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By George Monbiot,
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Other People's Money

Make bosses pay for the disasters they cause

Once more, they walk away. The senior bosses at Carillion, like those at RBS, Northern Rock and a host of other corporate zombies, went home to count their undiminished millions. The pain they inflicted was felt by others. Reckless greed paid out again.

The Commons report on this fiasco[1] is one of the most damning assessments of corporate behaviour parliament has ever published. But it's still pathetic. While it scorches the company's executives and board and laments the weakness of the regulators, it scarcely touches the structural causes that make gluttony a perennial feature of corporate life.

The problem begins with an issue the report does not once mention: the extreme nature of limited liability. To allow the owners of a limited company to risk nothing but the money they have spent on shares is to grant them free, uncapped indemnity against the risks they impose on others. It's the equivalent of permitting drivers to take to the roads without buying insurance, knowing that if they cause a crash they will carry no more than the cost of replacing their own car, regardless of the expense, injury and death they might impose on others.

The current model of limited liability allowed the directors and executives of Carillion to rack up a pension deficit of £2.6 billion[2], leaving the 27,000 members of its schemes to be rescued by the state fund (which is financed by a levy on your pension – if you have one). This indemnity permitted the owners of the company to walk away from the £2 billion it owed to its suppliers and subcontractors.

The same free pass landed the cost of rescuing the public services so foolishly entrusted to this company back on the government.

A recent study[3] exposes a direct link between the generosity of the limited liability regime and the corporate incentive to dump costs on other people. In 1998 the US Supreme Court ruled that parent companies were liable for only narrowly defined harms caused by their subsidiaries.

The study reveals that in the aftermath of this decision, toxic emissions by subsidiary companies in the US rose by an average of 10%, as they cut investment in abatement technologies.

Limited liability not only allows companies to act recklessly with regard to the interests of others – it obliges them to do so. Directors have a fiduciary duty to use all legally available means to maximise shareholder value.

Limited liability compels them to externalise risk.

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[1] https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/769.pdf

[2] https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/769.pdf

[3] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3083013

There is no way that fossil fuel companies could pay for the climate breakdown they cause. There is no way that car companies could meet the health costs of air pollution[4]. Their business models rely on dumping their costs on other people. Were they not protected by the extreme form of limited liability that prevails today, they would be obliged to switch to clean technologies.

Various estimates put the cost that businesses dump on society at somewhere between 4%[5] and 20% of GDP[6]. In other words, it exceeds the rate of economic growth. Were such costs internalised, the economy would have to be run on an entirely different basis. Human health and the survival of the natural world would come first; corporate greed would come last.

Executive incentives also conflict with the interests of society. Even as *Carillion* spiralled down, pay and bonuses spiralled up. The *UK Corporate Governance Code*[7] recommends that directors who fail in their duties should forfeit some of the pay they would otherwise have received, but the details are left to the discretion of their companies. In *Carillion*'s case, the remuneration committee defined the terms so narrowly that even total failure did not trigger a clawback of the executives' vast bonuses.

Its long-term incentive plans were useless. The finance director, Richard Adam, had a stack of performance shares that were held back for three years, ostensibly to prevent reckless behaviour. But the Commons report alleges[8] that his *"accounting tricks"* propped up the value of the shares until the day they became payable, whereupon he sold them. Within two months, their value had fallen by three quarters. Even when they work well, such incentives protect only the interests of the corporation, rather than the interests of society.

So what is to be done?

The first step, I believe, is a radical reassessment of limited liability. A recent paper[9] by the US law professor Michael Simkovic proposes that companies should pay a fee for this indemnity, calibrated to the level of risk they impose on society. Why, after all, should this insurance be free? As numerous leaks show[10], companies tend to be far more aware of the risks they inflict than either governments or the rest of society. The fees they are prepared to pay for limited liability will reveal their own assessment of the costs they currently externalise.

Antisocial practices could be progressively priced out.

As for the executives, I have a tentative proposal of my own. Any manager earning more than a certain amount – say £200,000 – would have half their total remuneration placed in an escrow account, which is controlled not by the company but by an external agency.

The deferred half of their income would not become payable until the agency judged that the company had met the targets it set on pension provision, workers' pay, the treatment of suppliers and contractors and wider social and environmental performance.

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[4] https://www.gov.uk/government/publications/air-pollution-a-tool-to-estimate-healthcare-costs

[5] read here

[6] https://ratical.org/corporations/hiddenCosts.html

[7] https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf

[8] https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/769.pdf

[9] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3121519

[10] https://www.climateliabilitynews.org/2018/04/05/climate-change-oil-companies-knew-shell-exxon/

This judgement should draw on mandatory social and environmental reporting[11], assessed by independent auditors.

If they miss their targets, the executives would lose part or all of the deferred sum. In other words, they would pay for any disasters they impose on others. To ensure it isn't captured by corporate interests, the agency would be funded by the income it confiscates.

❒ Are these the right solutions? I'm not yet sure. So please support them, oppose them or suggest better ideas in the comment thread. I know that, at best, they address only part of the problem.

❒ Should corporations in their current form exist at all?

❒ Is capitalism compatible with life on earth?

❒ Radical as they sound, the ideas in this column are small steps. But by comparison to the timid measures in the Commons report, they're giant strides.

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[11] https://www.cdp.net/en