Law and Investment Entities

This essay is a pre-proof version of the introductory essay from my book The Law on Investment Entities *which was published in 2000 by Sweet & Maxwell. The summary information about that book is elsewhere on this site. This essay considers some of the fundamental substantive law concepts relating to investment.*

LAW AND INVESTMENT

This book seeks to identify the central principles of the law on investment when that investment is effected through the particular forms of investment entity and legal structure considered in the sections which follow. It is argued that the core of the law on investment is not found solely in financial regulation nor any specific statutory provision: rather, the kernel of the law on investment is constituted by the complex system of inter-actions constituted by the investment entities themselves. To analyse the general principles of the legal treatment of investment it is necessary to unpack the component parts of these structures and to consider the respective rights and obligations which are arise between the investor, the manager and the investment entity itself.

The threads of analysis which makes up this book are therefore concerned with the legal nature of investment and, more specifically, with the legal nature of the entities through which investments are carried out. It is the investment entity which expresses the nature of the investment made - whatever form that investment may take. This book is not, primarily, an analysis of the legal rights and responsibilities which arise in investment generally (for example, the tortious or restitutionary liabilities of those who sell investments by way of a trade - although those issues are considered). Rather, it is a comparative analysis of the main forms of legal structure *in which* investments are made.

There are two basic techniques which constitute the fundamental structure of this book: the use of the trust and the use of the company. Therefore, early sections of the book considers that nature of the trust and then the nature of the company as tools of investment in English law in Part B *Law and fundamental investment structures.* Of particular concern are two main issues: first, the way in which the investor acquires proprietary rights in relation to the investment entity and, second, the personal obligations which are created between the investor and the investment entity's fiduciaries.

From that discussion grows a further analysis of various forms of investment entity based on one or other of those core structures. Those areas will be as follows: ordinary trusts used for investment purposes; issues of share capital in ordinary companies; partnerships; pension funds; bond and eurobond issues; use of bonds and trusts for collateralisation purposes in complex financial transactions; unit trusts; open-ended investment companies; 'investment trust' companies; friendly societies; industrial and provident societies (including co-operatives); credit unions; trade unions; NHS trusts; and both the Private Finance Initiative and the Social Fund in the

public sector. There is also discussion of the nature of banks and of building societies although these are presented in this discussion as not entities *in which* investment is made but rather as entities which occupy more complex status as entities *through which* investment is made.[1] The discussion then resolves itself into a discussion of the manner in which the development of ideas of stakeholding, social welfare and risk can and should implant themselves into English law's understanding of rights in investment entities in the concluding chapter.

CENTRAL THEMES IN INVESTMENT AND LAW

The follow discussion sets out the broad nature of these themes which are then pursued in the remained of this chapter and in chapter 2 *Theories of contract, property and money in law*.[2] In considering the nature of investment, there are a number of issues which fall to be analysed together. The aim of this introductory essay is to draw out some of those themes at an initial stage before analysing how they are considered generically in trusts law[3] and company law,[4] and then applying them to the detail of specific forms of investment vehicle.[5]

The term "investment"

This book will be at pains to present investment as falling into two broad categories: *speculative financial investment* and *social investment.* It is anticipated that many readers of this book will have acquired it or pulled it down from the shelf based on an interest in financial services and financial products. Therefore, *speculative financial investment* will be the pre-eminent interest of such readers. For them, the discussion of subjects such as the issue of share capital[6] and the mechanics of eurobond issues[7] will be of particular interest.

However, the concern of this book is with the many sets of rights and obligations which are created in investment entities. In that regard this book will also analyse *social investment* through community-based initiatives such as credit unions and

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[1] Therefore, this book is distinct from discussions such as Rider, Abrams, Ashe *Guide to Financial Services Regulation* (3rd edn., CCH Editions, 1997) and Powell and Lomnicka *Financial Services Law* (Sweet & Maxwell, successive releases). Both of those excellent texts are concerned with the statutory treatment of financial-speculative investment activity generally, rather than specifically with the structures *in* which investment is made. This book is concerned to draw out the particular component parts of the legal treatment of investment in the round.

[2] This will not therefore be an examination of the specific legal treatment of banks in the manner of Cresswell, Blair, et al, *Encyclopaedia of Banking Law* (Butterworths, successive editions); Cranston, *Principles of Banking Law* (Oxford University Press, 1997); Ellinger and Lomnicka, *Modern Banking Law* , 2nd edn., (Oxford University Press, 1994) which concern themselves with the law relating to banking activity (including cheques, the maintenance of bank accounts and so forth) and attendant regulation. This book considers the structures in which investment is to be made.

[3] Chapter 3, *Trusts used for investment purposes.*

[4] Chapter 4, *Companies used for investment purposes*.

[5] In Part C *Specific trusts used for investment purposes*, and Part D *Collective investment schemes and other mutual funds* respectively.

[6] Chapter 4, *Companies used for investment purposes*, particularly at p. *et seq.*.

[7] Chapter 6, *Bonds, eurobonds and collateral transactions*.

friendly societies. While this area has received little detailed consideration in technical legal literature since the 1970's,[8] governmental policy and broader social policy is once again emphasising the need for spontaneous self-help initiatives. Those initiatives will have to use structures which developed in the 19th century for selling insurance services to local communities. In this regard the discussion of community and social welfare in this area posits a very different context from speculative, financial investment.

At first blush it might seem that there is nothing of interest for those interested in modern finance in the social investment sphere. It is respectfully suggested that such a supposition would be a mistake. Rather, it will be demonstrated that the ordinary English law company is based on identical structures to the community-based initiatives considered in this book. A proper understanding of companies is predicated on the need to understand better the roots of the company in English law. Furthermore, the development of the private finance initiative (PFI) in relation to local government funding and the creation of bodies corporate like NHS trusts to manage public welfare services, draw on this context of combined public/private norms relating to investment. Indeed these social investment initiatives are increasingly important facets of investment activity for large commercial concerns. Therefore, it is instructive to consider the different legal contexts which exists in relation to each context.

Risk

"Risk" is a particularly modish concept in modern sociological theory[9] as well as a central concern of modern finance and speculative, financial investment. Those two contexts in which risk is considered are, however, very different. From the perspective of modern financial markets, 'risk management' is a familiar term connoting the quasi-science of measuring risk and volatility attaching to particular financial products which is then factored into the cost of those products.[10] One of the more famous risk management models is the Black-Scholes Model[11] for measuring the volatility attaching to financial options. This mathematical formula provides a quasi-scientific method for the cost of risk to be factored into the cost of investment products by "financial engineers" (itself a common market term for those who price such products which itself mixes finance with a reassuringly scientific imagery). Indeed many financial products are created with the express purpose of managing the risks faced by their buyers.[12] So it is that buyers of interest rate swaps will frequently

[8] See perhaps the most recent discussion of this area in Snaith, *The Law on Co-operatives* (London: Waterlow, 1984).
[9] The literature in this area is growing apace. See particularly Beck, *The Risk Society* (Sage, 1992); Giddens, *Beyond Left and Right* (Polity, 1993); Beck, Giddens and Lash, *Reflexive Modernity* (Polity, 1994). These ideas are considered in greater depth at p. … in this chapter.
[10] On which see the specific, technical literature such as Banks, *The Credit Risk of Complex Derivatives* (Macmillan 1994), and Das, *Swaps and Derivative Financing*, 2nd ed. (Irwin, 1994). The legal context is considered in Hudson, *Swaps, Restitution and Trusts*, (Sweet & Maxwell, 1999), 34 *et seq*., 78 *et seq*..
[11] On which see Black and Scholes, 'The pricing of options and corporate liabilities' (1973) 81 *Journal of Political Economy* 637-653.
[12] Hudson, *The Law on Financial Derivatives*, 2nd edn. (Sweet & Maxwell, 1998), 9 *et seq*..

be attempting to reduce (or remove) their exposure to market interest rate movements.[13]

The sociological approach is less closely centred on a purportedly scientific means of calculating, accounting for and managing financial risk. Rather than present 'risk' as something which can be measured and expunged or 'managed', the sociological theory conceives of the impact of social modernity introducing ever more risk to the biographies of individual citizens. In particular, this discussion will consider the work of Beck[14] and Giddens[15] in showing how a 'risk society'[16] has emerged from the break-up of social structures (such as the nuclear family, linear work patterns, geographically organised communities and so forth) in the late twentieth century in a way that is said to have created both opportunities for individual citizens and also hazard.[17]

For the purposes of this book, the social context of risk will be most clearly visible in relation to private pension funds[18] and those forms of investment entity which purport to provide personal welfare services. The discussion of pensions will consider the movement away from state provision of pensions and increased emphasis instead on reliance on private pensions. The result for the legal context of pension trust funds is the applicability of traditional principles of the law of trusts to the new, social context of private sector pension provision. The introduction of a pensions regulatory architecture is testament both to the social significance of private pensions and to an institutional nervousness as to the ability of trusts law norms to cope with this expanded context.

The legal nature of money

In relation to the discussion of investment (whether speculative, financial investment or social investment) the measurement of the value of the investment made is generally in terms of money, even if the investment itself is not made straightforwardly in cash.[19] The return in relation to speculative, financial investment (if not always in relation to social investment) is similarly measured in terms of the cash value generated by the initial investment. Given the central importance of money both as a currency and as a means of establishing value in investment or in the economy more broadly, the law has a very complex understanding (or, misunderstanding) of the nature of money. In the common law particularly, money is

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[13] *Ibid*.
[14] A good, representative sample would include Beck, *The Risk Society* (Sage, 1992); Beck, *World Risk Society* (…); Beck, *Democracy without Enemies* (…).
[15] Similarly, a reasonable sample would range from the early Giddens, *The Constitution of Society*… to the more recent focus on institutional reflexivity in Giddens, *Modernity and Self-Identity*, (Polity Press, 1991); Giddens, *Beyond Left and Right*, (Polity Press, 1994); Giddens, *The Third Way* (Polity Press, 1999).
[16] An expression coined by Beck, *The Risk Society* (Sage, 1992), *op cit.* n.14.
[17] The term "hazard" is used here to connote a particular, typically pejorative form of risk although the philosopher Heraclitus considered "hazard" to be a force more closely associated with the "social chaos" addressed in this book: on which see Fowles, *The Aristos* (Pan,).
[18] Chapter 5, *Pension funds.*
[19] Discussed at Chapter 2, *Theories of contract, property and money in law*.

considered to be a chattel with a constant value[20] even though many of the key cases decided by the English courts in the 1990's related to money held in electronic bank accounts as part of cross-border financial transactions.[21] That money does not in fact have such a constant value is demonstrated by the fluctuating value of sterling on foreign exchange markets. More difficult is the law's continued understanding of money as a tangible chattel in relation, for example, to the 'loss of the right to trace' rule[22] which means that a claimant loses any proprietary right in a bank account which is in credit at the time of the claim because the account has gone overdrawn.[23]

The nature of fiduciary responsibility

Of particular moment is the perpetually complex category of the fiduciary.[24] All that can be known about the nature of fiduciary responsibility is that its applicability will differ from circumstance to circumstance by broad analogy with established categories of fiduciary office like trustees, partners, company directors and agents.[25] Once it is accepted that a person occupies fiduciary office, broad obligations of loyalty will be imposed (typically precluding self-dealing and conflicts of interest).[26] Each form of fiduciary office will require separate analysis.[27]

This book will focus most specifically on various forms of trusts, companies and other bodies corporate used as investment entities. The nature of the obligations of trustees and directors appear well-established with well-developed streams of common law authority and smatterings of statutory intervention. However, what will emerge from the discussion is a distinction between the obligations imposed on professional fiduciaries who are able to restrict their liabilities by means of contract and the obligations imposed on non-expert fiduciaries who bear the ordinary burdens of office created by caselaw and statute. The result of this distinction is that the professional, despite her expertise, will frequently bear obligations generated by a lesser standard of skill than the well-meaning amateur. This results from the interplay between the law of fiduciaries and the law of contract.

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[20] *Ibid*; see also Gleeson, *Personal Property* (London: FT Law and Tax, 1997), 146.
[21] *Agip v. Jackson* [1990] Ch 265, 286, *per* Millett J.; CA [1991] Ch 547; *Barlowe Clowes International Ltd (in liquidation) v. Vaughan* [1992] 4 All E.R. 22; *Bishopsgate v. Homan* [1995] 1 WLR 31; *Boscawen v. Bajwa* [1996] 1 WLR 328; *Chase Manhattan Bank NA v. Israel-British Bank (London) Ltd.* [1981] 1 Ch. 105; *Goldcorp, re* [1995] 1 A.C. 74; *Guinness Mahon v. Kensington & Chelsea R.L.B.C.* [1998] 2 All E.R. 272; *Kleinwort Benson v. Sandwell Borough Council* [1994] 4 All E.R. 890, Hobhouse J; *Kleinwort Benson* v. *South Tyneside M.B.C.* [1994] 4 All E.R. 972, Hobhouse J.; *MacJordan Construction Ltd v. Brookmount Erostin Ltd* [1992] B.C.L.C. 350; *Macmillan v. Bishopsgate* (No3) [1996] 1W.L.R. 387; *Westdeutsche Landesbank Girozentrale v. Islington L.B.C.* [1996] AC 669, HL.
[22] *Roscoe v. Winder* [1915] 1 Ch. 62; *Bishopsgate v. Homan* [1995] 1 WLR 31.
[23] *Ibid*; *Westdeutsche Landesbank Girozentrale v. Islington L.B.C.* [1996] AC 669, HL.
[24] For an excellent, recent survey see McCormack, "Fiduciary obligations in a changing commercial climate", in Rider and Andenas eds., *Developments in European Company Law* Vol. 1 (Kluwer, 1996), 33, which suggests correctly that the categorisation of a person as a fiduciary is only the beginning of the question: thereafter there will follow the difficulty of establishing the precise nature of the duty owed and those capable of enforcing them.
[25] Finn, ed., *Fiduciary Obligations* (Sydney, 1977); Finn, "Fiduciary Law in the Modern Commercial World" in McKendrick, *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon Press, 1992).
[26] *Ibid*; see also Birks, *Privacy and Loyalty* (Clarendon Press, …) generally.
[27] See for example *Foskett v. McKeown* [2000] 3 All E.R. 97. ?????

Contract, property and trust

The investment relationship, when speculative-financial or social in nature, is orientated around the compact reached between investor and manager as to the use of identified property for the purposes of generating a return or providing some security against an anticipated risk. In legal terms a contract is created between investor and manager constituting a web of expectations, limitations of liability, obligations and entitlements. Each element may be expressed in the contract or implied from that arrangement. Alternatively, the general law of torts and of fiduciaries will govern the personal inter-action between investor, manager and investment entity. Layered onto that relationship will be legal entitlements to property (whether money or other property) and liabilities typically relating to the use of such property. Property will be applied as investment capital. However, the investor may or may not acquire proprietary rights in the fruits of the investment depending on the context. Differing forms of investment entity generate differing forms of personal and proprietary rights.

This book is concerned with the encapsulation of the investment activity in investment entities, rather than with the general activity of investment. Its concern is with investment through structures built on contract and trust - a schemata which necessarily includes the company and other bodies corporate. The trust and the company as vehicles for the holding and use of property are themselves webs of property rights and personal obligations (whether contractual or quasi-contractual) between the manager (trustee, director or other fiduciary) and the investor (beneficiary, shareholder or other participant).

The role of 'trust' here is important. Not only does it express, in broad terms, the nature of the fiduciary relationships created by investment arrangements,[28] but it also expresses a more subtle, non-legal bond between the parties: that of trust in its ordinary sense. As Cotterell explains the term,[29] trust in its legal sense reverses the usual dependency which the person 'doing the trusting' experiences in relation to the trustee (or, 'person trusted'). In the classic trust game in which I fall backwards and trust that you will catch me, I am dependent on your good faith. As I fall backwards through the air I am powerless and given a few long seconds in which to ruminate on the absurdity of my rapidly changing position.

The trust in Equity, however, creates the 'beneficiary' and vests her with great power over the trustee. In relation to the community-based investment entities considered in Part E, the nature of 'trust' is more equivocal. The investors do acquire legal rights against the manager of the entity (frequently undefined by the reported cases, as will emerge[30]) but they also place their personal wealth in the hands of people who are

[28] In relation to 'broad terms' it is accepted that company directors are not trustees, although as considered below, there is a broad correlation in the genesis of the legal rights and obligations attaching to each. The reference is also to the other forms of investment entity not falling neatly into either category of trust or company but rather being some form of 'body corporate' like NHS trusts or entities like friendly societies.

[29] Cotterell, "Trusting in Law: legal and moral concepts of trust", (1993) *Current Law Problems* Vol. 46(2) p.75.

[30] See chapter 15, *Local government: PFI and the social fund*.

frequently work colleagues,[31] fellow members of a club,[32] or near neighbours.[33] The trust here is bound up in the common bond[34] which has given birth to the collective investment entity. That is a different context from the collective investment schemes which were born out of similar economic and social movements in the 18th and 19th centuries (linked both the expansion of the British Empire and the making of a working class from the feudal serfs). Collective investment schemes are organised under the Financial Services and Markets Act 2000 as speculative-financial entities, along with the 'investment trust' companies. Trust in this sense encapsulates the bond between the members of a communal investment entity.

The use of the word 'trust' will appear in relation to entities which are not properly trusts at all (such as investment trust companies, NHS trusts, and housing action trusts) because of that word's political resonance. It carried overtones of reliability, solidity and mellow fruitfulness. The trust will also emerge as the root of the modern company.[35] The trust itself is based on a combination of proprietary rights exercisable by the beneficiary over the trust fund and personal obligations between beneficiary and trustee. The personal obligations are in themselves comparable to contract. All investment entities are formed from subtle adaptations of this root.

THE PLACE OF INVESTMENT IN LAW AND SOCIETY

This book takes the approach that all forms of investment have some social significance. In relation to speculative, financial investment there is a changed social context in which global markets speculate one on another and which drive domestic economies in a way in which they have not in the past.[36] To express the power inherent in these institutions is merely to enter into trite observation. For commercial undertakings in a domestic or international context, access to global capital markets is very important in raising capital. But investment is not restricted to the commercial sector. The development of public policy has seen public bodies (whether Ministries of State or Next Step Agencies) raise money not only by means of taxation, government bond markets or even ordinary debt from commercial lenders, but also through complex structures using private capital for large scale projects such as the Private Finance Initiative.

This section will attempts a working definition of the term 'investment' and also the essential component 'risk'.

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[31] For example in relation to a trade union or possibly friendly society.
[32] For example in relation to unincorporated associations, or pre-regulation friendly societies.
[33] For example in relation to credit unions.
[34] Still a pre-requisite of industrial and provident societies.
[35] See p. … .
[36] Chomsky, *Profit over people* (New York, Seven Stories Press, 1999),91 *et seq*., and 145 *et seq*.; Hutton, *The State We're In* (Jonathan Cape, …); Giddens, *Runaway World* (London, Profile Books, 1999) esp. 6 *et seq*..

The definition of the term "investment"

There are a number of legal definitions of 'investment' of which the best known is that in the Financial Services Act 1986, s.1 which referred to investment activities as including those activities which are defined in the legislation as requiring authorisation before an entity can carry on the sale of investments of the prescribed types.[37] That legislation is concerned primarily with the regulation of those who sell investment products. What that legislation does not help us to do is to analyse the component parts of investment activity and the risk and return decisions which are necessarily bound up with that.

Investment is not simply a question of financial return. Rather, there is investment by the state in the generation of greater social justice through the welfare state. For example, the Borrie Commission on Social Justice took as its preferred form of society one which invests in its citizens.[38] This was identified as the key to the achievement of a successful and social just organisation of our polity. It is a definition which has excited some comment from those on the Left who were disappointed that the Borrie Commission did not focus sufficiently on universal welfare benefits or a traditionally leftist goal of equality of outcome.

What is common to both definitions of investment is the presence of risk. Whether the risk borne by the investor or the more general risk that the investment will not generate the anticipated result. It is to that concept that attention must now turn.

Risk

In a book about investment it would be remiss to fail to consider the concept of risk. The following section of this chapter gives an account of the ways in which the idea of 'risk' have a part to play in investment as considered in this book, taking both financial and sociological accounts of risk into account.

The initial connotations of the term 'risk' are pejorative. They carry (for this writer in any event) immediate mental images of cliff edges or busy motorways in the rain. In financial terms they are also reminiscent of betting your shirt on a pit pony quoted long odds at Kempton Park. The meaning that is applied to 'risk' in the newer sociology is often positive.[39] It is said that risk is bound up with *choice*: wherever there is risk, there is also a decision.[40] We have more lifechoices than ever before: people are living longer, the average health and education of the population at the start of the twenty-first century is better than at the start of the twentieth, and many members of society (principally women) have greater opportunity to select their own life patterns than before. Thus opportunity and choice are in greater abundance than before. The monetarist economics of the time place a greater premium on this ability to choose than on the responsibility to contribute through taxation to a welfare state

[37] A scheme now replaced by the Financial Services and Markets Act 2000 in relation to the authorisation of investment and financial services.
[38] *Strategies for Renewal - report of the Social Justice Commission* (Vintage, …).
[39] Beck, "The Cosmopolitan Society" in *Democracy without enemies* (Polity,), .
[40] Beck, "…" in Beck, Giddens and Lash ed., *Reflexive Modernity* (Polity, 1994), .

which offers security. Risk then, while also reflecting the responsibilities and dangers bound up in the possibility that the choices we make will go awry, contains the possibility that those choices offer the chance of improvement and success. The bulk of lifechoices are built on investment: pensions, the home, education, healthcare. All involve more investment than ever before by individuals, financial service providers or government.

On this model, risk is omnipresent in modern life. With the enhanced focus on financial services, on efficiency, and on value for money in the modern age, the pressure to organise one's financial affairs is greater than ever. We are conscious of the money which we have and which we do not have. A more widely-travelled population with access to television, newspapers and the internet can know much more about the lives and lifechances of others than was possible for previous generations. Expectations are therefore higher; and potential for feelings of inadequacy are also more acute. With the expansion of choice and existential dilemma comes the shrinking of the welfare state.[41] The structures which once would have sheltered or reassured the citizen against the hazards of life are receding. We must all take responsibility for our old age, for the risk of redundancy, for those same risks awaiting our children and our parents. The language transmutes from hazard (tidal waves, epidemic illness, external dangers[42]) into risk - something which is bound up now with need for us to make choices between a variety of options rather than simply to shelter ourselves against acts of God. Risk is something which arises in this form of 'manufactured risk'[43] because we are responsible for the choices we make: we take the risk that their outcomes are not a desirable as other potential outcomes, that our chosen pension fails to perform, that we have not insured against the loss we have suffered.

Financial risk management

For the financier risk is both hazard and opportunity. Without the volatility of financial markets there would be little hope of the profits which the banks and investment institutions expect to generate. Profitability and wealth are dependent on a game of hazards. Banks would only be able to make profits from charging ordinary citizens fees for holding our puny salaries if it were not for the volatility inherent in the money markets and the stock markets which in turn make differing forms of investment by turns more and less profitable. Take the beta co-efficient in bond yields, the volatility priced into the Black-Scholes option pricing model, the arbitrage possibilities offered by the comparative performance of different currencies. Risk in the form of hazard (that is, losing as well as winning) is necessarily a part of financial activity in global financial markets. Risk and volatility are the bloodstream of financial profitability. Risk is a mixture of hazard and opportunity here.

The financial industry operates on risk. The investment policies of the speculative, financial investment entities considered in this book are dependent on strategies based on expectations of volatility and movement. Those who manage pension funds (and the future security of every pensioner) are concerned with the exploitation of risk:

[41] Giddens, *Modernity and Self-Identity*, (Polity Press, 1991).
[42] Or 'external risk' as Giddens calls it: Giddens, 'Risk and Responsibility' [1999] 62 MLR 1.
[43] *Ibid*.

hence there is risk borne by any pensioner who buys into a pension plan. The finance industry has created a sub-industry which offers management of the risks created by the main speculative activity. Ironically, these risk management strategies are often more risky than the hazards which they are created to control: the best example being financial derivatives. The financial derivative (whether future, option or swap) offers both the possibility of risk management and of speculation: all in the same tablet.[44] For the cynical, the legacy of financial derivatives has been the collapse of financial institutions like Barings and the generation of exceptionally complex litigation to decide how to unpack derivatives transactions once they go wrong.[45]

The risk society

The expression 'risk society' is one used by the social theorist Ulrich Beck.[46] It is avowedly not another brand of postmodernism.[47] For the postmodernists, politics has come to an end - perhaps under the weight of accumulated irony and pastiche.[48] The risk society is said to be one which offers a different kind of modernity: one in which the new arenas of political power are directed at the possibilities and hazards of risk. The key components of this politics for Beck are generally in ecology, gender and labour.[49] In relation to the environment we are said to have moved beyond simply *external risk* in which we fear the dangers of nature (like tidal waves, floods and volcanoes) and into an era of *manufactured risk* in which the principal risks are of our own making (like global warming, acid rain, and nuclear radiation). This risk is therefore *reflexive*: our concern is with risk generated by the risk society itself and need to cope with the inherent contradictions of our time.

The investment activities considered in this book, and particularly the use of financial investment to replace much state provision of welfare services, has generated an extra dimension of manufactured risk. Both requiring ordinary citizens to rely on investment to provide for their personal security and basing the funding of many infrastructural developments in the public sector constitute manufactured risk: that is, risk of those services failing to be fully provided depending on the outcome of that underlying financial investment.

Giddens has taken up this theme in considering the impact of re-allocating risk onto citizens in the form of increased lifechoices. It is in this discussion that he identified the potential for increased existential angst as the individual is required to identify the

[44] This discussion cannot encompass the detail of derivatives products: the reader is referred to Hudson, *The Law on Financial Derivatives*, 2nd edn., (London: Sweet & Maxwell, 1998).
[45] On which see the local authority swaps cases considered exhaustively by the authors in Birks and Rose, ed., *Lessons from the Swaps Litigation* (Mansfield Press, 2000).
[46] Beck, *The Risk Society: towards a new modernity* (London: Sage, 1992).
[47] He declares at the outset his concern to get past this prefix 'post', pointing out its unnecessary complexities: 'We have become used to post-industrialism now for some time, and we can still more or less make sense of it. With post-modernism things begin to get blurred. The concept of post-Englightenment is so dark even a cat would hesitate to venture in.' Beck, *ibid*, 9.
[48] Two of the key components of the postmodern as identified by Jameson, *Postmodernism: the cultural logic of late capitalism* (London: Verso, …).
[49] Each of these receiving a separate essay treatment in *Risk Society*, *op cit.*.

lifechoices which she or he wishes to make.[50] This ties into investment by the broader need for investment in our society - an issue pursued in chapter 16 *Conclusions.* There are two ways of conceiving of this reflexive risk: either as hazard or as opportunity. Its importance in relation to investment is this risk is bound up with the volatility necessary to generate gain and loss. This is reminiscent of the biblical parable of the talents[51]: the "wise" son used his talent whereas the "foolish" son buried his talent in the ground. The folly of the latter son is said to be based on his failure even to receive interest on depositing that money with the equivalent of a bank. In today's parlance that son is simply "risk averse". However, the global economy puts us all in the position of the first son: the position of taking risks dependent on the volatile performance of the many investments in which we participate willingly or on which we are unwittingly dependent.

Law, equity and risk

The law's understanding of risk is typically something very different from the sociological concept of risk: as is considered below in relation to *risk allocation*. Risk is not a legal concept nor a legal category. That is, social theorists understand "risk" as being a distinct sociological category bound up with modernity, in contradistinction to the common law which has no similarly comprehensive understanding of risk. Instead risk in law in conceptualised only in very particular contexts (such as risk allocation in the law of contract) without any more general understanding of risk as a social phenomenon. Specific commercial activities like insurance business and sale of goods necessarily involve risk but the law has not developed any particular theory of risk in that context.[52] The Financial Services and Markets Act 2000 does have a greater focus on the need for the regulatory bodies to take account of particular forms of financial risk, as considered specifically below.

At a very general level it could be said that the allocation of legal liability in any situation necessarily involves the fruition of a risk: the risk that that person would be held liable, that one person will win and that another will lose. In carriage of goods by sea, one person bears the risk that the goods will arrive in suitable condition at the end of the voyage: the contractual allocation of risk mentioned above. Taking advice from a lawyer on the probable legal outcome of a particular form of action requires the client to take a risk on that legal analysis. As citizens we take risks on the performance of the agencies of law and on the future development of the law as part of our lifechoices.[53] We depend on the law (or some legal agency) regulating the activities of those who look after our personal wealth, our health and our homes: whether through the law of contract, tort, or otherwise. Risk in these contexts is

[50] Giddens, *Modernity and Self-Identity*, (Cambridge: Polity Press, 1991); Giddens, *Beyond Left and Right*, (Cambridge: Polity Press, 1994).
[51] A "talent" in this context being a large sum of money.
[52] See for example Sale of Goods Act 1979, ss. 20, 32, 33; Goode, *Commercial Law* , 2nd edn., (Harmondsworth: Penguin, 1995), 248 *et seq*..
[53] Habermas outlines the importance of individuals being conceived of both as citizens under democracy and not merely as clients in relation to the law. The law does not simply stand in judgment of our particular circumstances but is also the result of political activity and a reaction to our communal claims to have moral norms established. 'The mobilising force of adjudication and legislation reminds us that the population supposedly has the role of author, is a public of citizens - and does not just play the role of client': Habermas, *Between Facts and Norms* (Polity, 1996), 395.

concerned entirely with the negative connotations of hazard and of harm to the subject matter of the contract.[54] Generally the concern is with destruction and with the frustration of the purpose of the contract.[55]

In relation to the law on fiduciaries generally there is a wholesale allocation of risk in favour of the beneficiary of the power. By 'allocation' I mean the strict liability which a fiduciary will generally face in relation to the legal obligations not to permit conflicts of interest or to make unauthorised profits from the fiduciary office.[56] The purpose behind this rule is not an allocation of risk *strictu sensu*, but rather a concern to protect the beneficiaries of a fiduciary power. In the law of trusts, the interests of the beneficiary are typically considered to be sacrosanct and the trustee is considered to owe personal obligations based on good conscience[57] to the beneficiary[58] to care for the trust fund and to make the maximum available return on the trust fund through investment.[59]

As considered in chapter 3 *Trusts as investment entities*, there is only an awkward recognition in the general law of trusts that a trust will occasionally be a commercial investment vehicle in relation to which the liability of the trustee will be limited by contract. Rather, the law of trusts purports to treat all trusts in exactly the same way regardless of context. So it is that pension funds, ordinary family trusts, trusts of homes, and even constructive trusts are ostensibly subject to identical principles in the caselaw,[60] whether the trustees are investment professionals or not. The standard legal tests compromise, not by recognising any particular concept of comparative levels risk allocation here, but rather by creating mutable concepts of liability built on the standard of care of a prudent person of business acting for one for whom she feels morally bound to provide.[61] In practice this can permit a judge the flexibility to consider what such a person would have done in the circumstances[62] - the weakness in this approach is precisely that the test itself does not make this malleability explicit. The focus is not on the nature of the trust but rather on an assumed standard of care based on a universal form of beneficiary founded in the protection of family wealth in the nineteenth century.

In other areas, when Equity does acknowledge either this need to cater for the particular context of risk, it nevertheless applies universal standards to all cases oblivious to context. The more modern approach to the trustee's investment obligations (as an example) refer to the need to observe 'current portfolio theory' as practised by investment managers.[63] On its face (and in its own terms) this does not

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[54] Goode, *ibid*. Sealy, 'Risk in the Law of Sale' [1972] CLJ 225.
[55] *Ibid*.
[56] *Keech v. Sandford* ; *Boardman v. Phipps* [1967] 2 AC 46.
[57] *Westdeutsche Landesbank Girozentrale v. Islington L.B.C.* [1996] AC 669, *per* Lord Browne-Wilkinson.
[58] Hayton, 'The Irreducible Core Content of Trusteeship', in Oakley ed., *Trends in Contemporary Trusts Law* (Oxford University Press, Oxford, 1996), 47; Hudson, *Principles of Equity and Trusts*, (London: Cavendish, 1999),.
[59] *Cowan v. Scargill* [1985] Ch 270.
[60] That is, aside from particular statutory rules considered on a case-by-case basis in the appropriate chapters.
[61] *Speight v. Gaunt* (1883) 9 App. Cas. 1; *Nestle v. National Westminster Bank* (June 29, 1988) [1993] 1 WLR 1260.
[62] Or, possibly, what such a person ought to have done.
[63] *Nestle v. National Westminster Bank* (June 29, 1988) [1993] 1 WLR 1260.

acknowledge any ability in the person of the individual trustee to do the best they can in the context of their own experience: rather it requires all trustees to live up to best market practice, regardless of their expertise. A better approach would have been to *require* trustees to employ professional agents (rather than leaving this as a power available to them under the Trustee Act 1925) or to require trustees to act as prudently as they are able (and either to procure the agreement of the beneficiaries to any investment or to give reasons in advance for their decision in the event of any complaint by the beneficiaries). At no point does this strand of the law really embrace the truth that 'risk' as a possibility for gain or loss is something inherent in the process of trust investment.

Risk has been acknowledged in relation to the personal liability of strangers to the trust to account to the beneficiaries in the event of their receipt of trust property in breach of trust[64] or their assistance of any breach of trust.[65] In the leading speech of Lord Nicholls,[66] it is accepted that liability for assistance in a breach of trust be based on the dishonesty of the defendant: such dishonesty including risks taken which are so reckless as to call into question the honesty of that defendant.[67] In this conception of the issue, risk is seen as something inherent in trust management such that risks taken attract liability only if they involve some level of recklessness.

What is absent from this jurisprudence is an understanding of the world as a web of risks taken and exploited by citizens. Also lacking is an explicit understanding of the risk management function carried out specifically by investment institutions in relation to the investment products which they sell to their clients. Rather, the law is operating on established forms of risk-through-contract or fiduciary obligations and not through risk-as-experienced in the modern world. The ramifications of this understanding of risk is then pursued into the context of each of the investment entities considered in this book.

Risk allocation

As considered above, in social terms risk is becoming a more pervasive daily factor for ordinary citizens than ever before. In commercial law risk allocation is a well-understood concept which parcels out responsibility for particular events during the life of a contract dependent on the agreement of the parties as to which party to the contract had accepted liability for losses arising from any given factor. In sociological terms it is far more difficult to isolate and allocate such a risk allocation model.

Examples of this tendency can be observed. One such would be the steady withdrawal of state pension from a living income to a subsistence living allowance. The risk allocation analysis of this phenomenon is that the state is loading responsibility onto the individual citizen to provide for old age during working life. The weaknesses with that analysis are many. First, the withdrawal of a decent standard of living predicated on a lifetime's contribution to the state pension system, only occurs once the pensioner has finished contributing and comes to draw the pension. There is a

[64] *Polly Peck No.2*. …
[65] *Royal Brunei Airlines v. Tan* [1995] 2 A.C. 378.
[66] *Ibid*.
[67] *Ibid*. See Hudson, *Principles of Equity and Trusts*, (London: Cavendish, 1999), … .

difference in expectation between the time of making the first contribution and final pension received. Second, there is no acceptance by the citizen of the allocation of risk in the same way that a party to a contract agrees to that allocation of risk: the citizen is simply the object of public policy in this context.

It could be expected that the law would need to take account of these varying contexts of risk. If the idea of risk is a sufficient explanation of a part of our new social life in the twenty-first century, then recognition of these risks ought to be adopted in law. In relation to contract it is perfectly acceptable that the law recognise a decision by the parties to identify one or other of them as bearing the responsibility for the effect of any such risk coming to fruition. In the area of investment, that context is more complex. Take the example of pensions which was posited above. In the event that private pensions do come to replace state pension provision for the majority of the population, litigation concerning rights to the scheme property may require a different approach from that practised at present. Rather than considering the question of rights to the pension fund as being merely one of private property law, perhaps it would be necessary to impose a broader set of liabilities on the fund manager in recognition of the manager's role in providing welfare benefits. Perhaps those obligations would need to be more akin to the fiduciary liabilities imposed on public sector bodies carrying out investment business, typically requiring that the interests of a broader range of potential beneficiaries be taken into account than simply that of the individual claimant. The creeping privatisation of the public sector through the private finance initiative, public-private partnerships and the contracting out of public services, have however brought a different range of issues to decision-making in that context too.[68]

Financial regulation and risk - the new deal

Core activities of the Financial Services Authority

The Financial Services and Markets Act 2000 ("the 2000 Act") creates a new arena in financial services regulation in the United Kingdom. The Financial Services Authority ("FSA") was brought into being as a body corporate with the passage of that Act on June 14, 2000.[69] In carrying out its duties the FSA is required to comply with a range of statutory principles of behaviour.[70] In contradistinction to the potentially far-reaching ramifications of creating a single financial regulator for all market areas and thus enabling that regulator to become particularly powerful in manner of the American regulatory bodies, there is a sense in the legislation that the regulator will be required to act in a manner which is sensitive to the needs of market participants. So it is that the FSA is not permitted to restrain activity simply because it deems that activity to be undesirable but rather:

> "a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be *proportionate* to the benefits, considered in general

[68] Considered in chapter 15 *Local government*.
[69] Financial Services and Markets Act 2000, s.1(1).
[70] *Ibid,* s.2(3).

> terms, which are expected to result from the imposition of that burden or restriction …"[71]

The idea of proportionality is one that is familiar to EU law[72] and to administrative law[73] in considering the manner in which public bodies reach decisions in relation to the exercise of their statutory or other public functions. What is peculiar about the application of this principle in relation to a financial regulator is that the FSA is empowered to take punitive action in relation to the activities of market participants. The unfortunate under-current in relation to a benefit-burden analysis in the financial sector is that it permits a potentially undesirable cost-benefit analysis rather than a straightforward use of power. For example, it might be thought that a burden imposed on a firm mis-selling financial products of only a small value might have a disproportionately large impact on that firm's profits. It is suggested that, while it is important that no public body act in disproportionate fashion generally, in relation to the financial markets which govern the personal welfare of individuals in particular there is a need to ensure that the regulator is able to maintain a tight rein on such activities.

In furtherance of this light touch in relation to regulation, the FSA is required to ensure that its activities do not interfere with "the desirability of facilitating innovation in connection with regulated activities" in financial markets.[74] Of course it is in relation to new markets and new products that there are generally perceived to be most risks. However, the protection of innovation seeks to maintain the place of London as a financial market centre: the legislation is clearly concerned both to create a potentially powerful regulator while ensuring that that regulator cannot restrict the free market in a general sense. Similarly, the FSA is required to have an eye to the

> "international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom …"[75]

The legislation thus ensures that the nation's economic position is not to be harmed by the regulator. It must avoid "adverse effects on competition" resulting from the exercise of its activities[76] and advance competition between regulated entities.[77] In the market socialist mantra there is much reliance placed on competition - as these provisions indicate.

The regulatory objectives

Beyond these statutory prescriptions on the manner in which the FSA is required to carry out its functions, it must also seek to advance four core, regulatory objectives: market confidence, public awareness, the protection of consumers, and the reduction

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[71] *Ibid*, s.2(3)(c).
[72] See generally Craig and De Burca, *EU Law*, 2nd edn., (Oxford University Press, 1998), 349.
[73] See generally Wade, *Administrative Law*, 7th edn., (Oxford, Clarendon Press, 1994), 403; Craig, *Administrative Law*, 4th edn., (Sweet & Maxwell, 1999), Ch. 18.
[74] Financial Services and Markets Act 2000, s.2(3)(d).
[75] *Ibid*, s.2(3)(e).
[76] *Ibid*, s.2(3)(f).
[77] *Ibid*, s.2(3)(g).

of financial crime.[78] In following the preceding discussion of the place of risk in this chapter, the core regulatory objectives place emphasis on the risks associated with financial activity and need for the FSA to understand the role which risk plays in the provision of financial services and the concomitant risk that is assumed by citizens using such services. So it is that the principle dealing with "public awareness" requires that the FSA promote public understanding of the financial system.[79] That purpose of generating awareness is said to include "promoting awareness of the benefits and risks associated with different kinds of investment or other financial dealing".[80]

The second principle relates to the "protection of consumers".[81] The definition given that objective is the provision of "the appropriate degree of protection for consumers". This standard of appropriateness includes consideration of -

> "(a)… the different degrees of *risk* involved in different kinds of investment or other transaction;
> (b) the differing degrees of *experience and expertise* that different consumers may have in relation to different kinds of regulated activity;
> (c) the needs that consumers may have for advice and accurate information; and
> (d) the general principle that consumers should *take responsibility* for their decisions."[82]

The focus on risk ties in with the general points which have already been made about risk. Similarly, levels of expertise and the laws treatment of them is a theme to which the detail of this book returns time and again. What is also interesting is the recitation of the need for consumers to take responsibility for their decisions, in spite of the fact that the risk society is both forcing those consumers to participate in financial markets in which they might not otherwise have done and in spite of the fact that it is the seller of the product who is the expert.

This final provision demonstrates the communitarian slant to these policies which favours responsibilities being imposed on citizens rather than an ever-expanding list of civil rights. At first blush, this purpose conflicts with what will be said at the end of this chapter about the development of human rights law in England in the wake of the implementation of the Human Rights Act 1998. The individual is described as a "consumer" and not as a "citizen" nor as an "individual" nor a "person". The dfinition of "consumer" in the 2000 Act[83] refers to persons carrying on regulated financial activities or to people who have interests or rights derived from such financial services. The rights of the individual are therefore restricted to her ability to contract and become a consumer and are not matched with a need to recognise the legal personality of such people *as people*. When the definition of financial services and investment is broadened to include co-operative activities (as are included in the 2000 Act) and the provision of public services or to welfare services, persons affected by

[78] *Ibid*, s.2(2).
[79] *Ibid*, s.4(1).
[80] *Ibid*, s.4(2).
[81] *Ibid*, s.5(1).
[82] *Ibid*, s.5(2).
[83] *Ibid*, s.138(7).

those financial services are the families of the pensioner and all members of a community co-operative association. The rights of people affected and the need to hold expert sellers of financial products to a highly-pitched duty of care towards buyers of services are necessary legal principles to ensure the protection of individuals in the risk society.[84] This book will argue for legal treatment of investment and of investment entities based on a recognition of their personality and not merely because they can afford to participate as consumers.

ISSUES OF SOCIAL AND LEGAL THEORY

This book considers "law" rather than particularly "regulation" or "governance". It is therefore important to have some outline conception of the nature of this "law".

After positivism

For the legal positivist "the law" is a system of primary and secondary rules (to borrow from Hart[85]) which command obedience as though from a sovereign (to borrow from ideas generally attributed to Austin[86]): the citizen is the object of that legal sovereign. It would be all too easy for this book to slip into the groove of dealing with the legal treatment of investment entities entirely in that way: that is, presenting the law simply as though it were a sovereign system of rules laying down a core of truth which investors are required to observe.[87] For most of this book it would be reasonable to suppose that its author is content to analyse investment entities from the stand-point of the legal positivist: that is, describing statute, unpacking the complexities of caselaw, and developing these normative statements into contexts as yet unexplored by either the judiciary or the legislature. In short, this book will generally appear to be like any other legal text at that level.

Frequently, this book will fall into the investment markets' standard practice of perceiving "the law" as a code of positivist rules which are to be obeyed, or else flattered by a show of obedience, or at least avoided in a way which will not excite criminal or civil penalty. It is at this level that the nature of the inter-action between financial regulation and the substantive law of finance becomes most problematic. Is "regulation" law in the same sense that "the law" is taken to be law?[88] Law is typically perceived by practitioners to be a risk which is to be managed. Rules are not 'rules' but rather prescriptions to be taken or obstacles to be avoided. At that level,

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[84] The 2000 Act requires that the FSA be advised by both a Practitioner Panel and a Consumer Panel (ss. 8 and 9) as to its general policies and practices. It is suggested that this is not the same as the recognition of individual rights which is argued for in this chapter and elsewhere in this book.

[85] Hart, *The Concept of Law* (Oxford University Press,).

[86] Austin, … .

[87] Albeit lawyers would expect to find some penumbra of uncertainty around the seeming certainty of those core rules.

[88] This area attracts its own very particular literature. See for example, Black, *Rules and Regulators* (Oxford, Clarendon Press, 199x); and Ogus, *Regulation* (…). On the issue of the regulatory role of the private law of finance see Hudson, "The Regulatory Aspect of English Law in Derivatives Markets", in Hudson ed., *Modern Financial Techniques, Derivatives and Law,* (Kluwer, 2000), 69.

law and regulation appear to be similar: the regulatory rulebook and the regulator are always considered.[89]

The behaviour of these powerful financial institutions in relation to the legal positivists' sovereign law can be likened to timorous schoolchildren in front of a cane-wielding headmaster: simultaneously fearful and uncomprehending. 'Fearful' that the sovereign law will scold them, declare their behaviour criminal or find their contracts void. 'Uncomprehending' of the law's treatment of financial products which come to conclusions which bankers, (people of affairs, people of action, people with great wealth) consider frequently intolerable.[90]

As an example of this last category, I would refer to the local authority swaps cases which I have considered in (perhaps too much) detail elsewhere.[91] Interest rate swaps were found by the courts to be unenforceable when entered into between banks and local authorities.[92] For the lawyers this revolved around complicated issues of trusts and of restitution of monies.[93] For the bankers this concerned only a form of financial product which had long transmuted from innovative novelty into standard operation.[94] That the former should object to the activities of the latter was a cause of much perturbation and despair.[95]

That law uses different language and responds to different stimuli from financial markets is made plain in Chapter 2 when the underpinnings of the laws of contract and property are considered.[96] Tangible money theory is the clearest example of the law of property clinging to its own heritage in the face of the development of bank accounts into merely electronic impulses stored in silicon-based microchips.[97] Money is a tangible item of property in the eyes (and the words) of the law and so it is that money is said to disappear once a bank account runs into overdraft with all the shabby

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[89] It should be noted that investment institutions do not have "obedience" departments; rather they have "compliance" departments which ensure that there is no breach of rules rather than ensuring laws or regulation as something to be obeyed. A subtle difference but an important one from the perspective of the entrepreneurial financial institution seeking to make profit without attracting sanction. In many situations financial regulation operates by observation of individual market actors by regulators in accordance either with grand statements of purpose (e.g. investment houses are required to act with "integrity", as under the SIB core principles) or with measurement techniques of microscopic detail (e.g. solvency ratios, liquidity ratios, capital adequacy ratios).

[90] See the impact of the local authority swaps cases on the finance houses who condemned the law for simply failing to understand how their interest rate swaps worked, before ignoring the courts' judgements and deciding not to alter their standard market documentation.

[91] Hudson, *Swaps, Restitution and Trusts*, (Sweet & Maxwell, 1999); for a shorter account see McKendrick 'Local Authorities and Swaps: Undermining the Market?' in '*Making Commercial Law: Essays in Honour of Roy Goode'* ed. Cranston (Oxford, 1997).

[92] *Hazell v. Hammersmith & Fulham* [1992] 2 A.C. 1, [1991] 2 W.L.R. 372, [1991] 1 All E.R. 545.

[93] *Westdeutsche Landesbank Girozentrale v. Islington L.B.C.* [1994] 4 All E.R. 890, Hobhouse J., CA; and reversed on appeal [1996] AC 669, HL; *Kleinwort Benson v. Sandwell Borough Council* [1994] 4 All E.R. 890, Hobhouse J; *Kleinwort Benson* v. *South Tyneside M.B.C.* [1994] 4 All E.R. 972, Hobhouse J.; *Kleinwort Benson v. Birmingham City Council*, Gatehouse J., (unreported); *Kleinwort Benson v. Birmingham City Council* [1996] 4 All E.R. 733, CA; *Kleinwort Benson v. Glasgow C.C.* [1997] 4 All E.R. 641.
Kleinwort Benson v. Lincoln City Council [1998] 4 All E.R. 513.

[94] See Hudson, *Swaps, Restitution and Trusts*, (Sweet & Maxwell, 1999).

[95] *Westdeutsche Landesbank Girozentrale v. Islington L.B.C.* [1996] AC 669, HL, *per* Lord Goff.

[96] Hudson, "The law of finance", in *Lessons from the swaps cases*, ed. Birks and Rose, (Mansfield Press, 2000), 62.

[97] Hudson, "Money as Property in Financial Transactions", [1999] J.I.B.L., Issue 14:06, 170-177.

artistry of a lazy magician.[98] It is important not simply to treat law as being a sovereign for these purposes: or merely as an inconvenience to be tolerated. Law is a language and a cultural product in itself. Its attitude to investment in particular is something which needs to be analysed and unpacked: these two distinct cultures must create a common vocabulary.

A study in difference

And so to positivism. This book will seek to break away from mere genuflection at the feet of the sovereign law. Similarly, it will not plead the cause of the financial institutions for special treatment or particular observance. Instead it broadens the field of investment entity, as considered above, beyond merely the commercial investment institutions to look at the investment activities of community-based initiatives like credit unions, the political activities of trade unions, and the public sector responsibilities of local government, NHS trusts and so forth. The law *on* investment entities is a survey of the way in which the law treats a range of investment activities: whether straightforwardly financial investment or alternatively social investment.

Peter Fitzpatrick has an elegant way of addressing the legal positivism advanced by Hart. Instead of focusing simply on the desirability of natural law theory as opposed to positivism, or only examining the linguistic heritage informing Hart, he considers the historical baggage which Hart brings to his theory. It is the baggage of a legal system which is positivist in that it believes its own hype: it believes that it is fundamentally right without the possibility of an alternative analysis. And so Prof. Fitzpatrick lays out the history of colonial peoples who have this law thrust upon them. A law that is so confident that it has right on its side that foists its modes of thought onto indigenous peoples who already had their own culture and ways of organising that culture: ways of thinking which were alien to the settlers and therefore considered by them to be primitive and immoral. It is this swaggering arrogance of legal positivism that he addresses in the following terms:

> 'If we [consider] a local habitation … we do not find inadequate and impoverished precursors of Western law but subtle, complex and elegant modes of regulation that bear no relation to the constrained conceptions of law as rules and social control that Hart imposes in the situation.'[99]

I take from the spirit of this discussion the following. When considering the legal treatment of a topic like investment (particularly when the term "investment" is applied to a broad range of human activity from financial markets to the provision of healthcare) it is important not only to analyse the subtly different ways in which similar legal concepts are deployed but also to recall the kaleidoscopic variety of ways in which different kinds of human activity may use those techniques.

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[98] *Roscoe v. Winder* [1915] 1 Ch. 62; *Bishopsgate v. Homan* [1995] 1 WLR 31; *Westdeutsche Landesbank Girozentrale v. Islington L.B.C.* [1996] AC 669, HL.

[99] Fitzpatrick, "The Abstracts and Brief Chronicles of the Time: Supplementing Jurisprudence", in Fitzpatrick, ed., *Dangerous Supplements - Resistance and Renewal in Jurisprudence* (London: Pluto Press, 1991), 17.

So it is, for example, that the office of a trustee in relation to a pension fund will bear similarities both with the trustee of a National Health Service trust (in providing for the future welfare of patients) and also with the trustee of a commercial unit trust seeking financial gain for its participants. Credit unions are formed as organic parts of a community's investment of its shared wealth and thus are radically different from investment companies with reference to their economic activities but possibly not in relation to the fiduciary duties owed by their officers. In each context it will be important to bear in mind that the well-developed (but still contested) concepts of the law of trusts and company law are treading virgin ground when applied to credit unions, trade union investment, NHS trusts and the like. We shall see that the law will tend to view all such contexts alike without consideration of the various sociological factors which feed into the creation and administration of those entities.

Autopoietic closure and the charm of legal creativity

There are two counterposing themes which will hover about much of the discussion in this book like the "good angel" and the "bad angel" so beloved of 1950's American cinema in which the hero is encouraged by one to act wickedly and by the other to act with integrity. The difficulty is that it is not obvious to this writer in all circumstances which is the good angel and which the bad for the purposes of the discussion that will follow. They are bound up in the fact that "the law" has its own vocabulary, its own culture and its own mores which might be considered to mark it off from other social constructs: to make it 'autopoietically closed'. In some contexts this development of a specific legal culture will be negative because it will seem to make law blind to the way society operates; at others it will appear to be a positive and impartial set of principles which can be deployed to resolve conflicts.

The first theme in this thinking is the possibilities offered by the law to provide structures and models which facilitate the aspirations of individuals and groups. There is a positive and resourceful creativity in citizens using legal techniques to assist them in their social activity. For example, using centuries of development of the trust provides a way in which citizens can manage pooled monies so that it becomes possible for them to apply those resources to achieve communal goals. They can create local banks, charities, associations, self-help groups and so forth by *using* law, rather than by simply seeing law as a source of power which is exercised against them as though a sovereign. This perception of law is creative. It does not reflect the positivist's conception of law as a force which simply exerts power over citizens.

Briefly put, the second, opposing theme is to identify the way in which law enables vested power interests to conceal their activities. For example, in much financial market activity the major players use legal techniques (like the trust) but deploy them to hide disputes away from the public legal system. When the Stock Exchange conducts its own disciplinary procedures, or when financial institutions take their disputes to private arbitration, the law loses the ability to comment on the rights and wrongs of the activities in issue in a public and transparent form. Those disputes are hidden. If law is an expression of the broader culture of society, then that culture is being deprived of the ability to control or address these privatised activities. This privatisation of law carries with it a danger that socially undesirable activity will be concealed from public scrutiny and that mandatory norms of the law will be eluded.

Thus the ability to take what is useful from the baggage of legal structures can occasionally lead to the concealment of private power.

These two themes sit in juxtaposition one with the other. The first uses the language of creativity and of communal initiative. Both terms coming from the lexicon of light-hearted liberalism. The second uses the language of concealment and evasion of public scrutiny: two pariahs of that same liberalism.

On the one hand, it can be said that for ordinary citizens to make use of legal concepts and to bend them to their own purposes demonstrates an humane and creative feature of English law. (This is an idea which will be identified with Durkheim in the next chapter.[100]) It is difficult to object to the notion that a local community can, for example, use concepts culled from the law of trusts when it has decided to share its sparse financial resources and use them to make loans to members as part of a credit union. The legal ideas used can regulate the manner in which the officers of that credit union carry out the purposes of the members' joint undertaking and the way in which their resources are held centrally. On the other hand, if a group of powerful financial institutions purported to take the idea of the trust and create a clearing house of wealth to underwrite transactions which would otherwise be against public policy, then we would look less favourably on this activity. The same fundamental activity is being carried on (trusts are being used to manage investment property) but in two very different contexts.

The distinction is between social creativity through law and a suspicious concealment by finance professionals - arguably a result of a form of autopoietic closure. This writer confesses to seeing autopoiesis (that is, closed social systems) as being a pernicious phenomenon in many circumstances. It smacks of concealment, of secret societies speaking coded languages, and of dealings behind closed doors. Closure of one area of social life from other areas of social life is not merely an observable phenomenon of the differentiation of society but is also a cause of distancing ordinary citizens from access to social goods. Furthermore, it is usually only the powerful who can create and access such effective closed social systems. Autopoiesis is a well-understood biological reference applied to social science. In biology, autopoiesis is the means by which cells expel and ingest matter. A cell is a closed biological system which inter-acts with other cells in very particular ways. So it is said of some social systems like law[101] that they communicate in a metaphorically similar fashion.

As an applied example of this phenomenon, for the purposes of this argument, it might be said that the self-regulatory procedures of the London Stock Exchange constitute an autopoietically closed system in which the language of equity transactions and the language of law meet in a tribunal which disciplines its members outwith the control of the public legal system. A more complex situation involves trade associations like the International Swaps and Derivatives Association which develop standard market documentation, standard market payment settlement practices and so forth. They operate as autopoietically closed systems when they seek to keep the practices and language of sophisticated markets like derivatives within their narrow range of influence so as to dictate both the content of those norms and

[100] See p. … .
[101] Teubner, *Law as an Autopoietic System* (Oxford, 1994).

their deployment. Alternatively, it could be said that their work to reduce the risks present in that market are possibly a very positive influence on the hazard personified by global financial markets. There are no easy answers. However, it is this dialectic inform much of the broader analysis of the use of investment entities.

The changed social context

Change is unavoidable because the world has changed drastically, almost violently, in the past 15 years. The globalisation of economic power reduces the ability of national government to restructure internal economic relationships. There has been a revolution in information technology for education, leisure and the workplace. At the same time society has become hyper-complex - as new power bases emerge, fragmenting traditional power structures. Employment relationships too have been de-traditionalised over the past 30 years. Work and career patterns are no longer inter-generational and linear. Mass unemployment and non-unionised, part-time labour have become a central feature of the new economic landscape. The accepted social 'truths' of our society (of the family, of work for young people, of geographic communities) have been destabilised by the modernist, monetarist project. There is a disenchantment among the "jilted generation"[102] which now sees no place for itself in the social and political landscape of previous generations.[103]

The old myths of our society have been destabilised by the modernist project.[104] One of the most important examples of this destabilisation process has been the dissolution of traditional "communities" where individuals and families lived around the workplace, shared communal facilities, communal values and communal aspirations. In seeking to erect a programme built on the concept of the community, the problem presents itself that such concepts no longer retain their traditional meaning nor does everyone understand them to mean the same thing.

This project still rumbles on. Habermas takes the postmodernists to task for suggesting that the modernist project has been completed. It is more accurate to suggest that different aspects of the modernist project are in different stages of development and perhaps that the deconstruction school has arrived to pull down those ideas which are either redundant because they belong to another time or which are redundant because they never had a valid claim to truth. In *The Philosophical Discourse of Modernity*,[105] Habermas begins with the claims of the French post-structuralists that they have moved beyond philosophical subject and the concomitant need to return to reason understood as communicative action. This notion of the individual's role being replaced by communication bears a number of straightforward, definitional political complications when placed alongside agenda which seek to "empower the citizen".[106]

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[102] Prodigy, *The Jilted Generation* (XL Recordings, 199).
[103] Hudson, *Towards a Just Society: Law, Labour and Legal Aid* (London: Pinter, 1999), Part 3.
[104] See generally Beck, Giddens and Lash, *Reflexive Modernity* (Polity, 1994) as a description of some of those social changes.
[105] Habermas, *The Philosophical Discourse of Modernity* (Polity,).
[106] Not least is the proximacy of communicative action to the systems theories proposed by Talcott Parsons, and pursued by Niklas Luhmann, while being reviled by luminaries of the new left like Anthony Giddens. Discussing these issues in a new political language is essential if the centring of "discourse" as part of the

This discussion is summarised most neatly in Giddens's *Beyond Left and Right*[107], a discussion which he pursues in *The Third Way*. His assertions as to the changing nature of the world seem unassailable - although his conclusions are more open to question. In Giddens's world, the welfare state stands in an equivocal position. Rather than focus on the generation of enormous poverty in the United Kingdom specifically (regardless of the poverty in other regions of the world like sub-Saharan Africa), the social change is presented primarily as one of challenge in which increased social risk offers as many chances for improvement as for loss. For the right is seen a need to temper and regulate the worst excesses of the market, for the left there is a need to accept the presence of global markets which need to be socialised.

The unfortunate side effect of this socialisation of global capital, as expressed by Chomsky,[108] precisely that while power and wealth are concentrated in the hands (and pockets) of the few in the global casino, the costs of market capitalism are borne by the many.[109] The effect of the capitalist principle creating corporations behind which the investors themselves can hide has the result that ordinary people are distanced from the capitalists. Chomsky refers back to Adam Smith's own critique of joint stock companies as being "a conspiracy against the public" through which capitalists could hide their individual responsibility of the activities of those companies beyond "government interference", meaning control by the public.[110]

The arena for contest here is therefore between those who celebrate the opportunities offered by global capitalism and those who identify in the nature of global capitalism itself the seeds of increased global poverty and the death knell of sustainable welfare provision by the nation state.[111] This debate is at the heart of the discussion in this book. While much of the text will consider the detail of the legal rules, behind the context of pension funds and community-based investment entities is precisely this

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debate is not to be mistaken for a displacement of the unfashionable "individual" from populist political discussion.

[107] Giddens, .

[108] Chomsky, *Profit over People* (New York, Seven Stories Press, 1999).

[109] Chomsky's particular concern is in relation to the enforcement of debt repayment obligations against developing nations: 'The simplest answer to the argument that countries who borrowed from the World Bank and/or the IMF have no right to ask for debt forgiveness is that the presupposition is false, so the argument is vacuous. E.g., the "country" of Indonesia didn't borrow; it's US-backed rulers did. The debt, which is huge, is held by about 200 people (probably less), the dictator's family and their cronies. So those people have no right to ask for debt forgiveness -- and in fact, don't have to. Their wealth (much of it in Western banks) probably suffices to cover the debt, and more. … Of course, that principle is unacceptable to the rich and powerful, who prefer the operative "capitalist" principle of socialising risk and cost. So the risk is shifted to northern taxpayers (via the IMF) and the costs are transferred to poor peasants in Indonesia, who never borrowed the money.' Taken from the reports delivered on Z-net (www.z.org) - sentiments reproduced in Chomsky (1999), *op cit.*.

[110] Chomsky, *Profit over People* (New York, Seven Stories Press, 1999), 148.

[111] Within that latter category is a deeper ideological divide between those who reject the wage-relationship of capitalism wholeheartedly (many readings of Marx, Reclaim the Streets, Paul Foot); those who accept the continued existence of capitalism but seek to temper its effects with universal welfare benefits sustaining citizens from cradle to grave (Titmuss, Van Parijs); those who accept the continued existence of capitalism but seek to temper its effects with means-tested welfare benefits provided to relieve the poverty of the worst off in our society (…); and those who accept the social market in many circumstances while still using the rhetoric of equality of opportunity (Gordon Brown).

debate about the ability of the market to support welfare-providing services[112] (like pensions) or the need (whether economic, political or even spiritual) for these services to be provided by or with the state. Chomsky points out the socialisation of sovereign debt which stands in counterpoint to the reduction in the socialisation of services in the welfare states of many of the same developed nations arguing for market economies elsewhere: investment contracts for pensions, wealth generation and welfare protection are thus coming to replace social provision of security.[113]

Human rights legislation

Between the completion of this manuscript and the publication of the book proper, the Human Rights Act 1998 will have come into full force and effect in October 2000. The consensus among the commentators is that this new piece of legislation ought to have an effect on English private law, as well as public law. That is, the norms of English common law are likely to alter so as to accommodate these new principles.

On the one hand, there is the possibility that the courts are asked to consider rights to property in the context of the Human Rights Act provision relating to freedom to hold possessions.[114] The court has two options. The first option (I shall call this the 'progressive option') is to declare that the introduction of this legislation (albeit constituting a well-established international convention) necessitates a novel understanding of the rights of persons to property. The second option (I shall call this the 'static option') is to say: 'the English common law has long recognised, implicitly, a right to hold possessions - however, to recognise such a right is not to answer the question "what does that right mean in contexts in which two people with perfectly cogent claims come into opposition one with another over identical rights in the same property?"'. In answering this more difficult question, English law might decide that the answer must lie in long-established principles and not in the creation of new ones. The static option would therefore permit English common law and English equity to assert that these principles are already sufficiently catered for in English law and need have little impact on its future development.

So, is there any scope for the progressive option? In my opinion there is. The question posited in relation to the static option was both a simple one and a vague one. It was simple in the sense that questions of competing property rights necessarily require more complex rules and approaches than the terms of the European Convention on Human Rights was ever intended to provide. Therefore, absent any direct clash between the provisions of the Convention and English law, there is no principled objection to the continuation of English law (unless it is based on the content of that English law itself outwith the context of the human rights legislation). The question is

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[112] In this discussion I preserve the strict division established by many between *state welfare* (that is, welfare services provided by the state out of central funds) and *social welfare* (that is, welfare services provided by communities and not the state, or provided by the citizen privately). See the taxonomy of the various structures in Epsing-Anderson, *The Three Worlds of Welfare Capitalism* (Cambridge, Polity, 1990); and Pierson, *Beyond the Welfare State?*, 2nd edn., (Cambridge, Polity, 1998), 173.

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[114] Hunt, 'The "Horizontal Effect" of the Human Rights Act' [1998] PL 423; Phillipson, 'The Human Rights Act, "Horizontal Effect" and the Common Law: a Bang or a Whimper?' [1999] 62 MLR 824.

also vague because I (deliberately) posited no factual context for the question upon which one could decide whether or not there was a human rights question bound up in it. Chapter 2 *Theories of contract, property and money* considers the difficult questions bound up in the use of normative, positive law to consider such questions. What is difficult for the human rights lawyer in this context is the possibility of arguing that the allocation property rights in British society is *socially* unjust and therefore that ordinary English property law rules ought not to be applied at all. That argument is so vast (taking in political theory, social policy and so forth) as too impossible to focus on in *this* discussion, although not perhaps in chapter 2. So, one possibility for the progressive option would be to argue for a social revolution to overthrow existing property relations.[115]

Another prospect for the progressive option lies within the confines the existing social order. Some commentators argue that the norms of the human rights canon will seep into the common law over time as judges align themselves with an emerging jurisprudence.[116] In relation to investment entities, I consider that it is the changing social context of investment that will *require* that human rights norms seep into the existing jurisprudence. The enormous social changes experienced in the latter half of the twentieth century, in my opinion, have created a cultural environment in which investment is no longer an activity for surplus capital but rather a life-necessity for many ordinary citizens. It is this very omnipresence of investment (in domestic mortgages, in private pensions, and so forth) which will require changes in the way in which law treats the investment relationship.

The applicable human rights norms

The relevance of human rights law to this discussion of investment needs to be clearly identified. There are two general issues. First, the role of the state in protecting rights enshrined in the European Convention on Human Rights which interact with investment. Second, the potential development of horizontal rights and obligations between private persons in circumstances in which common law rights are developed in accordance with Convention rights.

The position under English law is that, with effect from October 2000 the provisions of the Human Rights Act 1998 come into effect. The 1998 Act provides that 'primary legislation and subordinate legislation must be read and given effect in a way which is compatible with the Convention rights'.[117] The aim of the legislation is therefore to secure a form of interpretation of legislation although that is not intended to 'affect the validity, continuing operation or enforcement of any incompatible primary legislation'.[118] Therefore, legislation may be passed, perhaps in relation to immigration, which may lead to effects which are contrary to a literal application of the Convention rights: but that will not permit a court to declare that legislation ineffective, rather it is empowered only to make a declaration of incompatibility[119]

[115] On which see the discussion of "horizontal" applicability below; and the discussion in
[116] Gearty ….
[117] Human Rights Act 1998, s.3(1).
[118] Human Rights Act 1998, s.3(2)(b).
[119] Human Rights Act 1998, s.4(2).

which will not affect the validity of that provision.[120] The sovereignty of Parliament is thus maintained.

What the 1998 Act has not done is to create a new cadre of legal rules in the nature of a common law of human rights: the precise terms of the Convention have not become mandatory norms of English law. Whether a treaty is to have direct, mandatory effect as part of ordinary English law would depend on the terms of that treaty[121] and that is not the case here. Rather, the Convention rights are, initially, aids to construction of legislation.[122] What is less clear is how the courts will react to the concomitant possibility that human rights norms might come to influence the common law over time such that judges come to give effect to human rights norms as part of the common law.[123] This issue is considered in detail below.

Role of the state in securing rights

In relation to the investment entities considered in this book, the state (and public bodies more generally) may be deemed to owe a range of obligations to secure the rights of investors. These potential areas of liability fall under three headings: a duty on the state to secure regulation of financial services; a duty on the state to provide welfare benefits in certain circumstances; and a duty to secure that private persons do not suffer loss as a result of the actions of other private persons.

The first context to be considered, therefore, is the liability on central government and its attendant agencies to secure efficient and effective regulation of investment activities on the one hand, and also the freedom of individuals to join associations and other bodies which provide investment services as described in this book. In general terms, Convention jurisprudence does not provide for any general right to receive social security or other welfare benefits[124] although there may be circumstances in which contribution to specific schemes may entitle the citizen to a concomitant receipt of a benefit.[125]

The potential liability of the state to secure rights between private persons may be simply an extension of the potential obligation to secure efficient regulation of financial (and other) services. However, there is a broader possible range for liability to be imposed on public bodies other than the state in the person of central government. One such example is the extension of human rights norms to cover the procedures and decisions of courts, given that Convention jurisprudence considers courts to be public bodies.[126]

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[120] Human Rights Act 1998, s.4(6).
[121] See, for example, cases dealing with maritime treaties: *The Hollandia* [1982] Q.B. 872; *Caltex Singapore Pte v. BP Shipping Ltd* [1996] 1 Lloyd's Rep 286.
[122] Grosz, Beatson, Duffy, Gearty, et al *Human Rights* (London: Sweet & Maxwell, 2000), 7 *et seq*..
[123] Hunt, 'The "Horizontal Effect" of the Human Rights Act' [1998] PL 423; Phillipson, 'The Human Rights Act, "Horizontal Effect" and the Common Law: a Bang or a Whimper?' [1999] 62 MLR 824.
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[126]

Obligations between private persons

The possibility for the enforcement of human rights norms between private persons[127] is a matter of some difficulty. Writing before the implementation of the provisions of the Human Rights Act 1998 in October 2000 it is impossible to know how the courts will react. What is clear is that the Human Rights Act 1998 does not include any provision which requires that such Convention rights be applicable between private persons: an omission which suggests that they will not be. However, the possibilities open to the courts to permit some cultural change in the light of the human rights jurisprudence can be predicted with some confidence. In crude terms, the possible approaches of the English courts vary from a straightforward denial of the application of human rights norms in circumstances relating only to non-state actors and non-public bodies, to a seepage of human rights norms into the norms which the courts accepts make up the common law. Therefore, it is proposed by a number of commentators at the time of writing that, while the Convention will not itself be directly enforceable, judges may accept that the philosophy underpinning the common law ought to be based in future, and in part, on principles of human rights law where applicable. Clearly, it would be difficult to be much more vague than that - so some examples of areas of potential fusion may be useful.

THE ARGUMENT OF THE BOOK

The argument underlying this book is set out in this section to offer a map of the themes which will be pursued through the chapters which follow. A summary of the arguments made in each chapter is then collated in the concluding chapter.

Creatures of our social history

Investment entities constitute a dialectic between institutions of contract on the one hand and of property on the other: institutions that are both legal and social. Investment through an entity necessitates more than a mere contract between two people, one an investor and the other an investment manager. Rather, the existence of the entity makes the investment a social process – even if that entity is a society with a membership of only two or three persons. I argue that the legal treatment of investment and of investment entities can be explained historically and sociologically. The roots of investment are to be found in the development of the partnership (a form of contract) and of the trust (a hybrid of property and contract-like obligations). The legal treatment of these entities has its roots in English history and in sociologically developing means for citizens to achieve common aspirations with the use of communally-held property.

Some of the entities considered in this book are born not out of English commercial history (as arguably are the partnership and the trust) and the time after the

[127] That is, persons who are not public bodies.

displacement of law merchant, but rather out of the development of the English working class from the feudal peasant class. Friendly societies, co-operatives, trade unions and so forth are creatures of this social history as the repeal of the Combination Acts withdrew the criminalisation of working people forming associations. The law acted as both a coercive and a facilitative force in the development of these entities. Coercive in the sense that only particular forms of entity were enforced as being legal contracts and facilitative in the sense that the law lent ready-made models which such groups of individuals could use to achieve their communal goals of welfare and trade protection. The legal structures used for investment were therefore the legal models assigned to these associations and created to offer a compromise between the power of the ruling and merchant classes on the one hand and the collectivist aspirations of the emergent working class on the other. The working class were thus able to provide for their own income security. At the same time these models were also being used by the capitalists to invest in the many opportunities offered up by the expanding British Empire.

Early models of investment entity

The three principal, early models were the partnership, the unincorporated association (both of which were built on contract) and the trust. The common bonds of these models were a dialectic between obligations owed on the basis of contract and obligations owed in relation to property. Those obligations were typically owed as a result of an agreement between people to invest together by way of partnership (that is, a commercial undertaking) or association (that is, a contract formed perhaps for non-commercial purposes). The investment stake itself constituted the property element of this transaction. The use of the idea of the trust (developed from land law) offered a means of structuring the deployment of investment property which made the use of many of these entities possible. In consequence contract (and evidence of common intention more generally) have come to dominate resolution of disputes to do with the allocation of rights in property.

From this mixture of contract and the trust grew the joint stock company. Significantly these early companies did not have legal personality and the property used for the company's purposes was held on trust for the members. The joint stock company was typically organised as a partnership with the company being a structure made up of its members (rather than being a legal person in itself) holding property on trust for those members. Subsequently, the now well-understood ideas of incorporation and then of separate legal personality were ascribed to the incorporated company by the common law in 1897. Today, many of these features of the company (incorporation, distinct legal personality, and limited liability of members) are treated as though they were necessary facets of a company despite an early history in which some companies were unincorporated, where the members were beneficiaries under express trusts, and where the company existed as the amalgam of its members and not as a separate person. The development of company law is the result of ideological development and commercial convenience, and not a necessary logic of the company structure itself.

In this development of forms of investment entity have come different modes of protection of the investor's investment stake. In the contract-based investment entities

like the partnership or the association, the mechanism of control was the construction of the terms of the contract itself – shored up historically by a pro-active judiciary which applied principles of usury and fairness on a more interventionist model than would be thought possible today. The development of the trust brought with it a complex web of obligations between beneficiary and trustee. The protection of the beneficiary was said to be in the beneficiary's ability to hold the trustee to account and the strict liability attached to trustees who either made unauthorised profits from the trust or who committed even merely technical breaches of trust.

The protection for the investor was therefore in the detail of the proprietary rights themselves. The beneficiary had proprietary rights in pooled investment property on the basis of democratic control of whatever property made up the investment fund from time to time. Democratic control which was dependent on the beneficiary's proportionate rights in the entire fund and on the *Saunders v. Vautier* principle. It is this fundamental aspect of the legal nature of property rights as encapsulated in democratic control of the use of property through contract and communal agreement which, it is argued, has fallen into neglect in theories of property law and which, it is argued further, ought to be recognised as being an important facet of the modern law of property.

The proliferation of regulation and the infantilisation of the investor

With the increasing sophistication of financial investment, it is said, there has developed a need for regulation of investment entities. In the time of the opening up of financial services and other investment media there has been an ironic increase in the use of regulatory mechanisms for all aspects of investment. Two points are made in this regard. First, this financial regulation is typically a spurious attempt by government to be seen to act as though it is exercising control over investment activity. Its success is shown by the succession of financial scandals either in the City of London or in other financial centres involving English law institutions. The record of regulatory institutions in other jurisdictions is no better in this regard. The use of statutory financial regulation legitimates not only financial investment but also the successive governmental consensus which favours the erosion of the welfare state.[128] Second, the policy of developing of regulatory bodies accepts that the practice of legal enforcement of rights in property is incapable of protecting the investor sufficiently: that is, regulators are created precisely because the law is not trusted to provide a sufficient solution to the needs of investor protection. So it is that the pension fund, the unit trust, the investment company, the friendly society, and the co-operative have acquired their own regulatory structures.

The argument advanced in this regard is that the logic of the investor as a holder of proprietary rights has been lost in the investment entity. In relation to a modern

[128] The evidence for this is public being located in the number of major financial scandals and also anecdotal in this author's experience of financial regulators writing to banks months in advance of a visit to warn that they are coming. This is not meant to detract from the excellent work of Black in creating taxonomies of forms of regulation generally (see Rules and Regulators (Oxford: Clarendon Press, 1997)) but rather in the success of the regulators themselves to hold the impossibly international financial markets to account. See Hudson, *Modern financial techniques, derivatives and law* (London: Kluwer, 2000).

incorporated company, the shareholder no longer has any proprietary rights in the assets of the company in the way the member had such rights in a joint stock company. Rather, the shareholder has a complex set of personal claims against the company and only indirect rights against its assets in certain circumstances. The regulator has replaced the direct proprietary rights of the investor. The result is the infantilisation of the investor – reduced to the status of a child seeking protection from its guardian, the regulator. Control by the investor is being replaced with the expertise of the investment manager. Regulation has proved necessary in relation to forms of entity like pension funds in which non-expert investors are being required to participate by public policy. The law on fiduciary duties requires development to cater for these extended forms of financial investment and further yet in relation to public sector investment structures.

Durkheim, contract and property

The Durkheimian scheme is deployed in this discussion to analyse this dialectic between the law of contract and the law of property. It is said by Durkheim, in general terms, that rules of contract are a creative social force in which people act together and express solidarity, whereas property rules tend to be negative in delineating exclusive ownership and possession of resources – 'exclusive' in the sense of containing the ability to exclude others from the use of those resources.[129] I argue against the perceived necessity of property as being negative in this way in all circumstances. While I acknowledge a number of contexts in which property will appear to be the sophisticated, human equivalent of an animal's territorial pissings, there are also contexts in which rules of property (possibly in a manner reminiscent of contract) enable people to organise the way in which they will deploy resources for their common use. In this sense the discussion of communal and co-operative investment institutions (friendly societies, trade unions and credit unions) is instructive in highlighting the communal nature of many investment entities in the communal use of invested property.

Historical, economic selection

History has seen the development of some entities and not others simply because some entities, such as the company and the commercial trust, have acquired greater economic significance than others. They are also sufficiently powerful to take their disputes to court and consequently to shape the legal treatment of rights and obligations in this area. The desire of the state to express some control over these significant economic actors through regulation (as with pension funds, unit trusts, investment and accounting rules in relation to trading companies) has seen the development of sophisticated legislation throughout the twentieth century to cope with them. The academy has similarly lavished attention on these economic actors while paying comparatively little attention to the Victorian utilitarian models of non-charitable investment whose legislative roots remain outdated and whose jurisprudence is distinctly old-fashioned. Thus the partnership is still governed by an act of 1892, industrial and provident societies are still governed by rules created in the

[129] Cotterell, *Emile Durkheim - law in a moral domain* (Edinburgh University Press, 1999).

nineteenth century, similarly some forms of friendly societies. For example, the industrial and provident society's requirement that there be seven members mirrors exactly the nineteenth century rules governing joint stock companies. In relation to those kinds of entities, the applicable jurisprudence is the same as it was then (unincorporated associations, use of ordinary trustees, and concepts built on partnership) although creeping regulation has begun to replace the importance of beneficiary control by property law.

Corporate personality and the dehumanisation of rights

It is argued that the maintenance of the affection for the *Saloman* principle of corporate personality by the courts is responsible for the weakening of the rights of investors. It is only by empowering investors through vested property rights that they can exercise sufficient control. The development of the understanding of the company as a distinct legal entity has hardened into an unalterable ideology. Consequently, the unscrupulous entrepreneur can raise capital for a company which stands as a cypher for her own personal venture, see the venture fail, and then walk away leaving the shareholders to rue their investment.[130] What the law will not do is allocate liability to that entrepreneur even if there is clearly only one controlling mind standing behind the transparent facade of the company. More generally the allocation of personality to intangible corporations has the unfortunate social effects as identified by Chomsky.[131] Those effects are twofold. First, the faceless, quasi-bureaucracy of large multinational corporations who cause economic or environmental harm in countries outside their jurisdiction of incorporation without any human face to bear the blame for those results or to bear legal liability. As Chomsky puts it, the allocation of legal rights to companies serves to 'undermine the traditional idea that rights inhere in individuals, and undermine market principles as well.'[132]

In considering the assertion of proprietary rights for investors, democratic control over investment capital is asserted as being one component of effecting the protection of participants in mutual investment structures. By recognising the importance of democratic control in such contexts will constitute a better understanding of the role of such entities in providing self-help initiatives in communities which are disenfranchised from ordinary financial services. Furthermore, this extension of the ordinary understanding of property rights also offers a new means of understanding situations as wide-ranging as the shareholder in an ordinary company and the citizen making a claim for a loan from the Social Fund. Accountability to the citizen as a person vested with democratic rights ought to be recognised in this late capitalist society as being as important a means of protecting rights as a bare trustee. The responsiveness required of the fiduciary to the claims of the citizen ought to be recognised as being equally sensitive in all of those contexts and not simply in the well-established categories of fiduciary duties like trusts.

The new risk society

[130] Subject to the regulation of directors' disqualification and the common law dealing with restitution.
[131] Chomsky, *Profit over People* (New York, Seven Stories Press, 1999).
[132] Chomsky, (1999), *op cit.*, 97.

Investment is singularly important in the public life of the UK and in the private lives of ordinary citizens. The welfare state is rolling back and being replaced by reliance on investment to provide personal welfare services, infrastructural public investment and general economic growth. All of this social change necessarily carries with it greater manufactured risk than hitherto. It is in this context that risk becomes an important element of all forms of shared, communal investment. Risk is expressed differently but is present in this discussion at every level. There is risk not only in financial-speculative investment but also in the ordinary decisions of citizens in their everyday lives in their pensions, in their homes and in providing for their families futures - whether through mainstream financial services or through self-help groups. Risk-taking and speculation is required of ordinary citizens seeking to protect themselves against their old age every bit as much as in the financial derivatives markets at the other extreme. The erosion of the protective role of the welfare state (a phenomenon which this writer regrets greatly) makes speculative investors of us all. To recognise our status as citizens requires a radical remodelling of the nature of our rights in property and a new understanding of our means of social solidarity.

From this chapter, then, we take a view of a changed world with renewed individual responsibility for individual welfare; a vision of risk which generates both opportunity and hazard; and sophisticated combinations of the legal concepts of contract and property. These issues of contract and trusts are considered in more detail in the chapter which follows.