Ireland, Paddy (2001) *Defending the Rentier: Corporate Theory and the Reprivatization of the Public Company.* In: Parkinson, John and Gamble, Andrew and Kelly, Gavin, eds. The Political Economy of the Company. Hart, Oxford, pp. 141-173. ISBN 1-84113-120-2.

Defending the *Rentier*: Corporate Theory and the Reprivatization of the Public Company

PADDY IRELAND

All bodies of company law embody and reflect particular assumptions about the nature of companies and the relations between those who participate in their activities. In other words, they are all underlain by a theory of the company. While the presence of this theory usually goes largely unacknowledged, in recent years, as the issue of so-called corporate governance has risen to prominence, the nature of the company and, in particular, of the large corporations which dominate the economy has become the subject of considerable debate.[1] With this corporate theory has moved much closer to the centre of the company law stage and although the claim that this has precipitated a "crisis in corporate law"[2] is rather exaggerated, there is no doubt that in an environment in which there is growing international interest in the relationship between corporate governance and competitiveness (and to a lesser extent social justice), the debates about corporate theory are proving to be of more than purely academic importance. In Britain, for example, seemingly abstract questions about the nature and character of companies figure prominently in the consultation document recently produced by the Company Law Review Steering Group for the DTI[3].

The two alternative approaches to company law identified by the Steering Group, one labelled "enlightened shareholder value", the other "pluralism", broadly reflect the two principal rivals within Anglo-American corporate theory: contractual or agency theory, based in law-and-economics, and stakeholding theory. Contractual theories, which began to crystallize in the U.S. in the 1970s and whose influence in the U.K. and elsewhere has since steadily grown, perceive the company as a nexus of contracts, most crucially between shareholder-principals and director-agents, characterising even large publicly quoted corporations as fundamentally voluntaristic, private affairs, the products of freely negotiated contractual exchanges. For contractual theorists, the fact that existing corporate structures are the supposed products of such processes is *prima facie* evidence that they are "efficient", "efficiency" in the specific and narrow sense in which the term is used within orthodox economic theory being, in their view, what company law and corporate governance are (and should be) about.[4] Contractual theories

[1] In most English-speaking jurisidictions, what in the United Kingdom is called company law is generally called corporations or corporate law. In this paper the terms "corporation", "corporate theory" and "corporate governance" are used to refer to large, publicly quoted (joint stock) companies.

[2] See David Millon, "Communitarians, Contractarians, and the Crisis in Corporate Law" (1993) 50 *Washington & Lee Law Review* 1371.

[3] Company Law Review Steering Group, *Modern Company Law, For a Competitive Economy: The Strategic Framework* (London, DTI, 1999).

[4] There are two principal variants of contractual theory. In the more extreme version, the internal functioning of companies is analysed firmly within the assumptions and methodology of neo-classical microeconomics. The "institutional" variant, associated with Ronald Coase and,

thus have a clear political slant, simultaneously legitimating, as both just and efficient, existing corporate structures and the priority that company law gives to the pursuit of the shareholder interest. As Douglas Branson says, they have an "overwhelmingly apologist flavor" and with their general presumption against the regulation of corporate affairs they "dovetail nicely with the wishes and desires of the titans of corporate America".[5] They also, of course, contrast sharply with stakeholding theories which argue, in different ways, that the interests of a wide range of groups with "stakes" in public companies - employees, customers, creditors, the community at large - should be recognised and, in some cases, represented in corporate legal and managerial structures.

Locating Corporations on the Public-Private Axis

In large part because of their political and economic implications, and their neglect of issues of justice and equity, not to mention their rather impoverished conception of individual and social well-being, contractual theories of the corporation have been much criticised, particularly, but not exclusively, in the United States where they originated. As part of this process, a number of American scholars, most notably William Bratton and David Millon, have sought, among other things, to expose the political dimension of contractual theories by locating them historically, tracing their origins and situating them in relation to earlier theories of the corporation.[6] The history that they recount is undoubtedly remarkably rich. For a variety of constitutional, jurisdictional and political reasons, corporations in the U.S. have since the early nineteenth century generated a range of legal problems whose resolution has demanded direct consideration of their nature and status. Compelled to grapple with questions about the nature of corporate "citizenship" and "personhood", American courts and lawyers, unlike their British counterparts, have found it impossible not to be drawn openly into essentialist debates about the nature of corporations. At first glance, the issues with which the courts became embroiled - such as whether corporations were artificial creations of the state or the "natural" products of private

---

more recently, Oliver Williamson, is more realistic, taking seriously Coase's distinction between markets and firms. For the purposes of the arguments made in this paper, however, the two variants are sufficiently similar - Coase's non-market structures are little more than surrogates for markets - to render it unnecessary for me to elaborate their differences, important in certain respects though they are.

[5] Douglas Branson, "The Death of Contractarianism and the Vindication of Structure and Authority in Corporate Governance and Corporate Law", in Lawrence E. Mitchell (ed), *Progressive Corporate Law* (Oxford, Westview Press, 1995) 93 at 93-4.

[6] See William W. Bratton Jr, "The New Economic Theory of the Firm: Critical Perspectives from History" (1989) 41 *Stanford Law Review* 1471, reprinted in Sally Wheeler (ed), *The Law of the Business Enterprise* (OUP, 1994), 117; and David Millon, "Theories of the Corporation" (1990) *Duke Law Journal*, 201. For other recent explorations of the historical development of American corporate theory which do not consider the rise of agency theory, see Morton Horwitz, "Santa Clara Revisited: The Development of Corporate Theory" (1985) 88 *West Virginia Law Review*, 173; and Gregory A. Mark, "The Personification of the Business Corporation in American Law" (1987) 54 *Chicago Law Review*, 1441.

initiative, and whether they were entities with a "real" existence quite independent from that of their members or simply aggregations of people - seem abstract and academic. However, underlying them - "operat[ing] at a deeper level", as David Millon puts it - has been the "abidingly crucial" political question of whether corporations are essentially public or private entities. Indeed, it is the different answers that have been offered to this question over time that has provided the general framework for the recent analyses of the development of American corporate theory, all of which are in their different ways concerned with plotting the relationship between different theories of the corporation and the shifting location of corporations on the public-private axis. The contrast, Millon explains, is "between a public law, regulatory conception of corporate law on the one hand, and a private law, internal perspective on the other"; between "a body of law concerned solely with the techniques of shareholder wealth-maximisation [and] a body of law that embraces and seeks to promote a richer array of social and political values".[7]

In general terms, the claim is that, historically, designations of corporations as artifical creations of the state have tended to be used to counter claims that they are overwhelmingly private in nature and to support a pro-regulation, public law approach to corporate law; while designations of them as the "natural" products of private contract have usually been used to justify an anti-regulatory stance. In a similar vein, it is argued that characterisations of corporations as aggregates of individuals have tended to be used to assert their fundamentally private, contractual nature and to legitimate shareholder primacy and state non-interventionism; while characterisations of them as autonomous entities in their own right have commonly been used to underpin claims as to their public nature and to advance a less shareholder-oriented conception of corporate enterprise. From this perspective, the current wrangles within corporate theory are simply the latest chapter in the "long history of ... tension between the public and private character of the corporation"[8], with contractual theories representing the most recent attempt to accentuate and advance a private, shareholder-oriented conception of the corporation. They are, in Millon's words, "an elaborate justification for the now familiar view that corporate activity and corporate law are purely private matters" upon which public policy concerns should not be allowed to intrude; for the view that corporate law should concern itself only with the welfare and interests of shareholders. By emphasising the voluntary nature and market-like characteristics of corporations, contractual theory seeks to pull them to the private side of the public-private divide, bolstering shareholder primacy and diminishing the role of the state in corporate life. The corporation is reconstructed with few, if any, public elements, and "community values" are wrung from it.[9]

---

[7] Millon n.5 at 201-2. Or as he has more recently and more fashionably put it, it is the difference between a contractarian and a communitarian conception of the corporation. See David Millon, "Communitarianism in Corporate Law: Foundations and Law Reform Strategies", in Mitchell (ed) n.4, 1.

[8] Paul Cox, "The Public, The Private and the Corporation" (1997) 80 *Marquette Law Review*393 at 394-5. Bratton explicitly eschews use of the term "public corporation" to describe the large quoted company for fear that it prejudges the vital public-private issue, preferring instead the term "management corporation". See William Bratton, "The `Nexus of Contracts' Corporation: A Critical Appraisal" (1989) 74 *Cornell Law Review* 407.

[9] Millon, n.5 at 231; Bratton, n.7 at 428, 440.

In portraying the present as history and by emphasising the centrality to corporate theory of the public-private divide, this work has done much to cast light on the development not only of contractual theory, the ahistoricism of which makes it unusually vulnerable to historical analysis, but of corporate theory as a whole, revealing it to be not a steadily advancing body of knowledge but a long-standing site of ideological struggle. This paper argues, however, that while this work has provided many valuable insights, it does not fully get to grips with the issues which lie at the heart of company law and corporate theory: the constitution and allocation of rights over the assets and activities of joint stock companies. Not only does this issue precede that of efficiency, a concept which, as it is understood within orthodox economics, essentially presupposes both a pre-existing allocation of rights and that those rights take a particular (alienable) form[10], it is central to understanding the historical development of corporate theory, for it is the *re*conceptualisation (and *re*allocation) of corporate property and corporate rights necessitated by the transformation of productive relations effected by the rise of the joint stock company that has been the driving force behind theoretical change in company law. In offering an alternative history of corporate theory, the paper argues that, historically, contractual theories of the corporation, with their emphasis on efficiency-based justifications, emerged as an attempt to defend and legitimate the rights and privileges of *rentier* shareholders in face of the increasing difficulties involved in characterising corporations as private property and shareholders as corporate "owners".[11] Relying less on the fundamental moral principles traditionally associated with the ideas of private property and ownership (such as natural right, liberty, moral desert) and more on the alleged instrumental value of shareholder rights in contributing to productivity and efficiency, contractual theories of the corporation, it suggests, seek to give legitimacy to a legal status-quo in which corporations are run exclusively for the private benefit of shareholders despite their overwhelmingly social and public nature.[12] Indeed, in recent years, it argues, as both the power and influence of financial capital and inequalities of wealth and income have grown, the new legitimations of shareholder rights provided by contractual theories have become ever more important. In reminding us of the crucial, but increasingly neglected, issues surrounding the constitution and allocation of rights in and over

---

[10] The "Coase theorum", for example, asserts that economic efficiency will be achieved as long as property rights have been fully allocated and that completely free trade in these property rights is possible. It purports to demonstrate that it does not matter who owns what initially, only that everything is owned by someone, trade ensuring that resources are eventually placed in their occupation of highest value. Rights have to be constituted in a particular alienable form in order for the market to work its magic.

[11] In reality, contractual theorists often use the concept of "efficiency" in clandestine support for particular allocations of rights, rather for commenting on the outcomes generated by arrangments based on a *pre-existing* allocation of rights. Crucially, of course, efficiency is far from being the only basis upon which property (and other) rights might be constituted and allocated, see Alan Carter, *The Philosophical Foundations of Property Rights* (Hemel Hempstead, Harvester Wheatsheaf, 1989).

[12] John Christman distinguishes direct and indirect arguments in support of ownership rights, observing that indirect, instrumental arguments are "characteristically weaker" than direct arguments which rely on the assertion of fundamental moral principles, *The Myth of Property* (OUP, 1994), 8.

corporations, the paper hopes to broaden the focus of the debates currently taking place about company law reform and to indicate the issues which need to be addressed if an "effective *ethical* framework for [corporate] governance"[13] is to be constructed, a framework aimed more at meeting the material needs of society and enhancing the well-being of its members than at maximising the financial returns of *rentier* shareholders.

From Owning Assets to Owning Companies: The Rise of Entity Theory

What we now call "company law" began to emerge in the early-mid nineteenth century as "joint stock company law", the body of law applied to joint stock companies. Joint stock companies, although considered types of partnership even when incorporated, were distinguished from "ordinary" partnerships by their size, their separation of ownership from management and the transferability of their shares. In contemporary parlance, they were "public" rather than "ordinary" or "private" partnerships, to which the principles of the law of partnership, slightly modified, were thought generally applicable. Correspondingly, when the first book devoted to joint stock company law appeared in 1836 it was largely confined to explaining how the principles of the law of partnership had been modified in various ways for application to incorporated and unincorporated joint stock companies.[14] Early company law, such as it was, was thus treated as an adjunct to the law of partnership.

These conceptions reflected the fact that, unlike their modern counterparts, early joint stock companies were still relatively small organisations whose shareholders often had a personal link of some kind to the companies in which they held shares and who, even if not directly involved in management itself, were commonly involved in its monitoring.[15] And the fact that in the absence of a developed market in company securities, shares were not readily saleable assets and shareholders were, therefore, in a certain sense and to a certain extent, "tied" to the companies in which they held shares. The result was that, deep into the nineteenth century, both incorporated and unincorporated joint stock companies were conceptualised, like partnerships, as aggregates of people rather than, as they are now, as objects in their own right ("things") autonomous from their shareholders. A company's shareholders *were* the company. This was reflected in the conceptualisation of the property of companies. Until the mid-nineteenth century the joint stock company share was regarded in law as an equitable (and, therefore, direct proprietary) interest in a company's assets and shareholders as the equitable co-owners of those assets.[16] Indeed, although the rights of individual shareholders over the

---

[13] David Campbell, "The Role of Monitoring and Morality in Company Law" (1997) 7 *Australian Journal of Corporate Law*, 343 at 345.

[14] Charles F.F. Wordsworth, *The Law Relating to Railway, Banking, Insurance, Mining and other Joint Stock Companies* (London, Henry Butterworth, 1836; enlarged 2nd ed., 1837)

[15] See, for example, J.R. Ward, *The Finance of Canal Building in Eighteenth-Century England* (OUP, 1974).

[16] For a detailed discussion of this and issues raised in the following paragraphs, see Paddy Ireland, "Capitalism without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality" (1996) 17 *Journal of Legal History* 41.

corporate assets were inevitably diluted to accomodate joint property ownership, as a result of the collective power that they exercised through company general meetings - and of the relative illiquidity of their shares - there were important senses in which shareholders really did resemble asset "owners" in something like the sense outlined by Honore in his celebrated essay on ownership.[17]

From the middle of the nineteenth century, however, in the wake of the development of the railway system and the proliferation of railway companies, joint stock companies increasingly became qualitatitively rather than merely quantitatively different from ordinary partnerships. Railway companies were not only much larger than their predecessors, both in terms of the size of their memberships and of the capital that they embodied, they were fundamentally impersonal organisations the great majority of whose shareholders in no way participated in management. The growing number of "detached" shareholders was both reflected in and further encouraged by the rapid emergence in the 1830's and 40's of a developed and active market in company securities. In a very short period of time, the nature of the shareholder, of shareholding and of the share itself as a form of property had all been transformed. Very soon, the great majority of joint stock company shareholders were functionless *rentiers*, "investors" who took little or no direct interest in the companies in which they held shares, other, of course, than in the dividends they paid.

There were many legal dimensions to these changes. Perhaps most importantly, the legal nature of the joint stock company share was transformed. With the development of a relatively sophisticated share market, shares became readily marketable, liquid commodities with a value of their own independent of (and often quite different from) the value of a company's concrete assets. As a result, they ceased to be regarded in law as equitable interests in the assets of companies and came instead to be seen as rights to profit. Shares emerged, in other words, as an intangible form of property in their own right quite independent of the assets of companies; no longer did they constitute a direct proprietary interest in those assets. In this process, shareholders themselves ceased to be seen as owners of assets - these were now owned by "companies", conceptualised not as shareholders merged but as reified entities in their own right - but as owners of shares, titles to revenue with a (capital) value determied by the share market. There were now two quite different, legally constituted, forms of property, one owned by shareholders (shares, titles to revenue), the other owned by companies (assets); and two fully separate and quite distinct legal subjects, companies and shareholders. These reconceptualisations provided the basis for the development in the U.K. of the modern doctrine of separate corporate personality, with its "complete separation" of company and members; and, somewhat later, of what came to be called in the U.S. the "entity theory" of the corporation.

The reduction of shareholders from the status of relatively active "co-partners", as they were commonly called in the late eighteenth and early nineteenth centuries, to passive owners of titles to revenue, external to companies as productive units, was further reflected in the gradual transfer of power within joint stock companies from general meetings and shareholders to boards of directors and managers, a process in which shareholders gradually relinquished many of the the rights and powers traditionally associated with ownership. As a result of these and other developments related to the reduction of shareholders to the status of rentier investors external to the process of production, company law gradually diverged from the law of

[17] A.M. Honore, "Ownership" in A.G. Guest (ed), *Oxford Essays in Jurisprudence* (OUP, 1961) 107. Honore distinguished eleven incidents of ownership.

partnership and had, by the late nineteenth century, separated out as a quite distinct body of law in its own right. In 1889, the author of the leading treatise in the area, Nathaniel Lindley, who had for many years subsumed his coverage of company law within his book on partnership, a volume revealingly entitled *A Treatise on The Law of Partnership including its Application to Joint Stock and Other Companies*, finally accorded company law a volume of its own.[18]

As the ideas of shareholders as owners of assets and as *being* the company were displaced, there emerged a new notion of shareholders as the owners of "the company", a reified entity external to them. This idea persists today. So far as large publicly quoted companies were concerned, however, this idea had little basis in law, for while shareholders clearly exercised ownership rights over their shares, in relation to companies and their assets they possessed progressively fewer of Honore's incidents of ownership.[19] On the contrary, in exchange for limited liability (and an easy life), they had given up virtually all of the rights traditionally associated with ownership either of the corporation or its assets: the right to operate and manage; the right to sell, dispose, pledge, encumber, or hypothecate; the right to create lesser titles in interests, such as leases, licenses, easements of covenants; the right to bequeath.[20] This prompted Merrick Dodd to distinguish the "technical" legal position - that "the corporation and not the shareholders is the owner of the corporate assets" - from the "lawyer's theory" and the "business man's tradition" - that "the corporation owns the business [and] the shareholders in turn own the corporation".[21] The ownership myth[22], however, served one very useful purpose. With its Blackstonian implication of absolute sovereignty, of "sole and despotic dominium"[23], of exclusive and exclusionary "mineness", the idea that shareholders "owned" corporations, that corporations were their private property, suggested that the retention by functionless shareholders of their right to profit and to appoint and dismiss directors were underlain by the fundamental moral principles of natural right, liberty and moral desert; that the validity of these rights was free-standing and independent of their impact on, and consequences for, such things as productive efficiency and the distribution of wealth. In other words, the ownership myth pre-empted any proper analysis of the crucial question of what the rights and privileges of these

---

[18] The first edition of Lindley's treatise on partnership was published in 1860 (by William Maxwell). It had been through five editions before the separate volume on company law appeared.

[19] See Paddy Ireland, "Company Law and the Myth of Shareholder Ownership" (1999) 62 *Modern Law Review* 32.

[20] See Peter Rona, letter, 89 *Harvard Business Review* (Nov-Dec 1989) 198.

[21] E. Merrick Dodd, "The Modern Corporation, Private Property and Recent Federal Legislation" (1941) 54 *Harvard Law Review* 917 at 918.

[22] See Ireland n.19. Although the idea still persists that shareholders (including the shareholders of large public companies) `own' companies by virtue of their ownership of shares, lawyers have always found it next to impossible to give coherent legal substance to it. Hence the difficulty they have in defining the legal nature of shares and indicating how they constitute a proprietary interest in the company.

[23] Sir William Blackstone, *Commentaries on the Laws of England*, Vol II, 2.

rentier shareholders *should* be.

Radical Entity Theory and the Question of Corporate Ownership

In the first half of the twentieth century, however, this was precisely the question that many began to ask. As the externality of shareholders from production and management, and their lack of purpose became ever more apparent - and by this time the great majority of shareholders had not only ceased to contribute to management but to be significant sources of new capital for companies - the ideas that shareholders were corporate "owners" and that corporations were their private property came increasingly to be challenged.

In the U.S., in particular, there was growing recognition that the rise of the modern corporation had contributed to fundamental changes in the nature of property and property rights. Thorstein Veblen, for example, argued that ownership, which had previously entailed the control of tangible material assets and carried with it various duties and responsibilities, had come with the rise of the modern joint stock corporation to entail mere passive possession of intangible corporate capital. Corporate shareholders, he argued, had been reduced to the status of "anonymous pensioners" detached from the process of production; they were "absentee owners" possessing claims "to unearned or free income", "prescriptive rights to get something for nothing". He accordingly likened them to corporate bondholders, arguing that the lines between debt and property, credit and capital, and stock and bond were becoming increasingly blurred.[24] By the late 1920's, it had become commonplace to remark on the resemblance between shareholders and bondholders, thereby implicitly questioning the former's proprietary status vis-a-vis the corporation. "The average stockholder in the large corporation", wrote Franklin Wood, "regards himself more as a security holder than as in any sense a responsible managing partner in the corporate enterprise". As a result, he argued, the legal distinction between bondholders and stockholders was "fast becoming a distinction unwarranted by the actual situation".[25]

Ideas of this sort provided the basis for the radical reinterpretation of entity theory offered by E. Merrick Dodd in the early 1930s's in his celebrated exchange with Adolf Berle.[26] Concerned about the growing unaccountability of many American corporate managers, Berle had some years earlier argued for a strenghtening and tightening of the fiduciary duties compelling them to pursue the shareholder interest. He did so not so much for reasons of principle but because he could see no other way of preventing managers from feathering their own nests and making them accountable to *someone*.[27] Dodd responded by contesting the close

[24] See Thorstein Veblen, *The Theory of Business Enterprise* (New York, Scribner's, 1904); *The Vested Interests and the State of the Industrial Arts* (New York, Huebsch, 1919); and *Absentee Ownership and Business Enterprise in Recent Times* (New York, Huebsch, 1923).

[25] Franklin S. Wood, "The Status of Management Stockholders" (1928) 38 *Yale Law Journal* 57 at 59. For a similar view, see Jerome Frank, Book Review of Berle & Means, 43 *Yale Law Journal* (1933) 989 at 992.

[26] See Paddy Ireland, "Back to the Future: Adolf Berle, the Law Commission and Directors' Duties" (1999) 20 *Company Lawyer* 203.

[27] See, for example, Adolf Berle, "Non-Voting Stock and `Bankers Control'" (1926) 39

identification of corporations with their shareholders that this entailed, arguing that important changes were taking place in "public opinion" of the corporation in which society saw business not as a purely private enterprise but as something with wider social obligations. Some corporate managers, he argued, had responded by accepting that they had "social responsibilities" and the judiciary were showing tolerance towards the resulting changes in managerial orientation, notwithstanding the traditional view that charity had no business to sit at boards of directors. Crucially, according to Dodd, while such an extended view of corporate managerial social responsibility was "difficult to justify if [one] insist[ed] on thinking of the business corporation as merely an aggregate of stockholders...", it could easily be reconciled with a view of the corporation as a real entity, "as an institution which differs in the nature of things from the individuals who compose it". Once one recognised the corporation as a truly separate "person", he suggested, there was no reason why it should not operate, through its managerial agents, as a "good citizen ... with a sense of social responsibility". In short, Dodd used entity theory to provide a theoretical basis for the idea of the corporation as a partially, if not predominantly, public institution with broad social responsibilties.[28]

By the time of the publication of *The Modern Corporation and Private Property* in late 1932 Berle's own position had begun to shift. The rise of the modern corporation, he argued with Gardiner Means, "involved an essential alteration in the character of property", giving rise to important questions about both the orientation of the "great public" corporations and the allocation of rights in them. Because shareholders were now the owners of "passive" rather than of "active" property, the "traditional logic of property" no longer applicable to them. Having relinquished so many of the rights traditionally associated with ownership, they could no longer properly, or accurately, be called the corporation's owners. They had "surrendered the right that the corporation should be operated in their sole interest", "releas[ing] the community from the obligation to protect them to the full extent implied in the doctrine of strict property rights". The community was entitled "to demand that the modern corporation serve ... all society". Various groups should be "assign[ed] ... a portion of the income stream on the basis of public policy rather than private cupidity".[29]

After the second world war, as many commentators came to question the belief that shareholders were corporate owners in the traditional sense of the word, sentiments of this sort became quite commonplace. There was, however, considerable disagreement as to how shareholders should be reconceived and, consequently, as to how corporations should be viewed

---

Harvard Law Review 673; "Corporate Powers as Powers in Trust" (1931) 44 *Harvard Law Review* 1049.

[28] E.Merrick Dodd, "For Whom are Corporate Managers Trustees?" (1932) 45 *Harvard Law Review* 1147. Berle responded with "For Whom Corporate Managers *are* Trustees" (1932) 45 *Harvard Law Review* 1365, and Dodd came back with "Is the Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?" (1935) 2 *University of Chicage Law Review* 194.

[29] Adolf Berle & Gardiner Means, *The Modern Corporation and Private Property* (New York, Macmillan, 1932; revised ed., New York, Harcourt Brace, 1967). Berle first began to ponder the implications of the modern corporation for the institution of private property in "Corporate Devices for Diluting Stock Participations" (1931) 31 *Columbia Law Review* 1239.

and treated. Some began to designate shareholders "investors" rather than "owners", but continued nevertheless to treat their position as one akin to ownership and their rights as akin to private property rights over the corporation and its assets. They thus defended and promoted shareholder corporate primacy, though seeking to secure the interests of shareholders by means of investor protection rather than by means of measures aimed at rekindling shareholder participation.[30] For others, however, the recognition that shareholders were "investors" rather than "owners" highlighted their resemblance to creditors and the weakness of their proprietary claims over the corporation itself. As Edward Mason explained in *The Corporation in Modern Society*, an influential collection of essays published in 1959, with the "equity holder ... joining the bond holder as a functionless *rentier*" and having "only the vaguest idea where `his property' is or of what it entails", "the traditional justifications .. of private enterprise [and] of private property [had] gone forever". The old Lockean and Jeffersonian arguments that private property ownership was essential to the "full development of personality, to the maintenance of individual freedom .... and to the formation of a citizenry capable of self-government" might still be valid in relation to "individual possessory holdings" but were increasingly irrelevant to corporations whose "owners" had been converted into *rentiers*.[31]

This perceived erosion of the legitimacy of shareholder corporate rights and primacy was manifested in various ways. In the U.S., a number of commentators - among them Abram Chayes, Bayless Manning and Peter Drucker[32] - argued that shareholder voting rights should be pared down or even rescinded. Others called for a wider conception of corporate "membership" which would embrace, in particular, employees. In Britain, LCB Gower, doyen of post-war British company law, asked whether it was "not time to recognize that shareholder democracy, with its exclusive emphasis on the profit-making element in corporate activity, has a slightly old fashioned ring?".[33] And a little later, George Goyder called for company law reform aimed at creating "participating" and "responsible" companies, membership of which would be extended not only to shareholders but to employees, consumers and the community. He recognised that this required what he called "a certain subordination of the shareholders interest", but, likening them variously to money-lenders, investors, creditors and even userers - anything but owners - Goyder argued that their legitimate claims over corporations and corporate income were limited. They were entitled, at most, to a fair return on their investment though not necessarily to a perpetual return; perhaps, he suggested, shares should be compulsorily amortized.[34] A few years

[30] In the U.S. the demotion of the corporate shareholder from an "inside" owner to an "outside" investor was heralded by the Federal Securities legislation of the 1930s.

[31] Edward Mason (ed.), "Introduction", in Edward Mason (ed.), *The Corporation in Modern Society* (Harvard UP, 1959; reprinted, New York, Atheneum, 1966)) 1 at 2-6, 14-15.

[32] See Abram Chayes, "The Modern Corporation and the Rule of Law", in Mason (ed.) n.31 at 25; Bayless Manning, Review of J.A. Livingston, *The American Stockholder* (1958) in 67 *Yale Law Journal* (1958) 1477 at 1490-1493.

[33] L.C.B Gower, Book Review of Emerson & Latcham, *Shareholder Democracy* (1954) in 68 *Harvard Law Review* (1955) 922 at 927.

[34] George Goyder, *The Responsible Company* (Oxford, Blackwell, 1961).

later, K.W. (later Lord) Wedderburn, lamenting the lack of radicalism of the Jenkins Committee report, similarly argued that there was "no reason not to equate [the shareholder's] position with that of a well secured creditor" and that company law "should *not* treat the shareholder's as a `proprietor' entitled to control".[35]

Paradoxically, one of the reasons why the political pressure for a reduction in the legal rights of shareholders waned was because the issue was thought redundant by many on the left precisely because the *de facto* power of shareholders had been emasculated by their dispersal, their *rentier* nature, and their loss of rights within the company. Indeed, by the 1950's many commentators were arguing that the declining power of private property and of corporate shareholders in particular had altered the nature of capitalism itself. In the U.S., Berle began referring to the modern American business system as one of "People's Capitalism" or "Collectivism"[36], while J.K.Galbraith talked of shareholders as vestigial, of the subservience of the corporation to society and the state, and of the supersession of the market.[37] This was echoed in Britain by writers such as Anthony Crosland. Managers now controlled large corporations, Crosland argued, and "independent not only of the firm's own shareholders, but increasingly of the capitalist or property owning class as a whole", they balanced the interests of shareholders with those of employees, customers and the community at large. For Crosland, so significant were the differences in "the nature of the profit-goal and the degree of responsibility with which economic power is exercised", "present day society" had to be distinguished from capitalism, whose traditional ruthlessness and aggressive individualism had been replaced by "a suave and sophisticated sociability". Correspondingly, the pattern of ownership of industry - whether it was nationalised or privately owned - was now largely irrelevant, for it did not determine the extent to which socially responsible goals were pursued. Large corporations, Crosland argued, "acted in fundamentally the same way, whether publicly or privately owned". Using "a historical definition", he concluded, it was "manifestly inaccurate" to call contemporary Britain a capitalist society.[38]

Henry Manne and the Reprivatization of the Corporation

By this time, then, not only was the idea of shareholder corporate "ownership" under question, the old, traditional, ownership and private property based justifications for the rights and privileges of shareholders were becoming progressively less persuasive. It is in this context that the rise of contractual theories of the corporation need to be viewed. In this respect, the work of those most frequently associated with contractarian theory - Alchian and Demsetz, Jensen and Meckling, Easterbrook and Fischel - is in many ways less revealing than the work of Henry

[35] K.W. Wedderburn, *Company Law Reform* (London, Fabian Society, 1965).

[36] See, for example, Adolf Berle, *The Twentieth Century Capitalist Revolution* (London, Macmillan, 1955).

[37] See, for example, J.K.Galbraith, *American Capitalism* (Oxford, Blackwell, 1956).

[38] C.A.R. Crosland, *The Future of Socialism*, (London, Jonathan Cape, 1956); C.A.R. Crosland, *The Conservative Enemy*, (London, Johnathan Cape, 1962). Similar views were expressed by John Strachey in *Contemporary Capitalism* (London, Gollancz, 1956).

Manne, one of the founding fathers of law and economics.

It is clear that by as early as the mid 1950's Manne was concerned with the threat posed by contemporary thinking on the corporation, which he traced back to Berle and Means, both to shareholder rights and to the capitalist market economy as a whole. He blanched at suggestions that shareholders should receive only a "fair" return on their capital and that the interests of groups other than shareholders should be considered by managers. The movement for corporate social responsibility, he argued, was undermining market mechanisms, raising the suspicion that a "radically altered form of economy [was] being proposed" in which "the ideal of the market as a resource allocator ... [was being] abandoned". As a result of this politicisation of the economic sphere, he later wrote, we were entering "a new phase of concern" with the "political position" of the large corporation and with "the role it is and should be playing in the distribution and enjoyment of a great variety of the values in which the community is interested".[39]

Manne responded to the threat by arguing that, notwithstanding growing industrial concentration, market disciplines were still operative, preventing corporations from straying too far from their traditional, profit-making goal. It was, however, on capital, rather than on product, markets that Manne placed disciplinary reliance. The idea that capital markets might constrain corporate managers was not new[40], but most of those seeking to protect the interests of shareholders still looked to a restoration of participative shareholder democracy as the route forward[41], drawing encouragement from the emergence in post-war America of a small group of shareholder activists who occasionally forced proxy battles for the control of corporations.[42] As a result, there was still a tendency to regard the sale of shares by shareholders as not only "the weakest of all the tools in the hands of the stockholder" but as "a disloyal kind of activity which [was] really not desirable".[43] Manne sought to turn this view on its head. If done on a large enough scale, he argued, the sale of shares by dissatisfied shareholders could depress a corporation's share price, rendering the corporation vulnerable to take-over and its poorly performing managers vulnerable to removal. Although proxy fights were rare, the mere threat of "a raid" would often suffice, for the constant pressure of possible take-over "condition[ed] managers to a specific point of view perfectly consistent with the shareholders' interest, ..,

[39] Henry Manne, "The `Higher Criticism' of the Modern Corporation' (1962) 62 *Columbia Law Review* 399 at 399, 402, 414; and Henry Manne, Book Review of Richard Eells, *Corporation Giving in a Free Society* (1956), in 24 *University of Chicago Law Review* (1956) 194 at 198.

[40] See, for example, the discussion in Berle and Means n.29 at 255-263 (revised ed., 1967), concluding that they were "one of the economic enigmas of the present system".

[41] See, for example, Frank Emerson & Franklin Latcham, *Shareholder Democracy* (Cleveland, Western Reserve University, 1954)

[42] See, for example, J.A. Livingston, *The American Stockholder* (New York, Lippincott, 1956).

[43] See Henry Manne, Review of J.A.Livingston, The American Stockholder (1958) in 5 *St Louis University Law Journal* (1958) 309 at 311.

keeping the price of the company's shares as high as possible".[44] In this context, the rise of the institutional investor - by 1960, institutional investors owned 17.2% of the value of U.S. shares[45] - was, Manne argued, "one of the most dramatic and important events in the recent history of market finance", for what corporate management feared most was that the institution would sell its shares with a potentially disastrous effect on their market price.[46] Manne thus attempted to transform the externalisation of the *rentier* shareholder from the corporation - an externalisation in many ways accentuated by the rise of financial intermediaries such as institutional investors - from a vice, which arguably undermined not only shareholder control but the legitimacy of their residual rights, into a positive virtue. The very lack of commitment of shareholders to the corporation and their very readiness to "exit", he suggested, heightened the threat to "errant managements" who dared deviate from the gospel of profit-maximisation. "The fight for control" was, in his view, "a mechanism by which the market operates to weed out the inefficient and less productive".[47] By the mid 60's, he had further developed this argument and was claiming not only that an "active market for corporate control" existed and that a "great many mergers [were] probably the result of [its] successful workings"[48] but that the market for corporate control held the key to "true corporate democracy". Accordingly, he was highly critical of those calling for the dilution or removal of shareholder voting rights, not because he believed that these rights would (or could) be used by shareholders to restore participative democracy to corporations, but because the market for corporate control could only function to ensure "a rational allocation" of capital and managerial services[49] where shares carrying votes could be bought and sold.[50] Indeed, it was because of its alleged contribution to the proper working of this market that Manne defended insider dealing, arguing that it not only tied the interests of corporate managers more closely to those of shareholders, but helped to ensure that the price of a company's securities reflected its performance and the relative efficiency of its management. By trading in a company's shares, knowledgable insiders were, in effect,

[44] Henry Manne, "Our Two Corporation Systems: Law and Economics" (1967) 53 *Virginia Law Review* 259 at 265-66.

[45] See William Lazonick, "Controlling the Market for Corporate Control" (1992) 1 *Industrial and Corporate Change* 445 at 474.

[46] Manne n.43 at 312.

[47] Manne argued that in order to make management even more responsive to capital markets, the right of corporate managements to retain earnings - and thus to avoid going to the market for additional capital - should be strictly limited. They should, he argued, be required to pay out all income over the amount necessary for working capital.

[48] Henry Manne, `Mergers and the Market for Corporate Control' (1965) 73 *Journal of Political Economy* 110; extracted in Louis Putterman & Randall Kroszner, *The Economic Nature of the Firm* (2nd ed., 1996) 299. The article was an attack on prevailing antitrust doctrine.

[49] Manne, "Higher Criticism" n.39 at 409-413.

[50] Manne, n.44 at 265.

constantly "correcting" the company's share price.[51] Crucially, in making these arguments, Manne began to develop justifications for shareholder rights which relied less on the moral force of their claims as corporate "owners", and much more on the instrumental value of their rights in ensuring "allocative efficiency". Rather than attempting to defend their ownership claims and lamenting their detachment from corporations, Manne insisted that shareholders had *never* performed the traditional functions of ownership[52] but had, on the contrary, always been mere "investors", the "traditional capital investor[s] of economic theory" who put "money at risk for use by entrepreneurs and managers". They had, moreover, according to Manne, always been recognised as such by company law. What needed to be explained wasn't so much the contemporary lack of rights of shareholders - this flowed from their status as investors - but the more extensive corporate rights that they had possessed in the nineteenth century.[53]

In its static ahistoricism, Manne's account of the nature of corporate shareholding prefigured contractarian and agency theories of the company, propelling him not only into unpersuasive and inelegant historical distortions as he tried to explain away the earlier partnership (and "ownership") based rules of company law[54], but into confused and confusing assertions about the nature of the shareholder's property and property rights. He described, for example, the claims made by Berle and Means about the passive nature of the share and about the fundamentally social nature of the large corporation - claims which posed a threat to shareholder primacy - as based on "erroneous assumptions about the nature of property". They had wrongly assumed that the notion of private property necessarily involved "both the concept of risk assumption and that of control or use of the property", and that "the economic reward provided to property owners is justified only if they perform both of these functions", mistakenly concluding on this basis that the return to shareholders, as "risk takers only", should be limited. In fact, Manne argued, the only essential characteristic of a private property system was that owners "assumed the risk of a rise or fall in the market value of [their] property". An owner was not bound to use his property at all and was perfectly entitled to delegate control over it to managerial agents.[55]

Lacking a dynamic historical conception of capitalism, Manne was utterly unable to grasp that Berle and Means had simply been trying to address the practical and ethical problems thrown up by the *changing* nature of corporations, corporate property and corporate shareholding; and, in particular, by the transformation of the shareholder into a functionless,

---

[51] Henry Manne, *Insider Trading and the Stock Market* (1966); See also Manne, n.44 at 274.

[52] John Parkinson succinctly sums up this view: `Since the shareholders are not owners, there is no reason to suppose that that they should behave in an owner-like way, and the fact that they do not so behave does not signify that the corporate form has become dysfunctional'. See J.E. Parkinson, "The Contractual Theory of the Company and the Protection of Non-Shareholder Interests" in David Feldman & Frank Miesel (eds.), *Corporate and Commercial Law: Modern Developments* (London, Lloyds, 1996) 121 at 123.

[53] Manne, n.44.

[54] See Manne n.44 at 270-275 for examples.

[55] Manne, "Higher Criticism", n.39 at 406-07.

passive investor (a money capitalist) external to the corporation. He could not see that the nature of both shareholding and ideas and forms of property were subject to change. This was something of a paradox, for it was, of course, precisely the historical changes which had occurred in the economic and legal nature of the share which provided the foundation of Manne's own analysis, with its emphasis on the importance of the liquidity and alienability of the shareholder's property to the proper functioning of the market for corporate control. In his attacks on Berle, Manne simply confused and conflated the two property forms which had emerged, sometimes identifying the shareholders' property with the corporation's assets, sometimes with its shares. In short, while he was very keen to embrace the modern conception of shareholders as mere "investors", he was quite unwilling to confront the implications of this historic change in status for the nature and ethical defensibility of their corporate rights.

Manne's distortions did not go unnoticed or unchallenged, however. When he attacked managerialist theories which suggested that corporations were no longer subject to rigourous market disciplines - theories which he traced to Berle and Means and which he believed, had precipitated the worrying "newer concern with political values" - Berle re-entered the fray. In trying to place the modern corporation' within an essentially nineteenth century theory of economics, he argued, Manne had been forced into "redescriptions" which simply did "not fit the facts". Berle ridiculed Manne's "wholly imaginery" account of the proxy fight and the market for corporate control ("mere misdescription"); questioned the extent to which managements were bound by the capital market ("there is some truth in this - but not much"); and lampooned Manne's account of the role and value of the corporate shareholder. Manne simply refused, Berle argued, to face up to the difficulties involved in specifying the precise nature of the modern shareholder's "property" and, consequently, in justifying continuing shareholder corporate primacy. His claim that shareholders were "investors" was also, Berle added, in certain important respects a distortion of reality which flattered the *rentier*, for it was "pure fiction" to suggest that modern shareholders "invested in" companies in the sense of providing them with capital or supplying them with funds. While the original purchaser of the company's shares was "a genuine investor" who provided the company with money, this was hardly true of the modern purchaser of corporate shares who simply bought shares issued long ago from others who had done likewise. "When I buy AT&T or General Motors", Berle remarked, "I do not remotely `invest in' either concern". This claim was mere "folklore habit", part of an "unreal" attempt to describe late twentieth century processes institutions, and relations in traditional nineteenth century terms. He reiterated the conclusions he had reached thirty years earlier with Gardiner Means: "traditional theories of property no longer applied to the relation of stockholders in large corporations" and the "applicable logic would become increasingly social". Passive property certainly needed "new philosophical [and] economic bases", he argued, but they were not be found "in terms of `investment' or `capital markets'".[56] It was a withering riposte, but while Berle was not much longer for this earth, Manne and his intellectual counterparts were about to inherit it.

Governance and the Growing Power of Finance

While Berle derided Manne's theories, many economists began to see them as marking a path

[56] Adolf Berle, "Modern Functions of the Corporate System" (1962) 62 *Columbia Law Review* 433.

whereby corporations could be brought back within orthodox economic analysis. For many years, companies had been treated within neo-classical economics as unproblematic conflict-free, profit-maximising, productive "black boxes". Not even growing oligopolisation, nor Coase's famous 1937 article on "the nature of the firm", with its mildly subversive suggestion that firms entailed the supercession of the price mechanism by administrative decision[57], had dented this view. Indeed, Coase's work had been largely ignored, and, in the wake of Berle and Means, theories of the corporation (such as they were) tended to be managerialist and non-market in nature. This began to change in the late 1960's. In what turned out to be a pivotal moment, Manne co-ordinated a symposium on securities legislation and economic policy. The contributors included the economists Armen Alchian, Harold Demsetz, Michael Jensen, William Meckling and Oliver Williamson, as well as lawyers such as Bayless Manning and Wilbur Katz. The principle purpose of the symposium, as Manne explained, was to "bring the techniques of economics to bear on a broad spectrum of securities regulation problems", including capital allocation theory and the theory of the firm - issues which the economists involved readily admitted they had neglected.[58]

As a foretaste of the future, most revealing, perhaps, were the contrasting contributions of Williamson and Alchian. Examining the efficacy of the various markets described by Manne and others, Williamson concluded that while they operated so as to constrain managerial discretion, they did not entirely eliminate it. As a result, managerial approaches to the firm still "ha[d] something to be said in their behalf" and it was therefore necessary to "supplement" neo-classical theory with organisational theory to get "to grips with some of the bureaucratic realities of large organisations".[59] Significantly, it was from around this time that the influence of Coase's work and the transaction cost approach to the firm finally began to grow, becoming one of the central pillars upon which was built the "new institutional economics" in whose development Williamson played a leading role.[60] By contrast, Alchian argued that as long as there was no interference with the ability to make profits or with the ability freely to capitalise and to sell corporate property rights, the operation of the market would ensure efficient organisational forms. "In reality", he argued "the firm is a surrogate of the marketplace", from which he concluded that the traditional theory of profits, of private property, market, and

57 Ronald Coase, "The Nature of the Firm" (1937) 4 *Economica* 386. To a large extent, however, Coase merely substituted one black box for another.

58 See Henry Manne, "Introduction" to Henry Manne (ed) *Economic Policy and the Regulation of Corporate Securities: A Symposium* (American Enterprise Institute for Public Policy Reseaerch, 1969). For those who would like to put faces to the algorithms, the book provides snapshots of each of the principal contributors.

59 Oliver Williamson, "Corporate Control and the Theory of the Firm" in Manne (ed.) ibid at 373.

60 Williamson attempts to use transaction cost economics to explain much of social life. As a result, institutions tend to be viewed as webs of individual contracts rather than as social organisms with a life of their own. Although Williamson places administrative co-ordination at the centre of his analysis of the firm, politics and power still largely disappear from view.

competition was far from obsolete.[61]

Alchian's contribution was particularly warmly welcomed by Wilbur Katz, one of the lawyers present. Recanting what he called his "adolescent" attachment to the work of Thorstein Veblen, R.H. Tawney and Berle and Means, Katz argued that law teachers (but not, thankfully, economists) had been corrupted by "the literature that stem[med] from Berle and Means and the managerialists". He was "shocked" by the kind of suggestions made by Merrick Dodd (that the legal duty of directors to manage in the interests of shareholders on a profit-maximising basis should be relaxed), and, more recently, by Abram Chayes (that there was no reason why shareholders should have votes) and Bayless Manning (that maybe shareholders should not be allowed to vote until they had held their shares for longer than a certain period). In relation to corporate theory and shareholder rights, Katz argued, there was a need for "more theology", not less as Manning had suggested. What was required above all else was "mutual understanding on basic questions of policy and value", "a discarding of ... reticences and a sharing of basic convictions with respect to [the] good society". He therefore welcomed the "crypto-theology" he detected in Alchian's paper, but felt that it would be better if we could be "less cryptic"; if "somehow or other we could lose our mutual defensiveness with respect to `theological' beliefs".[62]

The lack of empirical support for Alchian's emerging theology did not go unnoticed. Alchian, remarked one respondent, "very cleverly ... refuses to do empirical work".[63] Very soon, however, the empirical validity or otherwise of the various claims being made about the operation of the stock market became secondary to their ideological usefulness, for it was from around this time that the long post-war boom came to an end and that the power of finance and of *rentier* investors began significantly to grow.[64] This precipitated the demise of managerialism and, in Britain, sounded a death knell to meaningful plans for worker participation. By the 1980's, the influence of the financial sphere had become greater than at any time since the 1920's and the corporate world which was emerging bore little resemblance to that described by Galbraith, Berle and others during the long post-war boom. For many, the takeovers and divestitures of the 1980's marked the final reversal of the trend towards managerial "non-

[61] Armen Alchian, "Corporate Management and Property Rights", in Manne (ed.), n.58, 337 at 348-350.

[62] Wilbur Katz, "Discussion", in Manne (ed.) n.58, 361 at 363-365. Katz felt that Williamson had eliminated theology from his paper, to which Williamson reassuringly replied that while `a normative emphasis in economics [was] very useful .... occasionally reality testing is useful also', "Discussion", ibid, 372.

[63] Peter Steiner, "Discussion" in Manne (ed.) ibid, 367.

[64] The gradual re-awakening of interest in finance can be tracked back to the 60's and 70's. See, for example, Robert Fitch & Mary Oppenheimer, `Who Rules the Corporations?' 1 *Socialist Revolution* (1970) and David M Kotz, *Bank Control of Large Corporations in the United States* (Berkeley & Los Angeles, University of California Press, 1978). Interest in the role of finance also began to re-appear in the pages of Paul Sweezy's *Monthly Review* in the early 1970's.

shareholder-wealth-maximising behaviour" that had developed in the post-war period.[65] Indeed, the influence of finance now extends well beyond the governance of large corporations and goes to the very heart of government policy, most notably in promoting tight monetary and fiscal policies aimed at controlling inflation and boosting the prices of financial assets. By the early-mid 1990's, it was quite clear, if it hadn't been before, that the post-war "Golden Age" - of social democracy, of expanding welfare states, of managerialism, of Berle's "People's Capitalism" - had come to an abrupt end.

In form, the influence now exerted by the financial sphere and its *rentiers* over Anglo-American corporations differs from that of earlier periods. The direct control by banks which was so marked in the U.S. in the early decades of the century, for example, has gone, banned in the U.S by the financial reforms of the 1930's. What we have instead seen is the rise and fall of devices such as the leveraged buyout (LBO) and, more recently and ubiquitously, the gradual growth - prompted in the U.S. and the U.K., in particular, by the increasing power of institutional investors - of what has come to be called "shareholder activism". It is not insignificant that the principle academic champion of the LBO has been Michael Jensen, one of the founding fathers of contractual theory. In the 1970's Jensen began writing about the problems created by the divergence of interest between shareholders and managers, the so-called principal-agent problem. Initially, his favoured solution was the extensive use of share options as part of executive pay so as to realign the interests of managers with those of shareholders.[66] By 1983, however, he was changing his mind, celebrating the market for corporate control as a market in which "alternative managerial teams compete for the rights to manage corporate resources".[67] Pursuing this, he had by the end of the decade become a leading advocate of the leveraged buyout, which he championed, somewhat prematurely as it turned out, as the new corporate form.[68] By the late 1980's, the idea of the "liquid" market for corporate control was ever more celebrated in the popular and academic literature, peaking during the leverage boom of 1989. The difference was that while the buyers in Manne's market for corporate control had been corporations, hence his focus on "mergers", the buyers in the late 80's were financiers, bankers and dealmakers such as the LBO boutique Kohlberg Kravis Roberts[69], rather than firms in related industries, hence the emphasis on the "liquidity" of the market. The era of the LBO proved shortlived, however, and after various buyouts suffered

---

[65] See R. Glen Hubbard & Darius Palia, "The Market for Corporate Control", in *The New Palgrave Dictionary of Economics and the Law* (Peter Newman, ed.; London, Macmillan, 1998), 611 at 614.

[66] Michael Jensen & William Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (1976) 3 *Journal of Financial Economics* 305.

[67] Michael Jensen & Richard Ruback, "The Market for Corporate Control" (1983) 11 *Journal of Financial Economics* 5.

[68] See Jensen's wildly unprescient "Eclipse of the Public Corporation" 89 *Harvard Business Review* (Sept-Oct 1989) 61, suggesting that the LBO Association was about to replace the public corporation.

[69] See Bryan Burrough & John Helyar, *Barbarians at the Gate* (New York, Harper & Row, 1990).

financial distress, the fashion for them waned, to be replaced by *rentier* assertiveness in the form of "shareholder activism" by institutional investors. This remains the dominant contemporary form.

The beginnings of a marked and sustained departure from the previously well-established passivity of institutional investors can be traced back to the 80's, by which time not only had the proportion of shares held held by institutions, particularly in the U.S. and U.K., scaled new heights, the competition between and within institutions had begun significantly to increase. Since then, with money managers increasingly judged on their quarterly performances, corporate managers have been confronted by an activism whose whole point is "to increase the profit share of national income, and to claim a larger proportion of that profit share for *rentiers*". As Henwood says, shareholders today "are far less passive, boards less rubber-stampish, and managements less autonomous than at any time since Berle and Means".[70] While direct intervention in corporations by institutional investors remains relatively rare, the enormous impact that their monitoring and cajoling has had on corporate managerial culture in the U.S. and beyond cannot be doubted. In recent years, it has become increasingly *de rigueur* for corporate managers, faced by increased pressure from demanding *rentiers*, to pay homage to the God of "shareholder value".[71] It is not insignificant or surprising, therefore, that one of the two possible models for company law identified in the consultation paper of the UK Company Law Reform Steering Group is explicitly based around precisely this idea. Correspondingly, as the 90's have progressed, bringing with them a period of ruthless labour exploitation, downsizing, investment cutbacks and *rentier* greed, the efficiency-based justifications that contractarian and agency theories of the corporation offer for shareholder rights have become not only ever more welcome but ever more necessary. If Manne's work in the 50's and 60's made the "marketisation" of the corporation and its return to orthodox economic analysis theoretically imaginable, the growing power of the *rentier* and of finance in recent years has made it ideologically indispensable.

A Priori Efficiency and the Contractualisation of the Corporation

It is far from clear even now, thirty years after Manne first posited its existence, whether the market for corporate control operates so as to weed out inefficient managers in anything like the way advertised. On the contrary, the historical record suggests that mergers and acquisitions often bring little in the way of efficiency gains. "There is", the authors of one study typically conclude, "no broad-guaged support for the `inefficient management displacement' hypothesis that acquired companies [are] subnormal performers" and the evidence "mandates considerable skepticism toward the claim that mergers are on average efficiency enhancing".[72] This view has

---

[70] Doug Henwood, *Wall Street* (London, Verso, 1997) 293.

[71] For evidence of the impact of the internationalization of equity markets on German corporate governance, see Thomas Andre, "Cultural Hegemony: The Exportation of Anglo-Saxon Ideologies to Germany" (1998) 73 *Tulane Law Review* 69.

[72] David J. Ravenscraft & F.M. Scherer, "The Profitability of Mergers" (1989) 7 *International Journal of Industrial Organisation*, 101.

broadly been endorsed by other studies.[73] In Britain, for example, Julian Franks and Colin Mayer, observing that the performance of targets of hostile takeovers in the UK is close to that of the average quoted company, conclude that the results of the research that has been carried out questions the common association of markets for corporate control with the correction of managerial failure.[74] There is, moreover, evidence that even when where the market for corporate control does contribute to the disciplining of poorly performing companies, its overall effect may nevertheless be to encourage managerial short-termism and to discourage longer-term investment.[75]

The empirical validity (or otherwise) of the theories associated with the market have, however, become increasingly less important as their ideological value has grown. Thus, despite the doubts about the way in which the stock market actually operates, the claims made for its contribution to economic efficiency are nevertheless "among the least restrained to be found in agency theory".[76] Whatever the reality, the alleged existence and efficacy of the market for corporate control and of a close correlation between corporate managerial efficiency and the market price of the corporation's shares has become one of the theory's bedrocks. As David Campbell explains, the significance of Manne's "discovery" of the market for corporate control lay in its suggestion that corporate managers were subject to market disciplines and that it was, therefore, possible to construct a market-based theory of the firm to rival the non-market based theories spawned by managerialism. The idea of the properly functioning market for corporate control is "the fundamental concept of agency theory" precisely because, theoretically at least, it "places [the managerially controlled company] back under the market".[77]

That contractual or agency theories of the corporation are able to offer neo-classical

---

[73] See, for example, Richard E. Caves, "Mergers, Takeovers, and Economic Efficiency: Foresight vs Hindsight", 7 *International Journal of Industrial Organisation* (1989) 151.

[74] See Julian Franks & Colin Meyer, "Hostile Takeovers and the Correction of Managerial Failure" (1996) 40 *Journal of Financial Economics*, 163; and "Ownership and Control in Europe", Palgrave, n.65, 722 at 726-729. They add, however, that while the market for corporate control does not appear to be associated with the correction of managerial failure as measured by past corporate performance, there is evidence that it gives rise to substantial corporate restructurings with high asset disposals and executive dismissals; they therefore draw a distinction between *ex ante* and *ex post* failure, see "Takeovers: Capital Markets and Corporate Control: a Study of France, Germany and the UK" (1990) 10 *Economic Policy* 189.

[75] See, for example, William Lazonick, "Controlling the Market for Corporate Control: The Historical Significance of Managerial Capitalism" (1992) 1 *Industrial & Corporate Change* 445; and see also the related papers by A.P. Dickerson, H.D. Gibson & E. Tsakalotos, "Short Termism and Underinvestment in Financial Systems" (1995) 58 *Manchester School* 351; "The Impact of Acquisitions on Company Performance" (1997) 49 *Oxford Economic Papers* 344; "Takeover Risk and Dividend Strategy: A Study of UK Firms" (1998) 46 *Journal of Industrial Economics* 281.

[76] See Campbell n.13 at 362.

[77] Campbell, n.13 at 359.

economists a solution to the problems generated by the ostensibly non-market nature of firms, enabling them to assert the efficiency of existing corporate structures, is also due in significant part, however, to the peculiar nature of their concept of "efficiency". Within orthodox economic theory, no attempt is made to evaluate the importance of the goal of efficiency relative to other competing goals; and the efficiency, or otherwise, of different arrangements and resource allocations is assessed not by careful, wide-ranging, empirical comparison, but by reference only to the formal nature of the arrangments and to the processes of which they are a product. Put simply, if the arrangements can be presented as the product of a process of free market exchange, they are deemed, *a priori*, to be "efficient".[78] As John Parkinson says, once it has been presumed that a governance structure is the product of contracting, "it follows that it must be efficient".[79] Spurred on by the "discovery" of the markets for corporate control and for managers themselves, contractual theorists made precisely that presumption, leaving their only remaining task that of identifying and elaborating the "contracts" involved. It is hardly surprising, therefore, that they have engaged in endless contortions purporting to show that existing corporate arrangements are, indeed, essentially the products of free market contractual exchanges. Discovering "contracts" in every conceivable corporate nook and cranny, they have generated in Biblical proportions the theology for which Katz called. With the irritating constraints imposed by empirical reality lifted, it is equally unsurprising that this contractualisation of the corporation has produced very varied accounts of the "contracts" constituting the corporation. Once one leaves the real world and enters a realm of theoretical fantasy, the possibilities are - within the contractual bounds set, of course - almost endless. Indeed, many of those sympathetic to stakeholding are now joining in, cheerfully trying to fabricate corporate "contracts" that are more favourable to employees and other stakeholders.[80] As David Campbell says, because the goal is simply "to bring the company within the theory", "real" contracts are placed on the same ontological plane as "unreal" (but theoretically necessary) contracts, contracts that, in empirical reality, simply do not exist.[81] As a result, despite its claims to tough, hard-nosed realism, contractual theory is, in fact, strikingly *un*realistic and empirically *in*accurate.[82] Hence Campbell's conclusion that, although it describes

[78] Conversely, if they aren't the product of the operations of the market, they are, *a priori*, inefficient. See, for example, Eirik Furubotn, "Co-Determination and the Efficient Partitioning of Ownership Rights in the Firm" (1981) 137 *Zeitschrift fur die gesamte Staatswissenschaft* 702 at 705.

[79] Parkinson, n.52 at 125.

[80] See, for example, Marleen A. O'Connor, "Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Displaced Workers" (1991) 69 *North Carolina Law Review* 1189. In the late 1980's, Katherine van Wezel Stone also saw the theory as granting labour equal standing with other parties in the struggle for power within the corporation, see "Labor and the Corporate Structure: Changing Conceptions and Emerging Possibilities" (1988) *University of Chicago Law Review* 73 at 161.

[81] Campbell, n.13 at 360-361.

[82] "Large corporations", explains Alan Wolfe, "are composed of people who speak many different languages, have never met each other, work in positions defined by different degrees of

the company as a nexus of contracts, there are, in fact, "no contracts .... only a nexus of metaphors". It "is not an empirically based theory" at all, but rather "carried by metaphor and assertion based on that metaphor", as a result of which it is "not readily open to rational debate".[83] Indeed, according to Alan Wolfe, "even as metaphor, the notion of the firm as a nexus of contracts has problems".[84] However, for all the metaphorical differences between the various contractual theories that have emerged, in one important and crucial respect they are more or less indistinguishable: they all conclude that the retention by shareholders of their residual income and control rights is legitimate and justifiable, not so much on grounds of shareholder corporate "ownership" but on grounds of efficiency. As Parkinson observes, the central purpose of nexus-of-contracts theorising has been "to establish that the large publicly owned company ... is efficient, notwithstanding the wide dispersal of shareholdings"[85]; or, to put it another way, to reprivatize the public company.

Agency Theory and the Problem of Ownership

The question of ownership is not, however, one that contractual theorists find easy to escape. Contractual theory generally tries to circumvent it and to avoid questions concerning the initial allocation of corporate (property) rights by conceptualising the corporation or "firm" out of existence. Viewed as a nexus of contracts, the corporation is deemed to be, in Jensen and Meckling's words, "just a legal fiction which serves as a focus for the complex process in which the conflicting objectives of individuals ... are brought in equilibrium within a framework of contractual relationship".[86] With the corporation diminished in this way, there is within agency theory a tendency to see nothing (no "thing") to be owned. Corporate governance is thus treated as little more than a more complex version of standard contractual governance and shareholders once again characterised, as they were by Manne in his exchanges with Berle, as the owners and providers of "capital", one of the factors of production, rather than as the redundant, functionless *rentiers*, the buyers and sellers of titles to revenue, which in empirical reality they now are. The

---

power and responsibility, and have wildly different motives, loyalties, and talents. Can contracts exist between people who never meet, have nothing in common, and are unavailable to pass judgment on the behaviour of the other parties to the contract? Perhaps they can in a metaphorical sense, in roughly the same way that early social contract theorists understood the body politic to operate. But no one ever claimed that the social contract was an *empirical* description of actual real world events". Alan Wolfe, "The Modern Corporation: Private Agent or Public Actor" (1993) 50 *Washington & Lee Law Review* 1673 at 1680.

[83] Campbell, n.13 at 360.

[84] Wolfe, n.82 at 1680.

[85] Parkinson, n.52 at 122.

[86] Jensen & Meckling, n.66 at 312. See also Daniel Fischel, for whom the corporation is "a legal fiction that serves as a nexus for a mass of contracts which various individuals have voluntarily entered into for mutual benefit", "The Corporate Governance Movement" (1982) 35 *Vanderbilt Law Review* 1259 at 1273.

kinds of questions that agency theorists pose reflect this mythology, presuming that shareholders actually give something to corporations, rather than simply place bets on their future profitability. "How does it happen", Jensen and Meckling innocently ask, "that millions of individuals are willing to *turn over* a significant fraction of their wealth *to organisations* run by managers who have so little interest in their welfare?". Or as Kenneth Scott puts it, "why are shareholders" - who "*furnish inputs into the business*" - "willing *turn* large sums of money *over to* other people (managers) on very ill-defined terms?".[87] Reinvigorated in this way, shareholders are subtly returned to former glories: no longer redundant traders in titles to revenue, they are re-elevated to their earlier, more exalted status of "real" investors, restored to an entrepreneurial function as risk-taking "providers of capital". The reality that the contemporary stock market "counts for little or nothing as a source of finance" is studiously ignored.[88]

Once again, this recharacterisation - or "misdescription" - of the shareholder and the corporation elides the distinction between the corporate assets and shares. The two distinctive and autonomous property forms which emerged with the development of the modern joint stock corporation and the reduction of the shareholder to the status of a pure *rentier* completely external to the company are conflated under the rubric "capital", a process which discretely re-unites the shareholder with the corporate assets. The curious effect of this is to eliminate the corporate entity as an owner of property, other than in a purely formal sense. Indeed, with shareholders characterised as the providers of capital, and with assets and shares conflated, the corporation more or less disappears, reduced to a mere cipher through which the owners of different factors of production are brought contractually together. The corporation, writes Eugene Fama, is "just the set of contracts covering the way inputs are joined to create outputs and the way receipts from outputs are shared among inputs".[89] While the various factors of production employed in a firm must be owned by someone, he explains, "ownership of capital should not be confused with ownership of the firm", for "ownership of the firm is an irrelevant concept".[90] The conceptual elimination of the corporation not only places shareholders in direct touch with the corporate assets (the "capital"), it also places them, in theory at least, in direct touch with corporate managers, for with no corporate entity of substance to come between them, the relationship between shareholders and managers is correspondingly characterised as a pure agency relationship. Corporate governance tends in consequence to be seen as involving not highly complex questions of productive organisation, social well-being and social justice, but

[87] Kenneth Scott, "Agency Costs and Corporate Governance", in Palgrave, n.65 at 26.

[88] Henwood n.70 at 292.

[89] Eugene Fama, "Agency Problems and the Theory of the Firm" (1980) 88 *Journal of Political Economy* 288; extracted in Putterman & Kroszner, n.48 at 302. See also Easterbrook & Fischel, "Voting in Corporate Law" (1983) 26 *Journal of Law and Economics*, 395 at 396.

[90] Fama, ibid (Putterman & Kroszner, n.48) at 304. Fama took the view developed by Alchian and Demsetz, and Jensen and Meckling still further, prising apart the two functions attributed to the entrepreneur, management and risk-bearing, treating them as `naturally separate factors within the set of contracts called the firm'. He would probably be horrified to discover that in this respect he echoes Marx.

simply the difficulties facing shareholder-principals trying to negotiate sufficiently binding contracts with agent-managers. Curiously, therefore, agency theory tries in many ways to turn the corporate-theoretical clock back to the early nineteenth century when the corporation was conceptualised as a purely artifical, fictional entity, harking back to the days when corporation and shareholders were perceived, for most purposes, as one and the same; when the shareholders *were* the corporation. Politically attractive though it is to defenders of *rentier* rights and corporate non-interventionism, however, the wholesale contractualisation of the firm is itself the source of a variety of conceptual problems.

Most importantly, perhaps, one of the effects of the reduction of the corporation to a nexus of contracts is that, in accordance with neo-classical ideology about the nature of markets, it tends to flatten the hierarchical elements within corporations, suggesting that they lack any in-built structure of authority. Alchian and Demsetz, for example, recognise that it is "common to see the firm as characterised by the power to settle issues by fiat, by authority, or by disciplinary action superior to that available in the conventional market", but argue that this is a "delusion". As "a highly specialized surrogate market", they insist, the firm "has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting". To speak of the management or direction of workers is merely "a deceptive way of noting that the employer continually is involved in renegotiation of contracts on terms that must be acceptable to both parties". In fact, they reiterate, "authoritarian, dictational, or fiat attributes" are simply "not relevant to the conception of the firm or its efficiency".[91] As William Lazonick wryly observes, Alchian and Demsetz' firm, with its denial of disciplinary power, appears not to be a *capitalist* firm at all.[92] It does, however, at least entail a central agent, referred to as the firm's "owner" or "the employer", who possesses, *inter alia*, the right to renegotiate the contracts of all the suppliers of inputs.

Others go even further, refusing to grant any one of the contracting parties the privileged role of "owner" of the firm. The provision of capital, it is argued, is based on exactly the same sort of contract as the provision of other factors of production, hence the "irrelevance" of the concept of ownership of the firm.[93] In these accounts, an attempt is made to derive both the manifestly hierarchical and authoritarian structure of corporations and the residual control rights of shareholders entirely from contract and the market, without any reference to ownership of the corporation or its assets. Shareholders are deemed simply owners and providers of capital, a factor of production like any other. It is argued, however, that as those entitled to the surplus, to what is left after all the other claimants have been paid, they have the greatest incentive to ensure that management operates in the most efficient and productive manner[94], but that as

[91] Armen Alchian & Harold Demsetz, "Production, Information Costs, and Economic Organization" (1972) 62 *American Economic Review* 777, extracted in Putterman & Kroszner n.48 193. In this respect, the work of Williamson is markedly different as from his perspective, hierarchy and authority within the firm remain very important.

[92] William Lazonick, *Business Organisation and the Myth of the Market Economy* (CUP, 1991) 181-88.

[93] See Fama, n.89.

[94] See, for example, Frank Easterbrook & Daniel Fischel, *The Economic Structure of Corporate Law* (Cambridge Mass, Harvard UP, 1991) 67-69.

"residual claimants" whose entitlements are not precisely specified they cannot easily protect themselves by contract. They accept the risks associated with their residual position, therefore, only in return for the protections provided by the legal rules which grant them voting rights and compel managers to act in their interests. The distribution of authority (of property rights) within existing corporate structures are thus portrayed as market products: either because they are said to have arisen arisen spontaneously from contract, or if it is conceded that they were not originally the products of contracting, because they are subject to a continual process of market review.[95] Whatever their origins, the fact that existing governance structures have survived market selection is regarded proof of their efficiency. There is, therefore, both a descriptive and a prescriptive dimension to the claims being made. Residual control rights and rights to the surplus *are* vested in shareholders as a result of market-contractual processes. Moreover, they *should* be vested in them - not because they "own" the assets or companies concerned but because this is the most efficient arrangement.[96]

These approaches have the advantage, at least in theory, of obviating the need to account for the authority vested in managers and shareholders in non-contractual, non-market terms. Other contractualists, however, feel unable to do this without resort once more to the idea of ownership. Recognising that it is impossible to foresee let alone plan for all future contingencies, and correspondingly impossible in practice to write a contract which comprehensively specifies rights in the many varied situations which might arise, they deem the contracts that constitute the corporation, and especially those involving shareholders, inevitably to be "incomplete".[97] This is not only a source of renegotiation costs[98] as contracts are revised and amended as the future unfolds, it renders vitally important the question of who is to have power over corporate assets and activities in situations where contractual incompleteness has prevented rights from being specified in advance. Power and authority - "not", Oliver Hart tells us, "standard feature[s] of economic theory" - thus re-enter the equation and, with this, the issue of ownership sneaks in through the backdoor. "A reasonable view", Hart argues, is that where contracts do "not specify all aspects of asset usage in every contingency ... it is the owner of the asset in question who has ... residual control rights over [it]", meaning "the right to decide all usages of the asset in any way not inconsistent with a prior contract, custom, or law". It therefore "matters who owns a piece of private property"[99], for ownership is "a source of power

[95] Parkinson n.52 at 123-28.

[96] It is commonly argued that the very fact that these rules and rights have emerged and survived in a market-contractual environment is evidence of their efficiency.

[97] Even if plans could be made for every contingency, it would extremely difficult for the parties to capture these plans in a comprehensive written manner amenable to later adjudication, see Oliver Hart, *Firms, Contracts and Financial Structure* (OUP, 1995) 23. In much contractualist literature, the shareholders' contract is regarded as the paradigmatic `incomplete' contract.

[98] Some of these costs are seen as *ex post*, others as *ex ante* costs. For a discussion, see Hart, ibid at 25.

[99] Hart, ibid at 4-5, 29-30.

when contracts are incomplete". But who are the "owners" of the assets of large corporations? Formally, of course, the assets are owned by the corporation itself, a legal fact that hardly helps to resolve the question. By initially developing his so-called "property rights" theory in the context of closely-held or owner-managed firms, however, Hart feels able to assert that the owners of a company's assets are its shareholders, because it is they who exercise residual control rights over them - a defensible assertion in economic reality, if not in law, in relation to firms of this sort. However, although he recognises that it is to closely-held firms that his theory "applies most directly", he proceeds to extend it, virtually unmodified, to large corporations, blithely arguing that "even though there are important differences between the owner-managed and large company cases, the main insights of the property rights approach continue to be relevant".[100] With this, corporate shareholders, as the possessors of residual control rights, are once again reunited with the corporate assets, as their "owners", and the significance of the changes in the process of production and in the nature of property and property rights associated with the rise of the modern corporation, and their impact on the idea of ownership, are more or less dismissed.[101] The complex issues surrounding the nature of the corporation as an entity - crudely, whether it is and/or should be characterised as a public or private entity - and the allocation of power (and rights) in and over it are thus dealt with by the simple expedient of attenuating and redefining the meaning of ownership so as to encompass the position of shareholders. The resulting reasoning is dizzyingly circular: Hart tells us that ownership is the source of residual control rights, while at the same time asserting that the possession of residual control rights is "the definition of ownership".[102] The rights of shareholders are thus seen as flowing from the pre-existing fact of their asset "ownership" while their "ownership" of those assets is inferred from their possession of residual control rights.

From the Myth of Ownership to the Myth of Efficiency: Private Property and the Public-Private Divide

For all its many faults, however, Hart's analysis does at least address the question of power, the whole thrust of his argument being that "[corporate] institutional arrangements are designed to allocate power among agents".[103] And in so doing, it goes to the issues at the heart of corporate

[100] Hart, ibid at 62.

[101] In other accounts, shareholders are deemed owners of `the firm', rather than owners of the assets, by virtue of their possession of the right to control the firm and their right to appropriate the firm's net earnings. See, for example, Henry Hansmann, "Ownership of the Firm" (1988) 4 *Journal of Law, Economics and Organisation* 267.

[102] Hart n.97 at 30. Kevin Gray has also noted "the horrible circularity of such hallmarks of `property'". If, he argues, "niavely we ask which rights are proprietary, we are told that they are those rights which are assignable to and enforceable against third parties. When we then ask which rights these may be, we are told that they comprise, of course, the rights which are traditionally identified as `proprietary'. `Property' is `property' because it is `property': property status and proprietary consequence confuse each other in a deadening embrace of cause and effect", Kevin Gray, "Property in Thin Air" (1991) 50 *Cambridge Law Journal* 252 at 293.

[103] Hart n.97 at 5. See also Sanford Grossman & Oliver Hart, "The Costs and Benefits of

governance: the constitution of corporate rights and the allocation of power in and over corporations - what John Christman calls the "structure of [corporate] ownership".[104] Indeed, it goes also to the heart of the public-private divide, for the conceptual delineation of a specifically private sphere of individual autonomy and sovereignty which not even the state can legitimately invade rests heavily on the idea of private property. This idea, as Jennifer Nedelsky says, forms "the foundation for everything from the public/private distinction to the ongoing market versus regulation debate".[105] When, therefore, theorists assert that corporations are contractual affairs in whose realm the principle of public non-interference should reign, they are, for all their emphasis on contract, in effect making a property-based claim: that the assets of corporations, if not the corporations themselves, are private property and that corporate affairs are, therefore, private matters.

As many have pointed out, however, the public-private divide upon which such assertions are based is itself premised upon a conception of private property as an essentially pre-political, natural phenomenon with an existence independent of the state and the *public* sphere; in other words, on a tacit denial that property is a social construct founded on a set of policy choices embodied in law.[106] Yet there are few better illustrations of the socially constructed, contingent and dynamic nature of ideas about property and property rights than those provided by corporate history. As we have seen, the changes which have occurred in the organisation and relations of production and in the economic nature of joint stock companies and their shares over the last two centuries have been accompanied by a transformation in the way in which companies and corporate property are perceived and constituted in law. Rights in and over joint stock companies were, of course, reconstituted in ways which favoured shareholders, enabling them to maintain their right to dividends and to appoint and dismiss directors despite their lack of function. But it was not inevitable that this should be the case: the new conceptions did not flow inexorably from the economic developments which underlay them. On the contrary, they were the products of policy (political) choices made by the courts and legislature. What corporate history highlights, therefore, is the often-overlooked role of the state in defining and redefining "property", underlining the fact that property and property rights are never truly private and always have what Kevin Gray calls a "public law character". There is, as he says, "in every property drama a third actor, in addition to the plaintiff and defendant, ... the state, expressing its collective judgement through the voice of the courts".[107] In short, corporate history highlights the fact that property is not a value-free phenomenon.

Ownership" (1986) 94 *Journal of Political Economy* 691; Oliver Hart & John Moore, "Property Rights and the Nature of the Firm" (1990) 98 *Journal of Political Economy* 1119.

[104] Christman, n.12 at 4.

[105] Jennifer Nedelsky, *Private Property and the Limits of American Constitutionalism* (University of Chicago Press, 1990), 247-8.

[106] It is probably because private propertry is commonly experienced in this way that legal entitlements to property tend to be experienced as qualitatively different from other forms of legal entitlement, see Nedelsky ibid at 248-9, 255.

[107] Gray n.102 at 297, 303-304.

For Gray's near-namesake, Thomas Grey, the proliferation of property forms such as the share which provide titles to revenue but which lack any direct link with tangible things has precipitated a `disintegration of property'. In the last two hundred or so years, he argues, we have gone from a world in which property was "a central idea mirroring a clearly understood institution", to a world in which "it is no longer a coherent or crucial category on our conceptual scheme".[108] He attributes this "collapse of the idea of property" to the workings of the market economy, to the inner logic of capitalism and its progressive exploitation of the division of labour and economies of scale[109], arguing that these have led to the subdivision and recombination of the rights that originally made up ownership, generating property forms "remote from tangible objects". As a result, he says, for many specialist lawyers if not for lay people, the "robust unitary conception of ownership" - the idea of private property as entailing comprehensive and exclusive "ownership" rights over real things - has been fragmented and replaced by a "shadowy" bundle of rights conception in which property lacks any necessary connection to tangible objects.[110] According to Grey, this "disintegration of property" has become a major source of political and ideological problems for capitalism. While the new forms of property and the economic structures that accompanied them, the corporation and share prominent amongst them, are "entirely consistent with full loyalty to [the market capitalist] system" - it is, after all, the internal logic of the market which has created them - the dissolution

[108] Thomas C. Grey, "The Disintegration of Property" (1980) 22 *Nomos* 69 at 74

[109] The disintegration of property is "in no way fueled by the ethics, politics or interests of socialism" but generated by the operations of the free market itself. The latter, Grey argues, sees proprietors subdivide and recombine the bundles of rights that orginally constituted ownership, "creating by private agreement the complex of elaborate and abstract economic institutions and claims characteristic of industrial capitalism, particularly the financial institutions and industrial corporations." Grey, ibid.

[110] The idea of property as a bundle of rights is traced back to Wesley Hohfeld, though it can be tracked back still further, see J.E. Penner, "The `Bundle of Rights' Picture of Property" (1996) 43 *UCLA Law Review* 711; Jeanne Schroeder, *The Vestal and the Fasces* (Los Angeles, University of California Press, 1998), 156-184. There seems little doubt that it currently the dominant paradigm of property, accepted by most writers on the subject (see, for example, Jeremy Waldron, *The Right to Private Property* (Oxford, Clarendon, 1988); Stephen Munzer, *A Theory of Property* (CUP, 1990)). In recent years, however, it has been subjected to criticism (see Penner, Schroeder, above). Kevin Gray expresses similar sentiments to Thomas Grey but sees the essence of property as inherently elusive. What, he asks, constitutes the "propertiness" of property? What is it that distinguishes the rights in the property bundle as specifically "property" rights? It is not easy to say, he argues. On the contrary, in the modern world, the notion of property "readily collapses back into contract". The "ultimate fact" about property, he concludes, is that "it does not really exist: it is more illusion ... a vacant concept". Just as we think that "we have found an objective reality which embodies our intuitions and needs .... [the notion of property] dissolves into a formless void". The conceptualisation of property as a bundle of rights, rather than as a thing is thus simply an attempt by legal theorists "to sidestep the unattainable quality inherent in the notion of private property", Gray n.102 at 252, 259, 292. Proudhon got it wrong: property isn't theft, it's fraud.

of the traditional thing-ownership conception of property has, he argues, "erode[d] the moral basis of capitalism".[111] Conceived as thing-ownership, property rights are perceived as having intrinsic worth linked to notions of moral right; and capitalism, to the extent that it "connotes a general regime of protection of private property", is able to "enlist .. on its side" the still potent justifications associated with this view. The problem, he argues, is that the replacement of the thing-ownership conception of property by a bundle-of-rights conception threatens to expose property for what it really is - a political relation between people; and that "the forceful intuitions behind the moral arguments" for simple thing-ownership do not readily transfer to the legal institutions and intangible property forms of modern capitalism, with the result that the latter is compelled to seek a moral basis in "other, more instrumental values", most notably, that of producing material well-being.

Arguably, nowhere is the erosion of these moral arguments more evident than in the case of shares and shareholders. The changes in the constitution of corporate property and corporate rights mark the completion of the historical process - inherent in the joint stock company as an economic form of organisation - whereby the shareholder has been externalised from the company and transformed into a functionless *rentier*, a pure money capitalist standing outside the process of production. An important aspect of this has been the relinquishment by shareholders not only of any significant managerial, supervisory or capital-providing function but of many of the rights traditionally associated with asset (or company) "ownership". Reflecting their redundancy, the bundle of rights which they have come to possess by virtue of their share ownership (the bundle of rights that constitute the share as a separate form of property) has gradually shrunk, coming to comprise but a few of the rights that would constitute "ownership" of the corporate assets (or corporation) in the traditional sense. Severed both from productive purpose and from the rest of the rights in the `thing-ownership' bundle, the moral basis for the remaining rights of *rentier* shareholders - rights which, despite their attenuated nature[112], are a source of extraordinary economic and social power - has become increasingly difficult to discern.[113]

With the justifications associated with the "robust unitary conception of ownership" weakened, it is, then, not only capitalism but *rentier* shareholders who are forced to seek legitimacy in "other, more instrumental, values".[114] It is in this context that the ascendancy of contractual theories of the corporation and their efficiency-based defence of shareholder

---

[111] Grey n.1o8 at 74-76. It might (but probably won't) be a sobering thought for those who currently believe that "there is no alternative" to (global) capitalism that, only twenty years ago, Grey was writing in this context of its "declining prestige [and] decaying cultural hegemony"..

[112] In Christman's terminology, they are now essentially "income rights", see his differentiation of income rights from control rights. Christman, n.12 at 7-8.

[113] Arguably, therefore, Grey has misplaced his emphasis. The concept of "property" has not so much disintegrated as simply been *transformed* in order to encompass the growing number of intangible, alienable titles to revenue which have proliferated as capitalism has developed. It is the concept of private "ownership", at least as it applies to corporations and their assets, that has disintegrated, becoming even harder morally to sustain and justify.

[114] Grey, n.108 at 78.

property rights needs to be seen. Although usually put forward as neutral, theoretical accounts of reality, these theories are more accurately seen as attempts to legitimate *rentier* rights in instrumental terms; as *pre*scriptive rather than *de*scriptive theories. No matter how vocipherous their advocates, however, claims based on grounds such as "efficiency" are inherently weaker and less compelling than the more fundamental, ethical claims surrounding the traditional ideas of private property and ownership, not least because as soon as one begins to offer a *purposive* account of why shareholders should possess these rights, arguing that they are justified for essentially instrumental reasons in terms of their effects, one invites not only an assessment of their effectiveness in achieving the stated goals, but an evaluation of those goals relative to other competing ones. There is certainly no doubting the current popularity of contractual theory. But this popularity rests less on its empirical accuracy, validity or intellectual merit and more on its consonance with certain powerful class interests. Contemporary company law, even if it does not yet explicitly embrace these theories, shares many of their presuppositions and values, and resembles them in its shareholder-orientation. And the current political climate, with its underlying neo-liberalism, its belief in the inescapability of market imperatives ("globalization") and its overriding emphasis on identifying the most "competitive" and "efficient" (meaning profitable) forms of production and governance, is very much more congenial to contractualism and its marketisation of the corporation than it is to its stakeholding rivals. Indeed, so great is the contemporary influence of contractual theory that supporters of stakeholding increasingly seek to demonstrate that stakeholding companies are (or would be) more efficient and competitive than their shareholder-oriented rivals[115] and are increasingly willing to try to conceptualise corporations in predominantly contractual terms, albeit in a manner which insists upon the relational, "implicit" and "incomplete" nature of many of the contracts involved. Notwithstanding this somewhat artificial consensus, however, the struggle between contractarians and stakeholders is, ultimately, more about ends than means, for stakeholding is animated as much by ideas of right and justice as it is by ideas of competitiveness; by a conception of the good, rather than of the efficient, life.[116] Indeed, stakeholders are ill-advised to try to fight the governance battle on the terrain of efficiency, in part because, whatever its current political appeal, it is a terrain which pushes one into a contractual conception of the corporation, with all that implies, and in part because as a goal "efficiency" in the abstract lacks meaning: what exactly is it that we are trying to do efficiently? At present the goal of corporate governance is, in reality, the efficient maximisation of *rentier* wealth, a task it carries out with aplomb. In practice this means maximising the wealth of a few, for the financial property forms constituted and protected by contemporary company law and contemporary mechanisms of corporate governance enable a small minority to appropriate a grotesquely disproportionate share of total social wealth and production, both nationally and internationally.[117] The question

[115] Usually on the grounds that stakeholding companies are more sensitive to the interests of employees and better able, therefore, to nurture and develop the `human capital' that is said to be increasingly crucial to long-term efficiency and competitiveness. See, for example, John Plender, *A Stake in the Future* (London, Nicholas Brealey, 1997); and the RSA's *Tomorrow's Company* (London, RSA, 1995). It has recently become quite fashionable to insist that the case for stakeholding is not distributive, but efficiency-based.

[116] Which is not to say that stakeholding companies are not more efficient than their contractarian rivals.

is whether the "efficient" attainment of this goal is defensible, let alone desirable.

The power of the large transnational corporations which increasingly dominate the world economy is enormous, reminding us that the developments that have underlain the historical changes that have occurred in corporate theory - the externalisation of the shareholder from the process of production, the growing difficulties involved in characterising corporations as private property and shareholders as corporate owners - are, ultimately, reflections and expressions of the growing *socialisation* of production, of its increasingly social and public, rather than individual and private, nature. There is, therefore, much truth in Marx's claims that joint stock companies not only take the form of "social undertakings as distinct from private undertakings" but represent "the abolition of capital as private property within the framework of capitalist production itself". As he observed, joint stock company shareholders receive dividends in the form of (if not at the same level as) interest, "as mere compensation for owning capital that now is entirely divorced from the function in the actual process of reproduction...".[118] Put simply and bluntly, in this context, the (public) constitution and protection of (private) corporate property rights by the state is more accurately seen not as the neutral enforcement of "natural" individual rights over things but as the use of collective force on behalf of haves over have-nots. Indeed, it is precisely because they "carry with them, when held in quantities larger than an individual can work by himself, power to control in some measure the lives of others" that property rights in land and capital are, in many ways, "in rather more need of justification than ... simple property in the consumable means of life".[119] If the myth of shareholder corporate ownership and the perception and promotion of private property and private property rights as pre-social, pre-political, natural phenomena have long operated so as to "hide the structure of [corporate] power and insulate it from democratic debate"[120], what we are now seeing, as the "powerful yet wholly spurious moral leverage"[121] of the idea of shareholder corporate ownership wanes, is the emergence of a new justificatory myth for shareholder property rights, a myth of "efficiency". But we must not forget that all forms of property and property rights, including those of shareholders, represent "not a pre-transaction state of equilibrium or of harmony", but a politically (and, therefore, publicly) constituted and

[117] For demolitions of the claim that ownership has become more "democratised" with the rise of pension funds and other forms of institutional investment, see Henwood, n.70, chapter 2; and Jeff Gates, *The Ownership Solution* (London, Allen Lane, Penguin Press, 1998). The most recent of the three-year surveys of consumer finances (SCF) conducted by the Federal Reserve in the U.S. shows that the bottom 90% of the American population now claims its smallest share of wealth on record. The top 10% (whose wealth is itself concentrated very heavily within its upper third) account for well over 80% of share and bond ownership. In 1996, the U.N. reported that the assets held by the world's 358 billionaires exceeded the combined incomes of countries with 45% of the world's people, see Gates, ibid at 7.

[118] Karl Marx, *Capital, Volume III* (London, Lawrence & Wishart, 1977), Chapter 27.

[119] C.B. Macpherson, *Property: Mainstream and Critical Positions* (Oxford, Blackwell, 1980), 12.

[120] Christman, n.12 at 3.

[121] Gray, n.102 at 305.

contingent power relation between people that is "inherently and continually conflictual".[122] The creation, sustenance and modification of (property) rights inevitably generates conflict, but as production relations change so, inevitably, will (and should) rights and entitlements. It is to the *re*constitution and *re*allocation of corporate rights and entitlements in pursuit of democratically agreed goals which take account of the complex issues of social and individual well-being and justice involved that those concerned with company law reform and corporate governance need to turn their attention.

[122] Alan Story, "Compensation for Banned Handguns: Indemnifying `Old Property'" (1998) 61 *Modern Law Review* 188 at 206.