEXIS 4494 p.174(S.D. Tex., Feb.16, 2005)
Re Parmalat Securities Litigation, 375 F. Supp 2d 278 (S.D.N.Y. 2005)
Santa Clara County v. Southern Pacific Railroad 118 US 394 (1886)
SEC v. Goldman Sachs 10-cv-3229 (2010) United States District Court, Southern District of New York

LIST OF STATUTES

Australia

Corporations Act 2001

UK

City Code on Takeovers and Mergers 2009
Combined Code 2003
Companies Act 1985
Companies Act 2006
Corporate Governance Code 2010
FSA Handbook
Financial Services and Markets Act 2000
Financial Services Act 2010
Joint Stock Companies Act 1844
Joint Stock Companies Act 1856
Joint Stock Companies Act 1862
Insolvency Act 1986
Royal Exchange and London Assurance Corporation Act 1719 (Bubble Act 1720)
Stewardship Code 2010

USA

Auditing Accountability and Responsibility Act in the House, Pub. L. 107-204, 116 Stat. 745, 2002
Banking Act 1933 Pub.L. 73-66 48 Stat 162 (Glass-Steagall)
Company Accounting Reform and Investor Protection Act in the Senate and Corporate and
Commodities Futures Modernization Act 2000, Pub L No 106-554, 114 Stat 2763
Credit Rating Agency Reform Act 2006
Financial Services Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (Gramm-Leach-Bliley) 1999

Public Company Accounting Reform and Investor Protection Act 2002, Pub.L. 107-204 116 Stat.745 (Sarbanes-Oxley)
Securities Act 1933
Securities Exchange Act 1934
Securities Act Release No.42746 (May 2 2000)
SEC Rules
Wall Street Reform and Consumer Protection Act 2010, Pub.L. No. 111-203, 124 Stat. 1376 (Dodd-Frank).

EU

Directive 89/616/EEC [1989] OJ L386/1, replaced by Directive 2006/18/EC OJL177
Directive 2009/111/EC, CRD II
Directive 2010/76/EU, CRD III
Directive 2003/125/EC, The Market Abuse Directive (MAD)
Directive 2004/39/EC, The Market in Financial Instruments (MiFID)
Directive 2006/48/EC, The Capital Requirements (CRD)
Directive 2004/109/EU, Transparency
EU Regulation No. 1095/2010 Establishing a European Supervisory Authority (European Securities and Markets Authority)
EU Regulation No. 1095/2010 *OJ* 2010 L331/84
EU Regulation No 1060/2009 on Credit Rating Agencies
EU Regulation No 513/2011 (amending Regulation on Credit Rating Agencies)
European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2002/87/EC, COM(2011) 453 final
Proposal for a Regulation of the European Parliament and of the Council on "Markets in Financial Instruments and Amending Regulation on OTC Derivatives, Central Counterparties and Trade Repositories" 2011/0296(COD)

Italy

Codice Civile (Civil Code)
CONSOB decision no. 14671 28 July 2004
D.Lg. 6/Sett./05 no.206

LIST OF CHARTS

PREFACE

The explosion of the global financial crisis in 2007-08 reignited the urgency to reflect on the origins and causes of financial collapses. As events during the above period triggered an economic meltdown that is still ongoing, comparisons with the Great Crash of 1929 started to abound. In particular, the externalities that a broad spectrum of societal groups had to bear as a consequence of various banking failures highlighted the necessity of a more inclusive and balanced regulation of firms whose activities impact on a wide range of stakeholders.

Research on this project started in late 2007, at a time when the "credit crunch" in the UK and US revealed the first stage of a much deeper and broader financial distress that eventually unfolded later in 2008. The following months in fact unveiled the full scale of the downfall of the global financial system and the subsequent economic crisis that we are still witnessing. The events characterising the global crisis progressively became part of the background of this book, linking to what had happened at the beginning of the decade in North America (Enron, WorldCom) and in Europe (Parmalat). Eventually the collapse of Lehman Brothers in September 2008 opened up the floodgates of academic debates on the very topical issue of financial crises and financial regulation.

Beyond these pressing issues, this research originated from the desire to explore the interplay between corporate governance and financial transactions in order to explain the genesis of the scandals that occurred between 2001 and 2003. This angle of enquiry proved to fit very well into the study of the more recent banking failures in the context of the global crisis. More specifically, the breakdown in the control of managerial behaviours, coupled with the very offspring of that managerial freedom, namely the abuse of capital market finance, provided the ideal platform to analyse and explain the financial scandals that occurred over the last decade. As research evolved, and as the initial consequences of the financial catastrophe became clear, the legal analysis conducted throughout the book started to point towards a converging set of conclusions. These eventually contributed to define the concept put forward as "enlightened sovereign control".

The book is centred on the proposal of this paradigm, the "enlightened sovereign control", that provides a theoretical, institutional and substantive

framework as a response to the legal issues analysed in the book. These stem primarily from the analysis of two sequences of events (the 2001-03 wave of "accounting frauds" and the 2007-08 global crisis) which, as said, represent the background upon which modern financial scandals are explained. This is done by highlighting a number of common denominators emerging from the case studies (Enron and Parmalat, Northern Rock and Lehman Brothers) which all led to financial instability and scandals and illustrated the legal issues identified in the book. The research is grounded on the initial recognition of theoretical themes in the field of corporate and financial law, which eventually link with the more practical events examined. This parallel enquiry leads to the investigation of two heavily interrelated spheres of law and finally highlights more practical legal issues that emerge from the analysis.

Through this multifaceted approach, the book contends that the occurrence of financial crises during the last decade is essentially rooted in two main problems: a corporate governance one, represented by the lack of effective control systems within large public firms; and a corporate finance one identified with the excesses of financial innovation and related abuses of capital market finance. Research conducted in this book ultimately seeks to contribute to current debates in the areas of corporate and financial law, through the proposals of the "enlightened sovereign control" paradigm.

This book is based substantially on the work undertaken in the context of my doctoral degree at the University of Manchester. This long, exciting and at times daunting adventure has been a journey beyond my expectations and an unparalleled learning experience. I have been very fortunate to meet a number of inspiring people at Manchester since my LLM in 2005-06. The willingness to embark on a research degree and on such a committing project stemmed to a high extent from that early experience, from the truly exciting lectures I attended and the joyous study shared with marvellous classmates. Inevitably, such an extended endeavour resulted in a number of intellectual debts. Firstly, I need to thank my PhD supervisor, Dr Pierre Schammo for the guidance he provided over two and half years. I am very thankful for his direction and for the intellectual stimulations that helped me to shape this work. I am indebted to Dr Sarah Wilson, who supervised me for the first two years of my degree and introduced me to the beauty of research work by awakening my motivations and by pushing me to do it full-time. I also thank Dr Rilka Dragneva-Lewers, my second supervisor, for always providing useful comments on my work. I am very thankful to Professor Emilios Avgouleas for the invaluable advice he offered on my research

and generally for his continuous interest in my academic development. And thanks to Dr Jasem Tarawneh for the help and support when I started teaching at Manchester. Last but not least, I am deeply grateful for the very constructive comments I received during my PhD viva by Professor David Milman and Mr Gary Lynch-Wood.

Over the past five years I have also been fortunate to come across and interact with a number of incredibly interesting colleagues and friends at Manchester. Conversations over lunch, debates in the Law School's corridors and research seminars all helped to fuel ideas that eventually flowed into this book. Special thanks to Folarin, Kabir, David, Shane, Rachael, Tim, Cecilia, Lola, Uche, Olive, Jorge, Franklin, Bo, Fang, Ozgur, Mel, Herbert, Ajay, Tareq, Tianzhu, Leander, Eduardo, Emmanuel, Swati, Lala. Much gratitude is also owed to my colleagues at Kingston University for their support over the past year and half since I joined the Law School over the Hill, and to the patient staff at CSP for the editing work on my manuscript.

Finally, but more importantly, thank you to my family for the constant support and relentless encouragement and to Sarah, for being there when it mattered and for her understanding and help.

Vincenzo Bavoso, Manchester/London,
September 2012

LIST OF ABBREVIATIONS

ABS	Asset Backed Securities
AMF	Autorité des Marchés Financiers
ASIC	Australian Securities and Investment Commission
BIS	Bank of International Settlements
CDS	Credit Default Swap
CDO	Collateralised Debt Obligation
CEO	Chief Executive Officer
CESR	Committee of European Securities Regulators
CFO	Chief Financial Officer
CFTC	Commodity Futures Trading Commission
CLRSG	Company Law Review Steering Group
CONSOB	Commissione Nazionale per le Società e la Borsa
CRA	Credit Rating Agency
DCO	Derivatives Clearing Organization
ESA	European Supervisory Authority
ESC	Enlightened Sovereign Control
ESMA	European Securities and Markets Authority
ESV	Enlightened Shareholder Value
EMH	Efficient Market Hypothesis
FSA	Financial Services Authority
FSB	Financial Stability Board
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
ISDA	International Swap and Derivatives Association
LSE	London Stock Exchange
MBS	Mortgage Backed Securities
NRSRO	Nationally Recognised Statistical Rating Organisation
NYSE	New York Stock Exchange
OTC	Over the Counter
SEC	Securities and Exchange Commission
SPV	Special Purpose Vehicle
SPE	Special Purpose Entity
SIV	Special Investment Vehicle

CHAPTER ONE

INTRODUCTION

"We make the rules, pal. The news, war, peace, famine, upheaval, the price of a paper clip. We pick that rabbit out of a hat while everybody sits around wondering how the hell we did it. Now you're not naïve enough to think that we're living in a democracy, are you, Buddy? It's the free market, and you're part of it".

—Gordon Gekko, 1987[1]

1.1 – Research Background

Financial crises and scandals have existed for as long as it can probably be recorded, as long at least as a system of money and rudimentary banking can be traced.[2] Events such as the Tulip Mania in mid-1630s[3] and the South Sea Bubble in 1720[4] awakened very early concerns about the dangers and oscillations of finance, at a time when the success of geographical and industrial enterprises were deemed worth the exploration of innovative commercial models.

From those early days finance has developed into an increasingly complex "science", one which over the last three decades has come to represent a very substantial slice of the economic system, particularly in certain countries where legal reforms and economic theories have contributed to the flourishing of financial economies as opposed to industrial ones.[5] The progressive globalisation of this economic model

[1] "Wall Street", directed by O. Stone, 1987.
[2] N. Ferguson "*The Ascent of Money*", Allen Lane 2008, ch.1.
[3] S. Kuper "Petal Power", *Financial Times*, 12 May 2007.
[4] See M. Balen "*A Very English Deceit: The Secret History of the South Sea Bubble and the First Great Financial Scandal*", Fourth Estate 2002.
[5] L.E. Mitchell "Financialism. A (Very) Brief History", 2010, available at http://ssrn.com/abstract=1655739. Even though this economic model has become virtually global, it can be said to refer predominantly to Anglo-American economies where financial markets have become the beacon of a new economic order where institutions therein trade to serve their own purposes and do not

over the last fifteen years made societies around the planet increasingly dependent on (and acceptant of) market fluctuations and cycles, on the "ups" and "downs" deemed intrinsic features of financially driven economies.

Over the last decade then, a number of corporate and financial events have severely shaken the foundations of economic systems based on financial services industry. The book contends that two sequences of events (the 2001-03 wave of accounting frauds and the 2007-08 global crisis) provided the background to analyse and explain modern financial scandals. It starts with the observation that financial crises from the last ten years are essentially rooted in two main problems: a corporate governance one, represented by the lack of effective control systems over those who run the company, and a corporate finance one identified with the excesses of financial innovation and related abuses of capital market finance. In response, the book offers a new paradigm – referred to herein as "enlightened sovereign control" (ESC) – which encompasses a new institutional framework for the regulation of certain corporate and financial activities and substantive solutions to the legal issues emerging in the research.

The backdrop of the research is, as mentioned, made of a number of case studies (Enron and Parmalat first, and then Northern Rock and Lehman Brothers) which, by pointing at a number of common denominators underscoring the emergence of financial scandals and general instability, provide evidence to corroborate the book's hypothesis. The analysis and explanation of financial scandals is conducted by highlighting the legal issues that have consistently arisen as main themes from the case studies. In particular, the study of financial scandals follows the path of the two main legal strands of the research, that is: corporate law and financial law. In the context of a legal enquiry into financial crises, these areas provide an ideal setting to examine theoretical and practical determinants recurred over the past decade. Moreover, the combination of these two spheres of law offers a comprehensive perspective into the study and a multifaceted approach to the understanding of events that have otherwise been often branded with mono-dimensional slogans.[6]

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provide resources to fund industry or society. This development will be further illustrated in the thesis.

[6] Arguably most of the works that followed corporate and financial scandals have concentrated on the analysis of one of these two legal aspects and have therefore looked at financial scandals from the perspective of either corporate law or financial law. This approach is probably what led in the aftermath of Enron, WorldCom and Parmalat, to tag these events as accounting scandals, or as

1.2 – Current Status of Research

The explosion of corporate and financial collapses has over the past decade triggered research and debates on their origin. Some of them have to a substantial degree been employed to validate the theoretical base of this book and are herewith briefly signposted.

In the area of corporate law, the work of Berle and Means[7] represents a starting point of the research, especially with regards to their recognition of new ownership patterns appearing in the American corporate world. Empirical data collected over a number of American corporations in the 1930s led to a redefinition of the legal environment within which shareholders and managerial powers were divided. Berle and Means in particular introduced the concept of "managerial power" that had come to dominate US firms, as a consequence of increasing dispersion of share ownership and new legal framework governing shareholders' rights.[8] Similarly, Cheffins more recently conducted a parallel enquiry into the changing business environment characterising UK corporations, and he strongly pointed to the role played – within different stages of British history – by widely-held firms in the broader legal and economic environment.[9]

In the attempt to define the causes of different ownership structures and their conduciveness to corporate instability, Coffee investigated the interplay between legal rules and institutional dynamics, such as the development of market-based, self-regulatory institutions, as main determinant, denying therefore a more central role played by the "legal origin"[10] theory.[11] A similar conclusion is reached by Roe, who, defying

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corporate governance collapses, whereas the corporate finance side of the story proved later to be equally central.

[7] A.A. Berle and G.C. Means "*Modern Corporation and Private Property*", Original edition published in 1932 by Harcourt, Brace & World; New Brunswick London 1991.

[8] Ibid.

[9] B.R. Cheffins "*Corporate Ownership and Control; British Business Transformed*", OUP 2008.

[10] R. La Porta, F. Lopez De Silanes, A. Shleifer and R.W. Vishny "Law and Finance" 106 *Journal of Political Economy* 1113, 1998.

[11] J.C. Coffee Jr "The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control", 111 *Yale Law Journal* 1, 2001; J.C. Coffee Jr "Dispersed Ownership: The Theories, The Evidence, and the Enduring Tension Between "Lumpers" and "Splitters"", *The Centre for Law and Economic Studies, Columbia University School of Law*, Working Paper No. 363, 2010.

the centrality of "legal origin" explanations, pointed at both historical and political factors influencing corporate and financial environments.[12] A different perspective on the debate is offered by Gilson, who emphasised the importance of good corporate laws rather than ownership structures, as main reason for corporate failures. The argument in particular refers to the different possible strategies to face agency issues and to the trade-off ensuing from either corporate model.[13]

The issue of the corporate goal is a central one within the research as it defines a number of corporate governance issues that permeate the very essence of the theory herein proposed. In this area the work of Keay is fundamental in illustrating the contours and main underpinning of the two main paradigms, namely shareholder value and stakeholder theory.[14] In particular, his research highlighted the links between each theoretical proposition and the resulting legal framework applied in this corporate governance context (more specifically with regards to directorial duties). A very useful approach to the study of corporate powers is provided by Parkinson who referred to the influence of politico-economic theories on legal rules in place. The focus is of particular importance in the context of liability rules and of how regulation in this sense has been frustrated by neoliberal corollaries that advocated reliance on market-based mechanisms.[15]

On the above subject a very valuable American perspective is also offered by Blair who countered a number of assumptions upon which shareholder value theory is premised.[16] Similar arguments are brought

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[12] M.J. Roe "Legal Origins and Modern Stock Markets", 120 *Harvard Law Review* 460, 2006; M.J. Roe "Political Preconditions to Separating Ownership from Corporate Control" 53 *Stanford Law Review* 539, 2000; M.J. Roe "*Political Determinants of Corporate Governance: Political Context, Corporate Impact*", OUP, 2002.

[13] R.J. Gilson "Controlling Shareholders and Corporate Governance: Complicating the Controlling Shareholder Taxonomy", *ECGI, Law Working Paper Series* No.49/2005

[14] A.R. Keay "Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach", 2007, *Sydney Law Review*, Vol. 29:577; A.R. Keay "Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?", Working Paper, November 2009, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1498065.

[15] J.E. Parkinson "*Corporate Power and Responsibility*", Clarendon Press Oxford 2002.

[16] M.M. Blair "Shareholder Value, Corporate Governance, and Corporate Performance. A Post-Enron Reassessment of the Conventional Wisdom", in "*Corporate Governance and Capital Flaws in a Global Economy*", by P.K. Cornelius and B. Kogut, OUP, 2003.

about by Stout whose main criticism against the above theory stemmed from the misguided economic view of shareholders as owners of the company.[17]

In the area of financial law, an essential contribution to the book's theoretical background is provided by Mitchell, who highlighted the changes occurred over the past three decades in the financial world and the far-reaching consequences these changes had on the economic system and on society more broadly.[18] This path is followed by pointing to the role played by stock markets within economies and to the persisting differences and implications between two broad patterns of financial development, namely bank finance on one hand and capital market finance on the other.[19] These considerations are linked to reflections on the more recent issue of financial innovation, and on the role it had in the context of the global crisis. Avgouleas provided a very useful perspective on the legal and socio-economic mechanisms that led to the creation of the bubble burst in 2008[20], while Blair exposed some key legal-economic arguments, pointing specifically to the importance financial innovation had in the growth of the shadow banking system and of leverage.[21]

In the context of financial regulation, initial reflections on general regulatory functions in the financial industry are grounded on the work conducted by Goodhard and al.[22], and also by Wood.[23] The role played by financial regulation in allowing the formation of a huge bubble and eventually of its burst is explored by Schwarcz whose research represents an ideal point of reference. In particular, a number of essential issues are

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[17] L.A. Stout "Bad and Not-So-Bad Arguments for Shareholder Primacy", 75 *Southern California Law Review* 1189, 2002.

[18] Supra Mitchell 2010.

[19] A. Hackenthal, R.H. Schmidt, M. Tyrell "Banks and German Corporate Governance: On the Way to a Capital Market-Based System?", *Johann Wolfgang Goethe Universitat*, Working Paper Series No. 146, 2005; H. Siebert "Germany's Capital Market and Corporate Governance", *Kiel Institute for World Economics*, Working Paper No. 1206, 2004.

[20] E. Avgouleas "The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a new Orthodoxy", *Journal of Corporate Law Studies*, Vol. 9, Part 1, 2009.

[21] M.M. Blair "Financial Innovation, Leverage, Bubbles, and the Distribution of Income", *Vanderbilt University Law School*, Law and Economics Working Paper No. 10-31, 2010.

[22] C. Goodhard, P. Hartman, D. Llewellyn, L. Rojas-Suarez, S. Waisbrod "*Financial Regulation – Why, How and Where Now?*", Routledge Oxford 1998.

[23] P.R. Wood "*Law and Practice of International Finance*", Sweet and Maxwell London 2008.

tackled in his work, namely the complexity that resulted from the innovation of financial products, the failure of disclosure mechanisms in unbundling the obscurity of financial information, and the systemic risk generated by the whole financial system.[24] On the adequateness of different regulatory techniques, a very critical approach is offered by Avgouleas, again with regards to the issue of disclosure and to possible alternatives to it.[25] These debates are also complemented by broader enquiries into different regulatory models and cultures that have been eventually reflected in regulatory policies in place.[26]

Beyond the above theoretical background, the book as announced culminates with proposals under the ESC. The paradigm is introduced by providing a review of the relevant theories upon which they are grounded and by developing its theoretical framework. This represents the foundation for institutional and substantive proposals linked to legal issues exposed in the thesis.

The research carried out in the book ultimately purports to contribute to the ongoing debate in corporate and financial circles as regard the causes of the global crisis (and of modern financial scandals more generally). This is achieved by presenting a multifaceted analysis of events occurred over the past decade and an original approach to possible solutions, grounded essentially on a revisited "role of law" in the two above areas. The ESC paradigm offers in this respect a different perspective on the regulation of specific corporate and financial activities, whereby the role of state in regulating and supervising such activities and its actors is envisaged as guarantor for the inclusion of broader societal interests within the regulatory process.

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[24] S.L. Schwarcz "The Global Financial Crisis and Systemic Risk", Leverhulme Lecture, Oxford University, 9 November 2010; S.L. Schwarcz "Regulating Complexity in Financial Markets", 211 *Washington University Law Review* 87, 2009; S.L. Schwarcz "Disclosure's Failure in the Subprime Mortgage Crisis", *Duke Law School Legal Studies* Paper No. 203 2008; S.L. Schwarcz "Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown", *Duke Law School Legal Studies Paper No. 175*, 2008.

[25] E. Avgouleas "The Global Financial Crisis and the Disclosure Paradigm in European Financial Regulation: The Case for Reform", 6 *European Company and Financial Law Review* 2009.

[26] R.H. Weber "Mapping and Structuring International Financial Regulation – A Theoretical Approach", 651 *EBLR*, 2009; E. Hupkes "Regulation, Self-regulation or Co-regulation", 427 *Journal of Business Law* 2009; A.W. Mullineux "Financial Innovation and Social Welfare", 243 *Journal of Financial Regulation and Compliance* 2010.

1.3 – Aim of the Research

As announced, the book's fundamental aim is to propose a paradigm, the ESC, as response to the financial crises occurred over the last decade. The paradigm purports to contribute to current policy debates in the areas of corporate and financial law, firstly by constructing a theoretical framework upon which it is grounded, and secondly by presenting both institutional and substantive solutions to the legal issues analysed in the thesis.

In order to come forward with the proposals, a legal analysis of financial scandals will be conducted. This is done by firstly providing a theoretical background which identifies key issues in the areas of corporate and financial law. The theoretical enquiry leads to the more in-depth analysis of legal issues identified as recurring over the last decade. These are examined also in connection with the relevant legislation that ensued the last crisis. This enquiry culminates with case studies which have the function of firstly illustrating the legal issues arisen as common denominators of financial scandals, and secondly of corroborating the hypothesis formulated in this research.

Admittedly, the two areas of law – corporate and financial law – on which the book is centred, could alone provide explanations to financial scandals without imminent necessity to look beyond their confines. However, the case studies herewith selected expose a high degree of interdependence between corporate governance structures and the strategies pursued by those firms on the capital markets. More generally, literature in the field of corporate governance has increasingly focused on the broad interplay between financial markets and corporations, especially insofar as the former can exert pressure and condition corporate behaviours and strategies.[27] This phenomenon progressively developed over the last three decades and reached its apex with the liberalisation and then with the globalisation of financial markets occurred during the 1980s. The expansion of capital markets in other words created the condition for what has been referred to as "financialisation" of corporate law in general, and more specifically for a tighter influence market logics have come to

[27] See M. Aglietta and A. Reberioux "Corporate Governance Adrift. A Critique of Shareholder Value", The Saint-Gobain Centre for Economic Studies Series 2005, ch.1; M.J. Roe "Legal Origins, Politics and Modern Stock Markets", 2008, available at http://ssrn.com/abstract=908972.

play on corporate executives.[28] Prominent examples in this sense can be provided by looking at the extent to which corporate remunerations have been increasingly aligned to stock market valuations, and by pointing at the reliance on the market for corporate control in the shape of hostile takeovers to create a means to discipline managerial behaviours.

By looking beyond more classical approaches to the interplay between corporate governance and corporate finance, the book focuses on the impact that corporate structures and corporate objectives have on financial strategies. Abuses of capital market finance transactions (some of which have become predominant corporate finance patterns) are in turn explained by looking at the short-term, rent-extraction effects they have for shareholders and executives.

The way in which corporate governance and structured finance problems are intertwined is above all manifested in the multidimensional reactions that the recent financial meltdown has generated. In particular, a multifaceted approach to the solution of regulatory issues seems to be emerging in the aftermath of the crisis, in contrast with responses that followed the Enron-type scandals almost a decade ago. At that time, as the collapses were labelled mainly as accounting and gatekeepers' failures, regulatory responses were centred on strengthening accounting and financial reporting standards[29], leaving outside the scope of that regulation other central issues that had contributed to cause those scandals. The case studies conducted over Enron and Parmalat will expose the relevance of legal issues (the abuse of structured finance transactions), beyond the corporate governance ones, that contributed to cause those corporations' collapse.

From what has been outlined, interrelations between corporate governance and financial transactions are at the centre stage of the research. This is to a large extent reflected by the ESC paradigm which is conceived to encompass institutional and substantive proposals in both areas of law.

With regards to the corporate law strand, the first enquiry is centred on the relevance of corporate ownership in the context of financial scandals

[28] Supra Aglietta and Riberioux 2005, p.1-3. In this sense see also L. Gallino "Finanzcapitalismo – La Civiltà del Denaro in Crisi", Einaudi 2011; R. Blackburn "The Subprime Crisis", New Left Review, 50 March-April 2008.

[29] Preeminent example was the Sarbanes-Oxley Act enacted in the USA in 2002 as a response to Enron, WorldCom, Adelphia, Tyco International, otherwise known as "Company Accounting Reform and Investor Protection Act" in the Senate and "Corporate and Auditing Accountability and Responsibility Act" in the House. See http://www.soxlaw.com/.

and the extent to which the ensuing agency problem can be seen as a cause of concern. The second enquiry revolves around the difficulty of establishing in whose interest corporations should be run. While this theoretical discussion can shed light on the principles underpinning corporate culture over the last three decades, it also triggers more practical questions as to the legal mechanisms in place to monitor those in control of the firm and to make sure that they act in accordance to their duties. These theoretical enquiries flow into the questions addressed in chapter three where legal issues related to the control of managerial behaviours are tackled.

The financial law research strand follows a parallel approach by firstly exploring different patterns of financial development, whereby the chief demarcation is between bank finance and capital market finance.[30] Ultimately, the intrinsic question within this enquiry is the extent to which financial models over-reliant on innovative and complex structures are needed at all to sustain economy and society. This leads to a second enquiry within this strand, namely that related to the regulatory models available to discipline financial markets and set constraints on the activities therein. A theoretical overview of this issue addresses the recurring question related to the regulatory culture from which the current global crisis underpinned and from which the complexity inherent to certain transactions generated. The above theoretical investigations are completed by a practical examination conducted in chapter four, on the way in which structured transactions developed in the context of capital market finance.

Addressing the above legal issues, and critically appraising *post*-crisis reactions, paves the way for the presentation of more substantial contribution of this research, reflected in the measures proposed in the paradigm to establish long-term solutions to different institutional and substantial problems exposed in the analysis.

1.4 – Methodology

Research in this book is conducted using chiefly a qualitative literature-based approach, which is complemented by legal resources (both

[30] See S.L. Schwarcz "Markets, Systemic Risk, and the Subprime Mortgage Crisis", 209 *SMU Law Review* 61 2008, p.211. The prevailing trend has seen over the last decade an increasing disintermediation from banks, with corporations resorting to capital markets finance, through the employment of structured finance transactions like securitisations and derivatives.

primary and secondary sources).[31] The project is to a large extent concerned with the analysis of the legal and socio-economic literature that serves firstly to illustrate the theoretical framework of the work and secondly to substantiate the critical review of legal issues. Similarly the case studies[32] conducted to expose the emergence of certain theoretical and legal issues, are based on literature or reports reviewing different aspects of the highlighted events.

It is worth pointing out here that while the main point of reference for legal analyses carried out in the thesis is English law, some aspects of the research involve areas of law that are to a substantial degree practice-driven and do not necessarily attach to a particular legal system (straightforward examples could be that of some corporate governance arrangements that reflect cross-border similarities, or the way in which some financial transactions are structured, which results in rather converging international practices). Beyond this, reference to relevant laws in the research is made with regards American laws, EU laws and also Italian laws. This phase of the analysis also seeks to explain that much of the literature available relates to the USA and the UK[33], and that writings relating to corporate and financial developments beyond this are more limited.

To the extent that the study involves a parallel examination of different legal systems, a comparative research methodology[34] is employed whereby literature and norms from appropriate sources are examined to expose the relevant dichotomies (for instance that between Anglo-American and continental European corporate governance, or between bank-centred financial systems and capital market driven ones).

Finally, it also needs to be pointed out that the research has followed in some chapters a selective approach to the issues analysed. In particular, chapter three and four take under consideration a number of legal matters

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[31] The former consisting of both statutes (UK, EU or US when relevant) and common law, the latter represented also by reports, journal articles and reviews of events and legal reforms.

[32] R.K. Yin "Case Study Research: Design and Methods", Sage Publications 2003, p.13, where a case study is defined as "...an empirical enquiry that investigates a contemporary phenomenon within its real life context...".

[33] This is due to the wider development of the Anglo-American literature in the field, which indeed reflects the impact on society of an economy characterised by large public corporations and deep and liquid financial markets, which are two common factors emerging from the research.

[34] See C.C. Ragin "The Comparative Method: Moving Beyond Qualitative and Quantitative Strategies", University of California Press1992.