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Property and contract in contemporary corporate theory

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Abstract: This paper critically evaluates the contractual theories of companies and company law which have risen to prominence in recent years. It argues that history reveals as misguided the attempt to depict public companies as essentially contractual in nature, one of the most striking features of the development in nineteenth century Britain of the first body of (joint stock) company law having been its gradual move away from the principles of agency and contract underlying the law of partnership from which it emerged. Against this backdrop, the paper moves on to explore the ways in which theorists have tried, against the odds, to characterise public Companies as contractual and the reasons for their attempting to do so. While it might be apposite to view many private or closely held companies through the prism of contract, the paper argues, public companies and much of company law itself can only properly be understood when viewed through the prism of financial property. Indeed, it suggests, this is implicitly confirmed by the Company Law Review and (paradoxically) by the recent work of corporate governance specialists and financial economists in the US, with its focus on investor protection and the preservation of financial property's integrity, and its emphasis on the crucial role of (public) regulation in these processes. The paper concludes that these property forms are not merely the objects, but the products of regulation and that this has important implications for our understanding of both company law and corporate governance. In making these arguments, it seeks to cast some light on the nature of intangible property, on the differences between contract-based and property-based rights, on the neo-liberal idea of 'deregulation', and on the unity and scope of company law as a legal category.

Keywords: *n/a*

Academic company lawyers in the UK have not generally been noted for their fascination with theory. On the contrary, they have long displayed something of an aversion to the important questions about the nature of companies, separate corporate personality and shareholder rights which underlie company law, preferring to busy themselves with more immediately practical, if less foundational, matters. In recent years, however, there have been signs that this may be changing. A growing interest in 'corporate governance',[1] fuelled by the belief that it might be a source of competitive advantage, has been accompanied by a growing interest in corporate theory, exemplified by the importation from the US of 'nexus-of-contracts' theories of the corporation

1. In this paper I use the terms 'corporation' and 'corporate' specifically to refer to the large, publicly quoted, joint stock company, and the terms 'corporate shareholder' and 'corporate governance' to refer to the shareholders and governance of such companies.

inspired by the law-and-economics movement. These theories, with their assertion of the essentially voluntary, private, contractual nature of companies and their underlying claim that 'efficiency', as defined by neo-classical economics and demanding the maximisation of shareholder wealth, should be the criterion by which company law is evaluated, have become increasingly influential, so much so that they now regularly figure not only in academic debates about company law in the UK, but also in discussions about company law reform.[2]

While it would be churlish not to welcome a development with the potential to broaden the intellectual horizons of academic company law, it is difficult to be effusive about this particular theoretical turn. In the US, for example, the advent of corporate contractualism,[3] buoyed in the 1990s by the irrational exuberance of the stock market bubble, the perceived strength of the US economy relative to its European and Japanese rivals and a growing belief in the superiority of Anglo-American governance mechanisms,[4] has been

2. The most sustained academic application of the contractual perspective to UK company law is Brian Cheffins' *Company Law: Theory, Structure and Operation* (Oxford: Clarendon Press, 1997). The recent work of both the Law Commission and the Company Law Review have been informed and influenced by law and economics. See eg *Company Directors: Regulating Conflicts of Interests* (Law Com no 153, 1998) pp 33–59.

3. In this paper, I use the term '(corporate) contractualism' to refer to the view that companies are essentially nexus of contracts and the term 'contractualist' to describe those who adhere to this view.

4. The latter has been manifested in various ways and contexts, most notably perhaps in the debates about convergence in corporate governance. In recent years, commentators in the US have spent much time pondering why the Anglo-American, stock market-based, public corporation, with its dispersed shareholdings and 'separation of ownership and control', has not emerged elsewhere, particularly in the civil law jurisdictions of continental Europe. Various explanations have been offered. Eg some have attributed it to the absence in those jurisdictions of 'high quality' corporate law offering adequate protection to investors, particularly minority shareholders. This, it is argued, inhibits the growth of external finance and capital markets: see R La Porta, F Lopez-de-Silanas, A Shleifer et al 'Legal Determinants of External Finance' (1997) 52 J Finance 1131, 'Law and Finance' (1998) 106 J Political Economy 1113 and 'Investor Protection and Corporate Governance' (2000) 57 J Financial Economics 3. Much of this work is underlain by the assumption that the exclusively shareholder-oriented, Anglo-American corporation is inherently superior, the economically most efficient ('end of history') organisational form which would triumph if economic forces were allowed to operate without impediment. From this perspective, which is itself premised upon an unspoken belief in a politically neutral and autonomous, market-based, trans-historical and (potentially) determining economic rationality, it is the absence (rather than the presence) of Anglo-American structures which needs to be explained, hence the tendency to attribute their failure to emerge in certain jurisdictions to legal, political and cultural *impediments* – such as inadequate investor protection or the 'anti-shareholder ideologies' of social democracy (see Roe, n 185 below, and accompanying text). Precisely because of its presumed inherent economic superiority, convergence towards the Anglo-American model is anticipated if or when global competition compels the lifting of impediments and the replacement of sub-optimal governance structures. For a discussion of the issues and literature, see J C Coffee 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications' (1999) 93 Nw ULR 641. Recent events have seen the convergence debate become more complicated and confused: see n 184 below and accompanying text.

characterised less by a blossoming of new avenues of inquiry than by a process of intellectual closure, albeit one distinguished by the intoxicated enthusiasm of born-again conversion. Indeed, a few sniffs of the contractual font have seen one or two rolling around the theoretical aisles on this side of the Atlantic too, though fortunately we have thus far been spared the boss-eyed inebriation which until recently characterised so much US corporate scholarship. With its slavish faith in the efficacy of 'the market', its yearning completely to privatise the public company and its uncritical commitment to 'shareholder value' as the overriding corporate goal,[5] it is difficult to escape the conclusion that contractual theory has ideological qualities which render it ill-suited to sober, open-minded analysis.

This is not to say, however, that contractual theory has been static and unchanging. Since the establishment of its core legal premises in the 1980s and early 1990s by law-and-economists such as Frank Easterbrook and Daniel Fischel[6] – who played a leading role in putting legal flesh on the rather skeletal, market-based, neo-classical economic accounts of the corporation developed by Alchian and Demsetz, and Jensen and Meckling[7] – contractual theory has evolved somewhat. Some of the internal weaknesses of the original model have been recognised. The problem of so-called 'contractual incompleteness', for example, has led to a growing focus on the importance of the allocation of residual control rights in firms and to a greater emphasis on the proprietary aspects of corporations.[8] More importantly, perhaps, in recent years – confronted by the downward slither of stock prices and the growing economic difficulties faced by the US economy,[9] and chastened by the at times disastrous attempts to introduce Anglo-American corporate structures into Eastern Europe[10] and by the corporate scandals and collapses of the last 18 months[11] – the focus of

5. '... the goal of corporate law is to increase shareholder wealth ... Because the participants in corporate law debates share the objectives of corporate law, to adopt policies that enhance shareholder wealth, their disagreements are over the means to that end ...': S Bhagat and R Romano 'Event Studies and the Law: Part II – Empirical Studies of Corporate Law' (2001) Yale Law and Economics Research Paper no 260.

6. Their work culminated in *The Economic Structure of Corporate Law* (Cambridge, Mass: Harvard University Press, 1991). In this paper I use Easterbrook and Fischel as the main examplars of contractualism.

7. See A Alchian and H Demsetz 'Production, Information Costs, and Economic Organization' (1972) and M C Jensen and W Meckling 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976), both extracted in L Putterman and R Kroszner *The Economic Nature of the Firm* (Cambridge: Cambridge University Press, 2nd edn, 1996) pp 193, 315.

8. See eg O Hart *Firms, Contracts and Financial Structure* (Oxford: Oxford University Press, 1995); and H Hansmann and R Kraakman 'The Essential Role of Organizational Law' (2000) 110 Yale LJ 387.

9. For a typically astute and historically informed analysis, see Robert Brenner's *The Boom and the Bubble: The US in the World Economy* (London: Verso, 2002); and 'Towards the Precipice' (2003) London Review of Books, 6 February.

10. See eg B Black 'Russian Privatization and Corporate Governance: What Went Wrong?' (2000) 52 Stan LR 1731.

11. See eg J C Coffee 'What Caused Enron? A Capsule Social and Economic History of the 1990s' (2003) Columbia Law School Center for Law and Economic Studies, Working Paper 214; and W Bratton 'Enron and the Dark Side of Shareholder Value' (2002) 76 Tul LR.

corporate scholars has shifted and broadened. There is now, for example, a burgeoning interest in comparative corporate governance and the differences in share ownership structures around the world.[12] Significantly, this has contributed to a growing recognition of the importance of 'regulation' to investor protection. Despite the tempering effect of and increased circumspection that has accompanied these developments, however, the prevailing model of the corporation remains rooted in contractualism and, more importantly perhaps, dominated by an overwhelming concern with maximising shareholder wealth.

This paper seeks, through an examination of the historical emergence and development of company law, critically to evaluate the contractual depiction and analysis of companies and, in particular, of the large joint stock corporations that dominate modern capitalism. It argues that history reveals the attempt to view the public company (as opposed to the closely held or private company) through the prism of contract to be fundamentally misguided: only by viewing public companies through the prism of property is it possible to develop an adequate understanding of their nature. Moreover, it suggests, the shift to a property-based perspective – one which focuses on law's role in the constitution and maintenance of intangible financial property forms and which, the paper argues, is implicit in some of the recent work of corporate governance specialists and financial economists in the US[13] – provides compelling reasons for radically revising the agenda for the debates about corporate governance. In short, the increasingly taken-for-granted concern with 'shareholder value' (enlightened or otherwise) needs critically to be examined and much greater attention devoted to the initial constitution and allocation of rights in and over corporations. Such a shift in perspective, the paper argues, also provides reasons for rethinking the approach we take to the study of company law and, more specifically, for developing a concept of *corporate company law* with expanded legal and institutional boundaries. In making these arguments, the paper hopes to provide insights both into the nature of the income rights which have become so central to wealth and power in contemporary capitalism, and into the processes whereby they are legally constituted as objects of property. In highlighting the role of law and other state agencies in constructing, maintaining and protecting these intangible financial property forms, it seeks also to cast critical light on certain aspects of contemporary neo-liberal ideology and the idea of 'deregulation'.

12. The literature is already vast and still growing. For a flavour of it, see the work of La Porta, Lopez-de-Silanes, Shleifer and Vishny (the 'Gang of Four'), n 4 above, and also their 'Corporate Ownership around the World' (1999) 54 J Finance 471.

13. And which is, therefore, quite different in orientation from that proposed by so-called 'property rights' theorists of the firm in the US.

I. COMPANY LAW AND THE RETREAT FROM AGENCY AND CONTRACT

The joint stock company as a partnership

One of the curious things about the recent attempts to reduce the corporations to nexus-of-contracts is that they run directly counter to the course and flow of history, one of the most striking features of the development in Britain in the nineteenth century of the first comprehensive body of company law having been its gradual move *away* from the principles of agency and contract underlying the law of partnership from which it sprang.[14] As a result, history has a singular capacity to cast light on the underlying nature of company law and to highlight the analytical shortcomings of corporate contractualism.

What we now call 'company law' first began to be developed in the late eighteenth and early nineteenth centuries as a body of rules for application to joint stock companies. At this time all joint stock companies, whether incorporated or not, were regarded as types of partnership. In contemporary parlance, they were 'public' partnerships, distinguishable from 'ordinary' or 'private' partnerships by virtue of the size and nature of their memberships – larger, fluctuating and lacking the intimacy of the ordinary partnership – and their separation of ownership and management. Correspondingly, joint stock company shareholders were regularly referred to as 'partners' or 'co-partners', and companies, like ordinary partnerships, were regularly identified with their shareholders and conceptualised as aggregates of people: a company was a 'they' rather than an 'it'. This was true even of incorporated companies, the corporate entity being thought of as its members merged into one legally distinct entity, 'a collection of many individuals united into one body' as Stewart Kyd put it.[15] In the eighteenth and early nineteenth centuries,

14. Although US corporate law also developed rapidly during the course of the nineteenth century, and often along independent lines, it was greatly influenced by English law, particularly during the first half of the century, as witnessed by the numerous US editions of the leading English treatises on the law of partnership (among them those by Watson, Montagu, Gow and Collyer), all of which dealt with the evolving law on joint stock companies. This practice only began to die out after the publication in 1841 of Joseph Story's treatise on partnership, which was itself heavily indebted to English law (and texts). Story's treatise did not prevent a US edition of Nathaniel Lindley's treatise on partnership from appearing in 1860 (see n 29 below). As late as 1898, William W Cook, writer of one of the leading US corporate law treatises of the late nineteenth and early twentieth centuries, was still to be found remarking that 'the English decisions though no larger in volume than the decisions of a single American state, continue to be of the first importance, because they treat of the most advanced questions of corporation law ... due to the fact that the modes of financing and organising in London – the moneyed center and clearing house of the world – are developed, elaborated, and refined far in advance of those in New York, the financial center of America': W W Cook *A Treatise on the Law of Corporations* vol 1 (Chicago: Callagan, 4th edn, 1898) p ix.
15. S Kyd *Treatise on the Law of Corporations* vol 1 (1793) pp 1, 7. For an elaboration of some of the arguments made in this section, see P Ireland 'Capitalism Without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality' (1996) 17 J Legal History 41.

therefore, notwithstanding the development of affirmative asset partitioning,[16] there was nothing resembling the modern doctrine of separate corporate personality, with its reified conception of the company as a separate property-owning legal person and its '*complete* separation'[17] of company and members.

It followed that when the first 'company law' text, Charles Wordsworth's *The Law Relating to Railway, Bank, Insurance, Mining and Other Joint-Stock Companies*, was published in 1836, it encompassed, as its title suggested, both incorporated and *un*incorporated companies and treated *all* of them as types of partnership and, as such, subject in principle to the law of partnership. 'Joint stock company law' was, for Wordsworth, an adjunct to the law of partnership. In common with his contemporaries, therefore, he saw joint stock companies, like 'ordinary' partnerships, as essentially voluntary, contractual affairs, irrespective of their legal status. Acts of Parliament, charters from the Crown, letters patent and other instruments of incorporation were regarded as akin to deeds of settlement, as simply one of the instruments by which 'the *partnership* between directors and shareholders [wa]s constituted and governed'.[18] The

16. Affirmative asset partitioning refers to the process (distinguishable from the 'defensive' partitioning associated with limited liability) whereby the property of firms, whether corporations or partnerships, came to be treated as constituting a separate estate shielded to some degree from the creditors of their members. It was thus responsible for establishing 'firms' as partially separate entities: see Hansmann and Kraakman, n 8 above; and H Hansmann, R Kraakman and R Squire 'Legal Entities, Asset Partitioning and the Evolution of Organizations', paper delivered to W G Hart Workshop, London, July 2002. In relation to incorporated joint stock companies, affirmative asset partitioning was achieved by the simple application to them of the principles developed in relation to non-commercial corporations, and meant (as it still does today) that the right to liquidate the company was confined to the company's creditors, the personal creditors of shareholders having only the right to seize the latter's shares. In relation to partnerships lacking separate personality, affirmative asset partitioning was achieved judicially and took a weaker form: the personal creditors of bankrupt partners could force a dissolution of a partnership, but their claims on the latter's assets were (as they still are today) subordinated to those of the partnership's own creditors. As Hansmann and Kraakman point out, while it is possible to try to achieve some degree of defensive partitioning (limited liability) through contract, affirmative partitioning '*cannot* feasibly be created by contract' and requires the promulgation of 'a rule of law'. The ability of firms (incorporated or unincorporated) to become separate 'entities' even in this restricted sense, however, was and is limited wherever the firm's creditors are not confined to the members property but can go beyond it to reach the members themselves: see S J Stoljar *Groups and Entities* (Canberra: Australian National University Press, 1973) pp 79–87. The interest in asset partitioning is linked to the recent emergence of so-called 'property rights' theories of the firm which place particular emphasis on the residual rights over the collections of assets which define 'firms': see text below.

17. The phrase is L C B Gower's: see P Davies *Gower's Principles of Modern Company Law* (London: Sweet & Maxwell, 6th edn, 1997) p 79.

18. C F F Wordsworth *The Law Relating to Railway, Bank, Insurance, Mining and Other Joint-Stock Companies* (London: Butterworths, 2nd edn, 1837). At this time, instruments of incorporation were usually bespoke documents, those sponsoring the company commonly being intimately involved in the drafting process, statutory or otherwise. Perceptions of the early incorporated trading companies were rather different as they were quasi-governmental in nature.

prevailing view was that the shareholders of companies were the equitable co-owners of tangible assets – legal title being vested in either a corporation in the case of incorporated companies or trustees in the case of unincorporated companies[19] – who stood in an essentially contractual relation both inter se and with outside third parties, albeit sometimes aggregated into an incorporated body and using directors as their agents. This was the case even in relation to incorporated joint stock companies, notwithstanding their 'confirmation by public authority'.[20] As a result, joint stock companies at this time really did bear some resemblance to nexus-of-contracts.[21]

This had important and troublesome implications, however, for with these contractual conceptions came not only rights but obligations. For example, unless a company was incorporated and its instrument of incorporation provided otherwise, company shareholders, as 'the company', were considered in important senses to be parties to the contracts that they, 'the company', had entered into with third parties. Prima facie, this was a barrier to the transfer of shares as, in principle, contractual liabilities could not be assigned. Thus, when the Bubble Act was revived in the early nineteenth century in the wake of a sudden proliferation in the formation of unincorporated joint stock companies, forcing the courts to adjudicate on their legality, the claims of many companies to have freely transferable shares figured prominently in their deliberations.[22] As John George explained in 1825, joint stock companies often acted as though on a sale of shares 'the purchaser st[ood] in law in the place of the vendor', when in the great majority of cases the sale could not have this effect because shares were, at least in part, debts and, as such, choses in action which were, 'with a few exceptions, ... not assignable at law'. Where contracts had been entered into but were not yet completely executed, or where there was any debt owing either by or to the partnership, he asserted, 'the vendor in law continues answerable for the performance of the contracts on the part of himself and copartners, and he is one of those who ought to sue for breaches of them by the other contracting party. He continues [to be] one of those who owe[s] the debts,

19. It followed that shares were conceptualised as equitable interests in the assets of a company with the result that if a company owned land, its shares were themselves, in part, interests in land. See Ireland, n 15 above.

20. Wordsworth, n 18 above, p 109.

21. Thus, Robert Pennington argues that after the courts abandoned the view that shares embodied equitable rights to the company's property in the early nineteenth century 'shareholders' rights were purely contractual at common law and in equity': *Company Law* (London: Butterworths, 7th edn, 1995) pp 69–70.

22. See eg *Ellison v Bignold* (1821) 2 Jac & W 503; *Joseph v Pebrer* (1825) 3 B & C 639. See also 'On the Transfer of Shares in Joint Stock Companies' (1839) Legal Observer 225, July. For a detailed account of the early nineteenth-century case law, see R Harris *Industrializing English Law* (Cambridge: Cambridge University Press, 2000) pp 230–249. The issue of transferability was crucial because it was very much to the advantage of shareholders to be able to assign their liabilities by simply transferring their shares (if necessary to 'men of straw') if the company ran into difficulties. The power to assign in this way was, however, thought to be a privilege which could be bestowed only by the authority of Parliament or the Crown.

or to whom the debts are owing ...'[23] Lord Chief Justice Best reiterated this in *Duvergier v Fellows* in 1828,[24] arguing that the attempt to create transferable shares without public authority was not so much illegal as legally impossible. When it was said that shares were to be transferable, it had to mean 'that the assignee was to be placed in the precise situation that the assignor stood in before the assignment; that the assignee was to have all the rights of the assignor, and to take upon him all his liability'. In fact, however, 'the assignee [could] join in no action for a cause of action that accrued before the assignment', for such rights of action continued to 'remain with the assignor, who, notwithstanding he has retired from the company, will still remain liable for every debt contracted by the company before he ceased to be a member'.[25] The difficulties surrounding the assignment of shares at this time was, therefore, precisely a reflection of their contractual character; of the in personam nature of many of the rights and obligations that constituted them and the perception of them as arising out of personal dealings and as inseparable from particular people.[26] Best noted, as did George, that incorporation was one way of overcoming this problem, for corporate privileges could suspend the normal operation of the law (of contract) and render joint stock company shares – as 'shares' both in the tangible assets and contracts of the company – transferable. But even the 'members of corporations', he observed, '[could] not assign their interest, and force their assignees into the corporation, without the authority of an act of parliament', for pretending to be possessed of transferable stock was 'pretending to possess a privilege which [did] not belong to many corporations'.[27]

23. J George *A View of the Existing Law Affecting Unincorporated Joint Stock Companies* (London: McDowall, 1825) pp 18–19, 50–51. At common law many of these emerging titles to revenue were classified as *choses in action*, a category used to describe all personal rights of property enforceable only by action rather than by taking physical possession. By the eighteenth century, this category encompassed financial instruments such as bills, notes, cheques, government stock, as well as joint stock company shares. Titles to revenue were, therefore, conceptualised as rights personal to the parties bound by the obligation and, as such, were prima facie non-assignable and incapable of being independent forms of alienable property, see W Holdsworth *History of English Law* vol VII (London: Methuen, 7th edn, 1969) pp 516, 531–532, 543. Indeed, at common law choses in action could not be stolen and legislation was needed to render them capable of being so. See eg 2 Geo II c 25, dealing with, inter alia, South Sea bonds, bank notes and East India bonds.

24. *Duvergier v Fellows* (1828) 5 Bing 248.

25. *Duvergier v Fellows* (1828) 5 Bing 248. By this time, of course, the Bubble Act had been repealed. Best was, therefore, asserting, like Lord Eldon, that joint stock company shares could not be assigned in this manner not merely because of a statutory prohibition (the Bubble Act) but because of the principles of the common law and the ordinary operation of (what we now call) the law of contract.

26. As James Penner explains, because choses in action are rights arising out of personal dealings 'it is natural not to think of either of the parties to such special relationships as substitutable by other people'. See his 'The Bundles of Rights Picture of Property' (1996) 43 UCLA LR 711 at 802.

27. See *Duvergier v Fellows* (1828) 5 Bing 248. This view persisted. In *Blundell v Windsor* (1837) 5 Sim 601, Vice-Chancellor Shadwell remarked that the deed of the company in the case at hand inferred that shareholders could freely transfer their shares and 'that the person[s] to whom the shares were assigned, would take all the liabilities attached to them'. This, he insisted, was 'a thing which could not, by any means, be done at law'. The deed was, therefore, fraudulent, falsely creating the impression that partners 'might continue to be partners as long as they pleased, and then get rid of their liabilities by assigning their shares'.

As this suggests, incorporation at this time did not create an entity radically separate from its shareholders; nor did it provide anything resembling a fully fledged alternative legal form for businesses. On the contrary, as Samuel Williston observed, in relation to 'the points which belong exclusively to the conception of the business corporation', as opposed to the conception of corporations in general, 'the law [was] formed very largely [after] 1800'.[28] So far as early nineteenth-century joint stock companies were concerned, corporate status was seen as merely entailing a partial displacement of the operation of the normal, essentially contractual, principles of the law of partnership, the degree of displacement depending upon the precise terms of the instrument of incorporation. Thus, in his exposition of the law relating to joint stock companies, Wordsworth presented the general principles of the law of partnership, highlighting 'the rights of partners or shareholders in a company between themselves' and 'the mutual rights of and liabilities of shareholders and third persons', and noting the gradual emergence within that law, mainly as a result of decisions by the courts of Chancery, of rules specifically applicable to companies. He then sought to outline the derogations from these (partnership) principles in the companies (some incorporated, some unincorporated) to be found in particular areas of productive activity, devoting separate chapters to railway, mining, banking, and insurance companies. He treated it as more or less axiomatic that joint stock companies, incorporated and *un*incorporated, were governed by the general law of partnership except in those important respects in which the latter had been '*superceded*' or '*limited and restrained*' either by the granting of corporate privileges or by the judiciary.[29] Indeed, this general approach to joint stock company law continued well into the second half of the century, long after the passing of the Companies Acts of mid-century, hence the revealing title of Nathaniel Lindley's *The Law of Partnership including its application to Joint-Stock and Other Companies*, first published in 1860 and for many years the leading English treatise on partnership law.[30]

The decontractualisation of joint stock company law

The partnership-based conception of the joint stock company as an association of people related by contract flowed from the economic nature of joint stock companies and shareholding during the eighteenth and early nineteenth centuries. Not only did the shareholders in these early companies – modest affairs by modern standards – tend to number hundreds or thousands, rather

28. S Williston 'History of the Law of Business Corporations Before 1800' (1888) 2 Harv LR 105 at 113.
29. Wordsworth, n 18 above, pp 35, 64, 101–104. A very similar approach to the law relating to joint stock companies was taken by J W Smith in his *A Compendium of Mercantile Law* (London: Saunders and Benning, 2nd edn, 1838) p 57ff.
30. N Lindley *The Law of Partnership including its Application to Joint-Stock and Other Companies* (London: Maxwell, 1st edn, 1860). In the US, where the public share market was slower to develop, the view of the joint stock corporation as a type of partnership persisted: see V Morawetz *Treatise on the Law of Private Corporations* (Boston: Little Brown, 2nd edn, 1886).

than tens of thousands or more, many of them had more than a purely financial interest in the companies of which they were members.[31] Moreover, in the absence of a large volume of shares and a developed share market, and with continuing constraints and restrictions on share transferability,[32] they were often (like it or not) tied to a much greater degree than their latter-day counterparts to the companies of which they were members, something which, coupled with their residual liabilities, encouraged them to take a personal interest in the affairs and management of the companies of which they were members.[33] This reinforced the conceptual identification of companies, incorporated as well as unincorporated, with their shareholders.

Following the rise of the railways, however, the economic and legal nature of the joint stock company and of shareholding irrevocably changed in ways which gradually but fatally undermined the partnership-based, contractual conceptions. Railway companies were far larger and more impersonal than their predecessors, raising vast amounts of capital by contemporary standards and generating detached, rentier investment on a scale and of a type never seen before. This process was both reflected in, and reinforced and encouraged by, the emergence for the first time of a developed market for company securities. In recognition of these changes, from around the mid-1830's the legislature and courts began to reconceptualise the legal nature of joint stock company membership, reconstituting shares as autonomous and freely transferable forms of property, relieved of any direct link to the assets of companies. Henceforth, the assets were deemed to be owned, in both law and equity, by 'the company' itself, either in the form of a corporation or through trustees, while shareholders were deemed to be the owners of shares, quite separate pieces of property in the form of transferable rights to profit. In this process, *all* joint stock companies, incorporated and unincorporated, were, in effect, (re)constituted as autonomous, property-owning legal persons:[34] in the changing language of the statutes of the time, people no longer 'formed *themselves* into' companies

31. As eg in the canal companies which began to proliferate from the late eighteenth century. See J R Ward *The Finance of Canal Building in Eighteenth Century England* (Oxford: Oxford University Press, 1974).

32. See A B DuBois *The English Business Company after the Bubble Act* (New York: Octagon, 1938).

33. The law of partnership presumed familiarity and solidarity between partners, and on this basis embraced both the doctrine of mutual agency, whereby partners had the authority to act on behalf of all within their actual or 'usual' authority (see eg *Hawken v Bourne* (1841) 8 M & W 703), and the requirement of unanimity regarding major decisions. This underpinned the further principle that partners were joint and severally liable for all the debts incurred in the ordinary course of business. The courts slowly eroded this doctrine as it applied to joint stock companies during the mid-nineteenth century: see text accompanying n 53 below.

34. See Ireland, n 15 above. Thus Hansmann and Kraakman's claim that defensive asset partitioning (limited liability) is 'not essential for the existence of the firm as a free-standing contracting entity' (see n 8 above) is misleading, in that while affirmative asset partitioning does indeed create a separate body of assets associated with the 'firm', the 'complete separation' of company from shareholders and the full establishment of the company as a separate, property-owning legal person (see Gower, n 17 above) which underpins the modern doctrine of separate corporate personality comes only when the joint stock company share itself emerges as a fully autonomous property form.

but 'formed' companies, objects external to them.[35] At the same time, shareholders gradually ceased being conceptualised as 'partners' in the traditional sense and were reconstituted as rentiers external to the company and production, a process which continued (and was perfected) as the century progressed with the rise to dominance of the fully paid-up share, the elimination of residual liability, and the spread of diversified, risk-spreading, portfolio shareholding.[36] These processes also saw a gradual redefinition of the legal consequences of incorporation as it applied to companies and what might aptly, if inelegantly, be called the *decontractualisation* of the law relating to joint stock companies, in that with the constitution of the company as a property-owning legal person and the externalisation of the shareholder from it, the contractual foundations of the relations between corporate shareholders, between shareholders and directors, and between shareholders and outside third parties were all in crucial respects eroded.

For example, with the introduction by the Joint Stock Companies Act 1844 of incorporation by registration, the relationship between the shareholders of most companies and third parties ceased to be contractual at all: third-party creditors now dealt not with a collection of partners liable for each other, but with companies as separate, property-owning, legal (and corporate) entities.[37] Although for a time indirect contractual links between shareholders and third parties remained, the products of unlimited liability and the residual liabilities arising out of sums unpaid on shares, these were eroded by the introduction of general limited liability in 1855 and gradually severed as shares increasingly became fully paid-up in the second half of the century (a process facilitated by judicial recognition of ever more ways in which shares could legitimately be paid for[38]), after which external liabilities attached only to the common corporate fund.[39] Indeed, for many

35. Compare the Joint Stock Companies Act 1856, 19 & 20 Vict c 40, s 3 with the Companies Act 1862, 25 & 26 Vict c 89, s 6.

36. On the latter, see A Scratchley *On Average Investment Trusts and Companies Dealing with Stock Exchange Securities* (London: Shaw & Sons, 1875), extolling the virtues of the risk-spreading investment trust.

37. See M Lobban 'Nineteenth Century Frauds in Company Formation: Derry v Peek in Context' (1996) 112 LQR 287 at 288, 312, 318–319.

38. A long line of decisions established that shares need not be paid for in cash but could be paid for in 'money's worth', a term which came to be widely interpreted. See eg *Woodhall's Case* (1849) 3 De G & Sm 63; *Drummond's Case* (1878) 4 Ch App 772. The Anglo-American cases are discussed at length in W W Cook *A Treatise on Stock and Stockholders* (Chicago: Callaghan, 3rd edn, 1894) chs 2 and 3. This underlay the problem of 'watered stock' which became a major problem in the US around the turn of the century.

39. After 1844 the links were nearly always mediated by a corporate entity. Thus one of the ways in which the 1844 Act, while retaining unlimited liability, deviated from the basic principles of partnership law was in providing that a creditor of a joint stock company incorporated under the Act could levy execution against a shareholder only if due diligence had been used to obtain satisfaction against the property of the company. The liability of shareholders thus became a subsidiary liability, subject to unsuccessful execution against the property of the company. In contrast, a partnership creditor who had obtained judgement against a firm could immediately levy execution against any partner. The liabilities of former shareholders did not, however, fully terminate on transfer, residual liabilities remaining in certain circumstances for a further three years. See Joint Stock Companies Act 1844, 7 & 8 Vict c 110, s 66.

contemporaries it was precisely its derogation from ideas of individual responsibility and from the normal partnership principles of agency and contractual liability that made limited liability so objectionable. The basis of the law of partnership, explained Edward Cox, editor of *The Law Times*, in 1856, was 'that there is a moral obligation, which it is the duty of the laws of a civilised nation to enforce, to pay debts, perform contracts, and make reparation for wrongs'. Limited liability was 'founded on the opposite principle ... permit[ting] a man to avail himself of his agent's acts if advantageous to him, and not to be responsible for them if they should be disadvantageous; to speculate for profits without being liable for losses; to make contracts, incur debts, and commit wrongs, the law depriving the creditor, the contractor, and the injured, of remedy against the property or the person of the wrongdoer, beyond the limit, however small, at which it may please him to determine his own liability'.[40] Like nexus-of-contracts theorists today, Cox failed to appreciate that as a result of the changes to the nature of the joint stock company and shareholding, directors were coming to be conceptualised as the agents not of shareholders but of 'the company' as a separate, property-owning legal person. Indeed, for many of Cox's contemporaries it was precisely the autonomous existence of companies and the externality from them of their shareholders (now owners of a quite separate piece of property, the share) that made limited liability defensible.[41]

Indeed, the coming of limited liability served in various ways to loosen the links not only between shareholders and third parties, but between shareholders and directors, and between shareholders inter se. In the days of unlimited liability and partially paid-up shares, for example, the residual liabilities of shareholders and the possible need of companies to make future calls provided good reasons for both companies and shareholders to be interested in who their (fellow) shareholders were and their financial wherewithal.[42] However, after the coming of limited liability and the rise to dominance of the fully paid-up share, which eliminated the residual obligations that impeded transferability,[43] this ceased to be the case. For companies, existing shares were no longer a potential source of additional funds and the identity and financial plenitude

40. E Cox *The Law and Practice of Joint Stock Companies* (London: Law Times Office, 1st edn, 1856) pp i–ii.

41. For this reason, when Easterbrook and Fischel seek to defend limited liability they place great emphasis on the separate existence of the corporation, the reality of which they elsewhere denigrate: see text accompanying nn 83–85 below.

42. As a result, early investment advisors stressed that it was 'important that a person intending to take shares in a joint stock company should make inquiry into the responsibility of those who join him in the speculation; for if they be men of no property, they will nevertheless, on the one hand, be entitled to share proportionately with the responsible shareholders in the profits of the undertaking, if there be any; while, on the other hand, the solvent shareholders alone must discharge all the liabilities which an unsuccessful speculation may entail': see R A Ward *A Treatise on Investment* (London: Wilson, 1852) p 99.

43. For the argument that the most important feature of limited liability – or, more precisely, limited liability with fully paid up shares – is that it facilitates transferability, see S E Woodward 'Limited Liability in the Theory of the Firm' extracted in R Romano *Foundations of Corporate Law* (Oxford: Oxford University Press, 1993) p 72.

of their shareholders increasingly unimportant. Similarly, to joint stock company shareholders who were now part of Clapham's 'blind capital seeking its 5%',[44] what mattered was not the identity of their fellow shareholders or their relationships with them and the company's directors, but the reliability and size of the income streams that the company produced.[45] In similar vein, the gradual demise of the partnership-based idea of directors as the agents of shareholders reflected the emergence of the company as a property-owning legal person and the erosion of the contractual character of the relationships of shareholders with both directors and one another. Once again, the growing detachment and externality of shareholders from 'the company' and the process of production lay at the root of these changes. Indeed, for courts and legislature, struggling to protect the new breed of shareholder and to secure the integrity of the share as a new intangible form of property, there were compelling reasons for moving *away from* a partnership-based, overtly contractual conception of, and approach to, joint stock companies and their constituent relations.

Ultra vires and shareholder protection

It had long been recognised that the joint stock company as an organisational form was likely to be accompanied by pure rentier shareholding and that investment in joint stock company shares was, therefore, by its very nature unusually vulnerable to the risks associated with fraud and speculation. This was evident in the various booms, collapses and frauds of the eighteenth and early nineteenth centuries, and underlined by the spectacular railway failures and scandals of the 1840s. By this time, however, joint stock companies had become more numerous and less controversial, and shareholding had become much more important among the dominant classes,[46] one of the main ways they could appropriate a portion of industrial surplus value. As a result, the need to address these problems was seen as more pressing than ever before. Both courts and legislature increasingly recognised, however, that the old partnership mechanisms of mutual agency and contract, with their reliance on intimacy, trust, vigilance and self-protection and their notions of contractual connection and obligation, were highly unlikely to form an adequate basis for protecting the new breed of passive, commercially ignorant, shareholder. When reconstituting the share and redefining the rights of shareholders, therefore, the courts and legislature quite deliberately moved away from the partnership-based, contractual model. The controversial introduction of limited liability and subsequent emergence of a strong version of separate corporate personality were important aspects of this, but this period also saw such things as the judicial

44. J H Clapham *An Economic History of Modern Britain* vol I (Cambridge: Cambridge University Press, 1926–28) p 388.

45. For Easterbrook and Fischel one of the advantages of limited liability is precisely that it eliminates the need for shareholders to monitor the company's other shareholders by rendering their identity 'irrelevant': see F Easterbrook and D Fischel 'Limited Liability and the Corporation' (1985) 52 U Chi LR 89.

46. For a provocative perspective on this, see R A Bryer 'Accounting for the "Railway Mania" of 1845 – A Great Railway Swindle' (1991) 16 Accounting, Organizations and Society 439.

development of the fiduciary duties of directors, the emergence of standard statutory articles of association which applied unless expressly modified or excluded,[47] and a spate of legislative measures seeking in different ways to ensure the integrity of the share as a reasonably secure form of rentier investment. Indeed, it is clear that shareholders were increasingly seen as part of the problem rather than as part of the solution, a paradoxical result of which was that while many of the changes which took place, like the introduction of limited liability, clearly sought to secure their interests, others divested them of power in and over the company. An illustration of this – and of the associated abandonment of partnership principles – is provided by the early ultra vires case of *Colman v Eastern Counties Railway*, decided in 1846.[48]

Colman involved a company incorporated by statute which proposed to offer financial support to a new steam packet company in the hope that it would increase traffic on the company's railway lines. One of the company's shareholders sought an injunction to prevent this, objecting that the proposal extended the company's operations beyond those laid down in its incorporating Act. Counsel for both parties argued from partnership principles. Counsel for the company claimed, first, that under the common law of corporations the company, as an incorporated body, had 'full power ... to employ their funds in any ... mode which the shareholders may approve of', subject to any restrictions imposed by its incorporating Act. And, secondly, that in accordance with the general principles of the law of partnership, only approval of a majority of shareholders was required as what was being proposed by the directors constituted an adjunct to the railway rather than an entirely new trade. Counsel for Colman agreed that the case depended on 'the usual principles applicable to ordinary partnerships',[49] but counter-argued that the company was proposing to do something beyond the objects laid down in its incorporating Act and that it therefore required unanimous approval: it was only with 'the consent of all the partners that the nature and objects of a partnership can be totally altered'.[50]

In ruling for Colman, however, Lord Langdale was emphatic that precisely because of the important changes that the railways and the development of the share market had wrought in the nature of the share and shareholding, it would be seriously mistaken to look upon companies of this kind 'in the light of a common partnership'. Langdale made it clear that in his view, the rapid growth in ill-informed, avaricious, pure rentier investment rendered the (contractual) principles of the law of partnership – which would have made the proposed extension of the business a matter for the shareholders – increasingly

47. See Joint Stock Companies Act 1856, s 9; Companies Act 1862, ss 14–15; n 28 above. These followed the more detailed regulatory regime of the 1844 Act.

48. *Colman v Eastern Counties Railway Co* (1846) 10 Beav 1.

49. Echoing Wordsworth (n 18 above), they argued that whereas in ordinary partnerships the rights, duties and objects of the association were regulated by the partnership deed, here they were specified in the company's incorporating Act.

50. As this suggests, both sides clearly identified the company, partnership-style, with its members notwithstanding its corporate status. At one point counsel for Colman referred to companies of this sort as 'great combinations of individuals'.

inapplicable to joint stock companies. 'To suppose', he argued, 'that the acquiescence of railway shareholders, for the last fifteen years, in any transaction conducted by a railway company is any evidence whatever of their having a lawful right to enter into it, is, I think, wholly to forget the sort of frenzy which, during that period, the country has been in. There has been no project, however wild, which has not been encouraged by some one or more of these companies; [and] ... in which shareholders have not acquiesced ...' The law, he explained, had to try to secure the integrity of the share as a new form of property. After the safety of passengers, the most important thing was 'that the property of railway companies should itself be safe; that a railway investment should not be considered a wild speculation, exposing those engaged in it to all sorts of risks, whether they intended it or not'. Given the vast property which was now invested in the railways, and its ready transferability, he explained, it was imperative that 'investment [in shares] should be of such a safe nature that prudent persons might, without improper hazard, invest their monies in [them]'. This could not be achieved if railway companies were at liberty to 'pledge their funds in support of any plausible speculations'. Langdale thus proposed strictly to limit the powers and capacity of the company: it should be permitted to do nothing beyond that authorised by the express words of the Act of Parliament'.[51] Crucially, of course, in ruling that the objects and purposes of a company should be determined by its incorporating Act, Langdale in certain vital respects placed the company beyond the will and agreement of its shareholders, constituting it as something beyond and apart from them, an approach which was, of course, extended three decades later to companies formed under the Companies Acts by the famous case of *Ashbury Railway Carriage & Iron Co v Riche* in 1875.[52] The decision in *Colman*, therefore, reflected and reinforced the increasing reification of companies and the externalisation of shareholders from them, marking a further move away from the contractual principles of the law of partnership. In explicitly derogating from the common law of corporations, it was also part of the process whereby a modified law of corporations specific to joint stock companies – and, with it, an autonomous company law – was constructed.

The rise of no-obligation, no-responsibility, personality-poor shareholding

The development of the doctrine of ultra vires was one of many restrictions placed by the courts and legislature on the rights and powers of joint stock company shareholders. Of greater everyday importance, of course, were those associated with the transfer of power from general meetings to boards of directors

51. That many members of the judiciary were personally familiar with joint stock company shareholding was illustrated by *Shrewsbury and Birmingham Railway Co v North-Western Railway Co* (1857), 6 HLC 114, when both Lords St Leonards and Wensleydale (the former Baron Parke) had to withdraw from the bench as they were shareholders in one of the companies involved. See also the comments attributed to Lord Westbury in Scratchley, n 36 above, p 3.

52. (1875) LR 7 HL 653. Part of the significance of *Ashbury* lies in the fact that the judges in the House of Lords refused to regard the company as a partnership, unlike many of their lower court counterparts.

and professional managers. Gradually, the powers of managers and members were increasingly differentiated as it was determined that joint stock company shareholders, even if they did still continue to be referred to as 'partners', could no longer exercise the right of mutual agency. '[A]lthough a joint stock company is a partnership', Lord Campbell remarked in 1849, 'it is a partnership of a different description, and attended with different incidents and liabilities from a partnership constituted between a few individuals who carry on business jointly, with equal powers and without transferable shares. All who have dealings with a joint stock company know that the authority to manage the business is conferred upon the directors and that the shareholder, as such, has no power to contract for the company. For this purpose, it is immaterial whether the company is incorporated or unincorporated'.[53] Later, not only was the power of shareholders individually restricted, so too was their collective power in general meetings. Increasingly, managing power was vested by the provisions of the standard statutory articles in boards of directors, the resulting division of power being not only judicially endorsed, but reinforced, with directors gradually coming to be conceptualised as agents of companies not shareholders, and as subject only to limited shareholder control and direction.[54]

However, although their rights became ever more circumscribed, shareholders retained their right to appoint and dismiss directors and became ever better protected in other ways. By the end of the century, joint stock company shares were, with few exceptions, no longer subject to calls and therefore no longer sources of liability or obligation, contractual or otherwise.[55] The introduction of general limited liability and the rise to dominance of the fully paid-up share thus paved the way for no-obligation, no-responsibility, no liability shareholding. And although their personam origins could still, theoretically at least, reassert themselves in certain circumstances,[56] shares were now treated as, and had the character of, property, of rights in rem which were 'only contingently related to any particular person'.[57]

53. *Burnes v Pennell* (1849) 2 HLC 497 at 521.
54. For the older view of the shareholders in general meeting as 'the company' and of the directors as their delegates or agents, see s 90 of the Companies Clauses Consolidation Act 1845; and Cotton LJ in *Isle of Wight Railway Co v Tahourdin* (1883) 25 Ch D 320 at 329. For the modern view, see *Automatic Self-Cleansing Filter Syndicate Co v Cuninghame* [1906] 2 Ch D 34, CA; and *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113, CA.
55. On the rise of the fully paid-up share, see J B Jeffreys *Trends in Business Organisation in Great Britain since 1856* (unpublished PhD thesis, University of London, 1938) ch IV.
56. As James Penner points out, the personam nature of intangible forms of property is sometimes reasserted 'when things go awry' and their holders, inter alia, 'launch shareholder suits ...': see Penner, n 26 above, at 813. By the late nineteenth century, however, the likelihood of the personam origins of joint stock company shares reasserting themselves was already diminishing, in part because of the increasingly rentier nature of shareholding and in part because of the developments associated with what Berle and Means later called the separation of ownership and control: A Berle and G Means *The Modern Corporation and Private Property* (New York: Macmillan, 1932). On this, see the comments of Maugham J in *Re Dorman Long & Co* [1934] Ch D 635. Paradoxically, however, this period also saw the rise of the private company whose shares were not freely transferable and whose fundamentally personam nature was often only too evident. See text below.
57. Penner, n 26 above, at 805.

What gave choses in action such as joint stock company shares the character of 'property' and distinguished them from contractual or other personal obligations was precisely that they had been cleansed of obligation and become freely assignable and separable from any particular individual or 'owner'. With the establishment of the incorporated company as an asset-owning separate legal person, joint stock company membership came to take the form of ownership of an unencumbered, free-standing right to revenue external to the process of production, to which was attached no particular obligations, contractual or otherwise, either to the company itself or to outsiders.[58] Shares had become instruments for the private appropriation of surplus value divorced from responsibility or function. They were circumscribed bundles of rights, certainly, but this mattered little to rentier corporate shareholders for most of whom they were nothing more than an income streams,[59] who were now benefiting from the development of modern financial reporting (the publication of independently audited, cost-based accrual accounts) and the emergence of an increasingly sophisticated accounting profession,[60] and who in any case retained residual control rights.

As the nineteenth century progressed, then, joint stock company shareholding became, legally speaking, an ever more curious affair. It had ceased to be, to use the terminology of James Penner, a 'personality-rich' phenomenon 'in which it fundamentally matter[ed] who the parties to the relationship [were]', and had instead become a 'personality-poor' phenomenon in which 'the personalities of the parties to the relationship determine[d] nothing of its nature'.[61] Shareholding could be still seen as contractual in the sense that the bundle of rights comprising the share was contractually acquired; in the sense that shares, although regarded and treated as objects of property, were still in certain respects choses in action and composed of rights in personam,[62] and in the sense that it was possible to depict some of the rights in the share bundle as contractual by emphasising that they depended upon the specific provisions of a company's articles and were therefore formally subject

58. The possibility of creating no-liability, no-obligation, no-responsibility shares was foreseen at the time of the passing of the Companies Acts by commentators such as Edward Cox: see n 40 above. It was later actively encouraged by Francis Palmer: see his *Private Companies* (London: Stevens, 1st edn, 1877) and P Ireland 'The Rise of the Limited Liability Company' (1984) 12 I J Sociology L 239. On the absence of obligations owed by shareholders to the companies in which they hold shares, see *North-West Transportation Co Ltd v Beatty* (1887) 12 App Cas 589, PC.

59. It is clear that by the late nineteenth century corporate managers were taking steps to ensure that shares provided regular and steady streams of dividends. See J B Baskin 'The Development of Corporate Financial Markets in Britain and the United States, 1600–1914' (1988) 62 Business History Review 199 at 230–232; and W H Lough *Business Finance* (New York: Ronald, 1917) pp 440–441.

60. On this, see R A Bryer 'The Late Nineteenth Century Revolution in Financial Reporting: Accounting for the Rise of Investor or Managerial Capitalism?' (1993) 18 Accounting, Organizations & Society 649.

61. Penner, n 26 above, at 802–812.

62. See Fry LJ in *Colonial Bank v Whinney* (1885) LR 30 Ch D 261; affirmed (1887) LR 11 App Cas 426. As Penner observes, the *personam* origins of bundles of rights such as shares tend to reassert themselves only when things go awry: n 26 above, at 812–813.

to determination by the shareholders inter se. But by this time shares had come to possess a market value of their own, based upon the capitalisation of the income streams they were expected to generate in the future[63] and had been legally and commercially constituted 'very much [to] fulfill the role of property'.[64] Shareholders were now, as Ben Pettet says, 'in' the (stock) market rather than 'in' the company,[65] as a result of which shareholding conformed less than ever to the traditional image of a contractual process in which an individual possessor of pre-existing property rights negotiates new rights through agreement and exchange with other rights-holders. Indeed, quite apart from the severance of shares from responsibility and obligation, contractual or otherwise, many of the key rights constituting the share, such as the right to appoint and dismiss directors, were, de facto, determined by law. They still are, of course, for, as Robert Pennington points out, 'many of the most significant rights attached to shares are conferred by the Companies Acts ... and cannot be abridged by agreement'.[66] Indeed, even those rights within the share-bundle that are formally for shareholders to determine are, in reality, more often the product not of anything resembling contractual negotiation or agreement but of the '*statutory* contract'[67] contained in a company's memorandum and articles. This 'contract', as many have pointed out, is 'peculiar', 'depart[ing] radically in a number of respects from the contract of classical tradition',[68] not least in that it is not always enforceable by those deemed to be parties to it.[69] Even arch-contractualists Easterbrook and Fischel are forced to concede,

63. It was for this reason that Marx referred to them as forms of 'fictitious capital': see K Marx *Capital* vol III (London: Lawrence & Wishart, 1959) Pt V. See also R Hilferding *Finance Capital* (London: Routledge, Kegan Paul, 1981, originally published 1909); P Ireland, I Grigg-Spall and D Kelly 'The Conceptual Foundations of Modern Company Law' (1987) 14 JLS 149.
64. Penner, n 26 above, at 813.
65. B Pettet *Company Law* (Harlow: Longmans, 2001) pp 7–8. 'In dispersed-ownership companies', Pettet explains, 'it is a mistaken analysis to regard the shareholders as being "in" the company in any of the [traditional] senses. Typically in dispersed-ownership companies shareholders will not vote; there is little point since their relatively small overall stake (perhaps 1%) will give them very little influence over any outcome. If they do vote, it will usually be by filling in a proxy form; they will not be "in" the meeting listening to arguments and explanation. Nor will they be sufficiently committed to the company's fortunes, either financially or emotionally, to want to litigate disputes. If they do not like what seems to be happening in the company they will "exit" by selling their shares on a liquid market, and re-invest in something else. So if shareholders in dispersed-ownership companies are not "in" the company, then where are they? They are in the market'.
66. Pennington, n 21 above, pp 70–71.
67. A phrase which is widely used: see eg Pennington, n 21 above, p 70; S Worthington 'Shares and Shareholders: Property, Power and Entitlement' (2001) 22 Co Law 258.
68. L S Sealy *Cases and Materials in Company Law* (London: Butterworths, 7th edn, 2001) p 116.
69. See Companies Act 1985, s 14. 'One would have thought', Pettet writes, 'that the law would provide that the members would be able to enforce the articles ... Unfortunately, for those of this mind, UK case law has prepared a disappointment': see n 65 above, p 95. Under *Foss v Harbottle* (1843) 2 Hare 461, eg, some breaches of the statutory 'contract' cannot be litigated; and the courts have on occasions used this principle to prevent members from insisting that the management of the company be conducted in accordance with the memorandum and articles, see *McDougall v Gardiner (No 2)* (1875) 1 Ch D 13, CA.

therefore, that, at least in the case of public (joint stock) companies, it is 'almost impossible' for investors to amend their rights, for there is 'no practical way' for them to amend the articles.[70] In short, then, during the course of the nineteenth century, as joint stock company shareholders were legally reconstituted as owners of freely transferable revenue rights, they became the possessors of a peculiar bundle of rights and privileges *acquired* by contract but in crucial respects *constituted*, *conferred* and *defined* by law.

With these and other related developments the law relating to joint stock companies increasingly departed from the ordinary principles of agency and contract which underlay the law of partnership. Indeed, by the final decades of the century, the processes of *de*contractualisation had become so advanced that company law finally separated out from the law of partnership, crystallising into a fully autonomous, independent, and quite distinctive legal category.[71] Marking this, in 1888 Nathaniel Lindley ceased his practice of subsuming his treatment of the law relating to joint stock companies in his text on partnership, now in its fifth edition, and instead accorded company law a separate volume of its own.[72] There was, however, a final paradox, for at the very moment that it was finally being extricated from the law of partnership and being established as a legal category in its own right, company law was invaded by partnership from another direction. From around the late 1870s, prompted by the economic difficulties associated with the Great Depression of 1873–96, the Companies Acts came increasingly to be used not only by joint stock companies, as originally intended, but by small partnerships and one-man companies anxious to get the benefits of limited liability. The legality of this practice was, of course, challenged by both the court of first instance and the Court of Appeal in *Salomon v Salomon & Co Ltd* but endorsed by the House of Lords, paving the way for

70. Easterbrook and Fischel, n 6 above, p 93. The mandatory elements of corporate law have long been a source of potential embarrassment to those wishing to stress the latter's private, contractual nature and have, therefore, been a focus of considerable (and often rather arcane) academic attention in the US.

71. In the US, where from the outset joint stock companies were more readily able to obtain corporate status, their equivalent of 'joint stock company law' was from an early date seen more as a branch the law of corporations than as a branch of the law of partnership (hence 'corporate law' rather than 'company law'): incorporated joint stock companies were 'private', as opposed to 'public', corporations. See J Angell and S Ames *A Treatise on the Law of Private Corporations* (Boston: Little Brown, various editions from 1832). Nevertheless the perception and treatment of joint stock corporations as types of partnership persisted for longer than it did in the UK: see Morawetz, n 30 above. This was in part because of the later development in the US of the market in joint stock company shares, see Baskin, n 59 above; and in part because the characterisation of corporations as partnerships – and, therefore, as flesh and blood aggregations of real people – was a potential source of constitutional benefits to shareholders, see M J Horwitz *The Transformation of American Law 1870–1960* (Oxford: Oxford University Press, 1992) pp 65–107.

72. Sir N Lindley *Treatise on the Law of Companies* (London: Sweet & Maxwell, 1889). Although Lindley now saw company law as sufficiently distinctive to merit a separate volume, however, he continued to refer to it as 'statutory partnership law' and to see it as in part a 'branch of the law of partnership', albeit a quite distinctive one. The new generation of company lawyers, headed by Francis Palmer, were rather more separatist. See eg his *Company Law* (London: Stevens, 1st edn, 1898).

all firms to incorporate and to obtain the benefits of limited liability.[73] As company lawyers subsequently discovered, applying a body of law whose conceptual structure was designed for joint stock companies with rentier shareholders to private or closely held companies is far from problem-free. As we shall see, however, it has created at least one area within company law – that relating to what are sometimes called 'quasi-partnership' companies whose shares clearly retain their personam character – where contractual conceptualisations undoubtedly have analytic and normative value.

II. DEPICTING CORPORATIONS AS CONTRACTUAL

Against this historical backdrop, it is hardly surprising that the current vogue for conceptualising (public, joint stock) corporations as a nothing more than nexus-of-contracts has met with criticism. Indeed, given the many fundamentally non-contractual, non-market dimensions to such firms,[74] one feels bound to ask *how* contractualists manage to depict them as nexus-of-contracts and *why* they are so determined so to do.

How? Into the nexus-of-contracts time-warp

The answer to the first of these questions is largely to be found in historical erasure. Nexus-of-contracts theorists try, in effect, to turn the corporate-theoretical clock back to the early nineteenth century and to expunge many of the crucial *qualitative* changes which have since taken place in the nature of the joint stock company. They try to ignore the effects and significance of the emergence of the share as an autonomous form of property, the transformation of most shareholders into pure rentiers, and the legal constitution of the company as a separate property-owning person. They seek instead to treat the modern joint stock corporation as though it is still, in essence, a large partnership whose constitutive relations can be analysed through the old partnership prisms of agency and contract.

This entails, amongst other things, a radical recharacterisation of the corporate shareholder. Rather than recognising and addressing the difficult conceptual, practical and ethical problems thrown up by the relegation of the great majority of corporate shareholders to the status of rentier buyers and sellers of titles to revenue, nexus-of-contracts theorists seek to reinstate them to their earlier role as providers of capital. They thus portray corporate shareholders as people who actually give something to corporations, rather than as people who for the most part are simply placing bets on their future profitability. This is implicit in the questions they pose. Why is it, muses one contractualist, that shareholders – who '*furnish inputs into the business*' – are 'willing *turn* large sums of money *over to* other people (managers) on very ill-defined terms?'[75] The simple answer, of

73. See Ireland, n 58 above.
74. Something emphasised in different ways by, among others, R Coase 'The Nature of the Firm' (1937) 4 Economica 386; and A Chandler *The Visible Hand: The Managerial Revolution in American Business* (Harvard: Belknap, 1977).
75. K Scott 'Agency Costs and Corporate Governance' in P Newman (ed) *New Palgrave Dictionary of Economics and the Law* (London: Macmillan, 1998) p 26.

course, at least so far as shareholders in public companies are concerned, is that they do not: buying shares puts money in the hands of the seller not in the hands of the company. But by regularly asking such questions, contractualists try subtly to reinvigorate corporate shareholders, to restore them to their former elevated status as 'real' investors. The reality – that the contemporary stock market counts for 'little or nothing as a source of finance' – is studiously ignored.[76]

It is, therefore, no accident that these theorists commonly begin their analyses with newly formed enterprises[77] or with small firms,[78] where their characterisation of the shareholder bears a much closer resemblance to reality. They then move on, however, with little or no analytic modification, to large, established joint stock corporations where it is wholly anachronistic. Brian Cheffins, for example, recognises that 'the fact' that a firm is a nexus-of-contracts 'is more obvious with sole proprietorships' and concedes that companies 'seem different from other firms' because of their existence as distinctive legal entities. He acknowledges that this creates 'the impression ... that the corporate entity is the appropriate focal point for analysis and not the underlying bargaining relationships', and admits that this is an impression 'accentuated when the role which companies legislation plays is taken into account', for it seems companies 'could not exist in their present form without legislation'. He also agrees that the inference which one might draw from this, 'that companies are a creation of statute rather than contract' is reinforced by the 'great privilege' of limited liability. But he nevertheless insists that 'companies ... resemble other types of firms in important ways' and that the companies legislation 'has had in and of itself only a modest impact on the bargaining dynamics which account for the nature and form of business enterprises'. Analytically, he argues, 'an incorporated company is, like other types of firms, fundamentally a nexus of contracts'. Thus, 'from a practical perspective, incorporation of a commercial enterprise often changes little', a point he illustrates by reference to a 'video rental business operated as a partnership by three equal partners' which later incorporates.[79] Cheffins is, of course, right that when a partnership of this sort incorporates to form a (quasi-partnership) company, little changes. But this rather misses the point. The key contrast is not that between a partnership and an *incorporated* company, but that between a partnership and a *joint stock* company. What is at issue is not the impact of the act of incorporation, of adoption of the *legal* form of an *incorporated company*, but the impact of adoption of the *economic* form of the *joint stock company*. What changes matters, and changes them a lot, is when

76. D Henwood *Wall Street* (London: Verso, 1997) p 292. It is for this reason that although foreign direct investment is said to be smaller as a proportion of world output than before the First World War, international financial flows have nevertheless increased exponentially in recent years: the trade is in existing stocks and securities, in the 'portfolio' markets of secondary instruments, along with the purchase of newly issued stock, especially newly privatised companies. For a fierce critique of the 'redescription' of the modern corporate shareholder as an 'investor' in the sense of a provider of capital to companies, see A A Berle 'Modern Functions of the Corporate System' (1962) 62 Col LR 433

77. As eg do Easterbrook and Fischel, n 6 above, pp 5–7.

78. As eg do Alchian and Demsetz, n 7 above; and Hart, n 8 above.

79. Cheffins, n 2 above, pp 31–41.

one moves from analysing a small partnership-like firm to analysing a large publicly quoted joint stock company, for the nature of shareholding in the latter is qualitatively quite different from that in the former, incorporated or not.[80] Indeed, as we have seen, it was precisely the growing economic differentiation of the joint stock company as an organisational form which generated the emergence of the specific and distinctive body of rules that eventually became company law, a separate legal category autonomous from the law of partnership.

In misdescribing the joint stock company and the joint stock company shareholder, contractual theory also elides the distinction between the assets owned by the company and the shares (rights to revenue) owned by the shareholder. They are conflated under the rubric 'capital', a process which discretely reunites shareholders with the corporate assets and eliminates the corporate entity as an owner of property other than in a purely formal sense. With corporate shareholders recharacterised as 'providers of capital' and with assets and shares conflated, the corporation itself is stripped of substance and more or less conceptualised out of existence, reduced to a mere cipher through which the owners of different factors of production are brought contractually together. Thus the corporation, Jensen and Meckling inform us, is merely '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 relationships'.[81] Crucially, this conceptual elimination of the corporation not only reconnects shareholders with the corporate assets (the 'capital'), it also reconnects them, in theory at least, with corporate managers, for with no corporate entity of substance to come between them the relationship between shareholders and managers can once again be characterised, partnership-style, as 'fit[ting] the definition of a pure agency relationship'.[82] In short, then, nexus-of-contracts theory tries to spirit us back to the early nineteenth century, to the days before general limited liability, fully paid-up (no-liability, no-obligation) shares, developed share markets, and coupon-clipping rentiers; to the days when joint stock corporations were conceptualised as essentially artificial, fictional entities (shareholders merged into one body), when shareholders really did give money to companies and were conceptualised as 'partners' (with its implication of managerial and monitoring function), and when directors were conceptualised, partnership-style, as their agents. Unfortunately, while the companies it portrays bear some resemblance to the joint stock companies of this earlier era, they bear little resemblance to their contemporary counterparts.

This becomes apparent when nexus-of-contracts theorists attempt to elaborate the 'contracts' which allegedly constitute the corporation. In this

80. Cheffins uses the term 'company' as an abridgement of 'incorporated company' and focuses on the legal status rather than the economic nature of firms.

81. See Jensen and Meckling, n 7 above, pp 320–321. Similarly, for Fischel 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': D Fischel 'The Corporate Governance Movement' (1982) 35 Vand LR 1259 at 1273.

82. Jensen and Meckling, n 7 above, p 319. See also E Fama 'Agency Problems and the Theory of the Firm' (1980), extracted in Putterman and Kroszner, n 7 above, p 302.

respect, even the corporation's relationships with third parties, many of which are clearly contractual in nature, are not entirely problem-free because the rights possessed by third parties are, of course, held against the corporation, not its shareholders, and necessarily so for rentiers wanting the benefits of freely transferable, no-liability, no-obligation shares. As a result, in this context at least, contractualists require the 'fictional' corporate entity to spring briefly to life. Thus, although Easterbrook and Fischel begin their book, *The Economic Structure of Corporate Law*, by curtly dismissing the 'personhood' of the corporation as 'a matter of convenience rather than reality', they find themselves forced to resuscitate it a few pages later when defending limited liability, 'perhaps *the* distinguishing feature ... of corporate law'.[83] 'Not so fast', they tell those who suggest that limited liability is 'the antithesis of contract' and 'a privilege bestowed on investors'.[84] It can 'be depicted as anti-contractual only if it is inaccurately described', for '*corporations* (their emphasis) do not have limited liability; they must pay all of their debts, just as anyone else must'. In other words, limited liability can be treated as anti-contractual only if the 'personhood' of the corporation is not taken sufficiently seriously.[85] If this looks suspiciously like a case of having one's corporate cake on page 12 and eating it on page 40, it does at least demonstrate that for contractualists the reality of the 'personhood' of the corporation, or lack of it, is indeed a matter of convenience. It comes as no surprise, therefore, to find that 50 pages later, when Easterbrook and Fischel turn their attention to other matters and wish to emphasise the congruity of the corporate and shareholder interests, the separate corporate entity – the legal person brought to life to 'pay all of its debts just as anyone else must' – has vanished into thin air once again. When considering the relationship between shareholders and directors, which they wish to characterise in pure agency terms, making the presence of a genuinely separate corporate entity decidedly *in*convenient, they look straight through it, unblinkingly telling us that the 'corporate contract makes managers the agents of equity investors'.[86]

The problems continue when Easterbrook and Fischel attempt to elaborate the content of this 'corporate contract', for they are forced to concede that it 'does not specify the agents duties'.[87] Undeterred by this seemingly disturbing news, they attribute this radical lack of contractual specification to the difficulties faced by shareholders trying to draft sufficiently detailed, prescient and binding agency contracts to control potentially disloyal managerial agents. However, rather than concluding from this, like Ronald Coase, that the firm is in fact in crucial respects a realm *beyond* contract and the market, contractualists persist in trying to establish the opposite, arguing that it 'makes little or no

83. Easterbrook and Fischel, n 6 above, p 40.

84. Somewhat paradoxically, they do so shortly before elaborating in impressive and loving detail the many benefits that of limited liability bestows on investors.

85. Elsewhere, Easterbrook and Fischel claim, rather recklessly, that the 'the liability of "the corporation" is limited by the fact that the corporation is not real', a view which might persuade over-literal corporate debtors that they should not worry unduly about breaching any contracts they may have made with these non-existent entities: see F Easterbrook and D Fischel 'Limited Liability and the Corporation' (1985) 52 U Chi LR 89.

86. Easterbrook and Fischel, n 6 above, p 91.

87. Easterbrook and Fischel, n 6 above, p 91.

sense to try to distinguish those things which are "inside" the firm (or any other organisation) from those things that are "outside" of it'.[88] The fact that it is impossible to foresee and plan for future contingencies, and, correspondingly, practically impossible to write a contract which comprehensively specifies rights in the many varied situations which might arise,[89] is, they argue, merely evidence that the contracts constituting the corporation, and especially those involving shareholders, are an extreme example of contractual 'incompleteness'. They seek to fill the resulting holes by recharacterising the fiduciary duties of directors as implicit contractual obligations owed to shareholders. Fiduciary principles may be 'uncommon in contractual relations', Easterbrook and Fischel tell us, but they 'sneak into' corporate contracts[90] and are 'best understood as implicit contractual terms',[91] as 'obligations [on the part of directors] to act in shareholders' interests when explicit contracts are silent'.[92] In contractual theory, fiduciary duties are transformed into rules for completing incomplete bargains and the fiduciary relation depicted as 'a contractual one characterised by unusually high costs of specification and monitoring'. Contract and fiduciary duty are thus said to 'lie on a continuum best understood as ... a single, although singularly complex, algorithm',[93] from which it follows that fiduciary duties 'have no moral footing' but are binding only by contract.[94]

Indeed, in its most extreme, market-fundamentalist manifestations, it is suggested that firms lack not only any moral, but also any hierarchical elements. According to Alchian and Demsetz, for example, the firm is merely 'a highly specialized surrogate market' with 'no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting',[95] a view echoed by Easterbrook and Fischel when they argue that 'the contractual approach does not draw a sharp line between employees and contributors of capital'.[96] Depicted in this way, William Lazonick wryly

88. Jensen and Meckling, n 7 above, p 321.

89. 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 Hart, n 8 above, pp 23–28.

90. Easterbrook and Fischel, n 6 above, p 90.

91. F Easterbrook and D Fischel 'Contract and Fiduciary Duty' (1993) 36 J Law and Economics 425 at 429.

92. Easterbrook and Fischel, n 6 above, p 110.

93. Easterbrook and Fischel, n 91 above, at 427, 446.

94. See D Campbell 'The Role of Monitoring and Morality in Company Law' (1997) 7 Aust J Corporate Law 343 at 354. For a more detailed critique of the contractualist account of fiduciary duties, see P Ireland 'Recontractualising the Corporation: Implicit Contract as Ideology' in D Campbell, H Collins and J Wightman (eds) *Implicit Dimensions of Contract* (Oxford: Hart, 2003) p 255.

95. Alchian and Demsetz, n 7 above, p 193. In this respect, the work of Williamson is markedly different as from his perspective, hierarchy and authority within the firm remain very important.

96. Easterbrook and Fischel, n 6 above, p 37. In Easterbrook and Fischel's work all participants are seen, formally at least, as equal. The question is 'not whether employees and other "constituencies" of the firm have entitlements or expectations – they do – but what those entitlements are'. And this is a matter, they argue, for contractual negotiation.

observes, the contractualist firm appears not to be *capitalist* in nature at all.[97] This radical attempt to strip the firm of any disciplinary elements merely accentuates the problem of contractual incompleteness, however, and this has led some to reassert the importance of hierarchy within firms[98] and others to reassert the importance of property rights over a firm's assets. The so-called 'property rights' theory of the firm developed by Oliver Hart and others, for example, argues that the problem of contractual incompleteness is resolved by the allocation of residual control rights over a company's assets (meaning the right to control all aspects of the assets that have not been given over to contractual specification ex ante) to shareholders on the basis of their asset 'ownership'. In the context of the closely held or owner-managed firms in which Hart develops this theory, this may be a defensible assertion, in economic reality if not in law. However, although he recognises that it is to such firms that this theory 'applies most directly', Hart proceeds to extend it 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'. The effect is to reinstate *corporate* shareholders as asset owners, notwithstanding the corporate entity and the legal (and economic) nature of their shares. The reasoning which results is circular: the residual control rights of shareholders are 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.[99] The existence of the corporation as a separate *asset-owning* entity – which is central to the processes whereby shareholders are divested of obligation and responsibility – is effectively ignored, as is the existence of the share as a distinctive, autonomous form of property, quite separate from the company's assets. Thus, although Hart's construction of a proprietary base for the corporate contractual superstructure enables the gaps in the latter notionally to be filled, it comes at the expense of a mischaracterisation of both the corporation and the nature of the corporate shareholder's property. The 'property rights' approach simply ignores the fact that it is precisely the processes whereby shareholders are relieved of asset ownership (involving the establishment of the company as a separate asset-owning legal person) that provide the basis for their relief, as *share* owners, from liability, obligation and responsibility; and, therefore, for their establishment as passive recipients of income streams external to the company.

Implicit contract and the quasi-partnership

Moreover, although this reinterpretation of fiduciary duties and reassertion of shareholder asset-ownership enables contractualists to stuff shareholder rights and corporate relations into contractual clothing, they are acutely aware that

97. W Lazonick *Business Organisation and the Myth of the Market Economy* (Cambridge: Cambridge University Press, 1991) pp 181–88.
98. The institutional theory of the firm developed by Oliver Williamson and others, eg, focuses on the hierarchical elements of the governance mechanisms necessary for firms to function.
99. See Hart, n 8 above, pp 61–63. On the creation of the collection of assets defining 'the firm', see Hansmann and Kraakman, n 8 above.

their introduction of the idea of implicit contract unleashes a potentially unruly horse which might be used by other corporate participants in support of their claims in and over corporations. Thus, while to sustain their analysis they are bound to uphold the view that the 'specification of [corporate] rights is generally effected through contracting, *implicit as well as explicit*',[100] contractualists are very anxious to establish that the rights of 'any employee or investor other than the residual claimant' (in other words, everyone but the shareholders) are *all* to be found in '*explicit* negotiated contracts'. This, we are told, is because the rights of suppliers, employees and the like can all be specified in sufficient detail in advance. These groups must, therefore, 'look to their contractual rights rather than invoke fiduciary claims'.[101] As a number of writers have pointed out, however, it can forcefully be argued that it is not possible to write in advance complete contracts which protect the interests of employees and other corporate participants, particularly those who have made so-called 'firm specific investments'.[102] And that, therefore, the provision of rights derived from implicit contracts for these stakeholders would also serve merely to complete or perfect the terms of incomplete contracts, giving to them rights due because of costs and risks which cannot be effectively contracted for.[103] Moreover, because one is often dealing in these contexts with active relationships involving real interactions and negotiations, implicit contract arguably has more analytical purchase here than it does in contexts involving rentier corporate shareholders. Put simply, contractualists may be invoking the idea of implicit contract in the wrong corporate contexts.

Indeed, it is precisely because long-term relationships involving trust, real (if informal) agreements and understandings, and genuine, complicated and nuanced personal interactions lie at the heart of many private or closely held companies that in this particular context the contractual account of companies often has considerable descriptive, analytic and normative value. Here, writes John Parkinson, 'as well as having the legal status of a contract, the articles *content* can also be meaningfully described as having been determined by a contractual process',[104] although, as Robert Goddard points out, the idea of contractual incompleteness might also have greater relevance in these contexts, particularly to minority shareholders, because company articles, even if modified, might still not capture important aspects of the actual agreements and understandings of the parties. In private companies, he observes, shareholder expectations are 'likely to be more complex and intricate', not least because shareholders are more likely to have a managerial role and their relations more likely to be 'founded upon mutual confidence and trust'.[105] Company law, with its impersonal joint stock origins, was not, of course,

100. Jensen and Meckling, n 7 above, p 318.
101. Easterbrook and Fischel, n 6 above, pp 37, 90–91. Elsewhere, of course, Easterbrook and Fischel argue that 'fiduciary claims' are contractual in nature.
102. See G Kelly and J Parkinson 'The Conceptual Foundations of the Company' in J Parkinson, A Gamble and G Kelly (eds) *The Political Economy of the Company* (Oxford: Hart, 2001) pp 125–132. See also K Stone 'The New Psychological Contract' (2000) 48 UCLALR 560.
103. See S Deakin and G Slinger in Campbell, Collins and Wightman (eds), n 94 above, p 2; Kelly and Parkinson, n 102 above.

designed with such firms in mind, and as a result is often conceptually ill-equipped to capture their underlying nature. When many of its principles are applied to small, private, closely held companies, there is often a feeling of conceptual dissonance: separate corporate personality notwithstanding, company and shareholders often seem intuitively connected, and an overtly partnership-based, contractual characterisation of the relationships involved frequently seems apposite. If shareholding in large corporations is 'personality-poor', shareholding in these companies is commonly 'personality-rich'. Or, to put it slightly differently, unlike corporate shares, shares in smaller, closely held companies are more *personam* than *rem* in character. Lacking ready assignability, they have the character of contractual rights and 'significantly involve personality, such as people, their actions, and their ongoing, dynamic relations with other people' – unlike corporate shares which are personality-poor, freely transferable 'things' with a propertied character and an independent market value of their own.[106]

This has increasingly been recognised by the courts in recent years, particularly in their handling of cases arising under s 459 of the Companies Act 1985 on unfair prejudice, nearly all of which involve private companies. In their deliberations, the courts have in different ways acknowledged the personality-rich, contractual nature of shareholding in many such companies, making liberal use of ideas of implicit understanding, informal agreement and equitable obligation in their analyses and decision-making. They have been trying, so to speak, to *re*contractualise a largely *de*contractualised company law for application to economic partnerships in which shareholding takes a predominantly personal, contractual form. This was exemplified by the recent House of Lords decision in *O'Neill v Phillips*, where it was confirmed that in certain contexts it is appropriate to go beyond a company's articles – articles often derived from the statutory model with little or no modification – in order to try to discover and give effect to what has really been agreed by the shareholders involved.[107] In similar vein, the recent Company Law Review

104. J Parkinson *Corporate Power and Responsibility* (Oxford: Clarendon Press, 1993) p 183.
105. R Goddard 'Enforcing the Hypothetical Bargain: sections 459–461 of the Companies Act 1985' (1999) 20 Co Law 66 at 69–70; see also C A Riley 'Contracting out of Company Law: Section 459 of the Companies Act 1985 and the Role of the Courts' (1992) 55 MLR 782.
106. Penner, n 26 above, at 801. The personality-rich (contractual) nature of the shares (and therefore of shareholder rights) in many small companies is further enhanced by such things as personal guarantees for company debts and by shareholder agreements.
107. *O'Neill v Phillips* [1999] 2 All ER 961. In s 459 cases involving such companies, argued Lord Hoffmann, it is 'useful ... to ask whether the exercise of the power in question would be contrary to what the parties, by word or conduct, have actually agreed. Would it conflict with the promises which they appear to have exchanged?' Although some believe that his intention was to try to restrict the circumstances in which s 459 might be invoked to cases in which there is clear evidence of prior agreement, he added that 'exercising rights in breach of some promise or undertaking is not the only form of conduct which will be regarded as unfair for the purposes of s 459'. Thus, in certain circumstances it might still arguably be perfectly legitimate to invoke ideas of equity, fairness and good faith. Interestingly, when seeking to justify the introduction of elements of good faith into the terms of association of companies, Hoffman specifically draws on the idea of partnership to support his arguments, suggesting that 'company law has developed *seamlessly* from the law of partnership', a claim which, as I have argued, simply cannot be sustained historically.

clearly recognises that shareholding in private companies is qualitatively different from corporate shareholding, noting that company law was not designed with private companies in mind – 'the *form* of the [Companies] Act reflects the needs of large companies' – and that there will 'often be little or no distinction between the board and the members in many [such companies], as most or all of the members will be also be directors'[108] Although it eschews advocating the creation of a new legal structure for private companies,[109] the Review not only explicitly endorses the approach taken in *O'Neill*, it proposes a range of new measures for specific application to private companies, many of which – such as that to establish an arbitration scheme to deal specifically with shareholder disputes – reflect and underline their personality-rich, predominantly contractual nature.[110] As we shall see, the Review recognises that shareholding in corporations is a quite different matter.

Why? Defending shareholder rights

Given the empirical implausibility of their analyses, *why* are contractualists so hell-bent on depicting corporations as essentially contractual entities? Clues to an answer are be found in the fact that contractualists, despite the often different accounts they offer of the explicit and implicit contracts which constitute the corporation, almost invariably conclude – or, more accurately, assume – that the retention by shareholders of their residual income and control rights is both legitimate and desirable. This rather lets the ideological cat out of the bag.

Paradoxically, although contractual theories of the corporation rest in many ways on a denial of the historical changes which have taken place in the nature of shareholding and shareholder rights, it is, in fact, precisely to the impact of these changes on the perceived legitimacy of shareholder rights to which they are a response.[111] No longer managers or monitors of managers, no longer major sources of new capital, the great majority of corporate shareholders ceased long ago to perform any discernable function. Relegated by the early twentieth century to the status of rentiers, the legitimacy of their rights began in some quarters to be questioned. With the rise of the company as a radically separate,

108. 'Modern Company Law: For a Competitive Economy: Final Report' (2001) 1 CLR 23 at 27, June. 'Small and medium-sized companies suffer regulation that was designed for large, publicly-owned companies ...'

109. It did so, it would seem, mainly because of potential problems of classification: see CLR, n 108 above, at 25.

110. The Review recognises that in such companies 'there is a greater element of debate between the members and directors and that one of the areas that needs to be addressed is how to create 'an efficient procedure for the resolution of disputes' and to 'restore' relations in situations in which 'the working relationship between members has broken down'. See also the proposals to sweep away the requirements relating to the holding of general meetings for 'those private companies that have no need for them'; to place the derivative action on a statutory basis; and to clarify the nature of the company's constitution. See CLR, n 108 above, at 23–38, 65–88.

111. For an elaboration of the arguments made in this section, see P Ireland 'Defending the *Rentier*: Corporate Theory and the Reprivatisation of the Public Company' in Parkinson, Gamble and Kelly (eds), n 102 above, p 141.

property-owning legal person, and the transformation of the share into an obligation-free, autonomous property form external to the company, it could no longer be claimed that shareholders were the owners of the corporate assets, and although the alternative view emerged that shareholders were 'owners' of the company itself, this claim too lacked legal grounding.[112] It was further undermined by the empirical work of Berle and Means and others which suggested that shareholders had lost control of the companies in which they held shares (not that this was something which seemed greatly to concern them). As a result, shareholders found themselves being unfavourably described in some quarters as 'absentee owners', owners of claims to 'unearned or free income', and likened to corporate bondholders.[113] With this, their status as corporate 'owners' was called into question, as was their exclusive claim to corporate surpluses. This was accompanied in the mid-twentieth century by growing recognition of the increasingly *social* nature of productive activity and by a growing perception of corporations as public institutions rather than private associations, a perception which led many to query the traditional belief that they should be run solely in the interests of shareholders. In his famous debate with Adolf Berle, E Merrick Dodd, taking separate corporate personality seriously, advanced a radical version of entity theory in support of this proposition, contesting the close identification of corporations with their shareholders and offering a view of the corporation as an essentially social institution with wider social obligations. Indeed, although Berle and Means couched their arguments in terms of a separation of ownership and control, their frequent and pointed insertion of inverted commas around the word 'owner' when describing the relationship of shareholder to corporation suggested that they too suspected the problem might be more fundamental. Indeed, they questioned whether the 'traditional logic of property' applied to corporate shares, wondering aloud whether various groups should be assigned a portion of the corporate income stream 'on the basis of public policy rather than private cupidity'. Although ideas of this sort waned somewhat during the war years, they re-emerged in the 1950s and 1960s, not least in the debates about industrial democracy and worker participation. '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', wrote Edward Mason in 1959, the 'traditional justifications' for private property had 'gone forever'.[114] In a different context, Coase's observation that intrafirm organisation was a quite distinctive, non-market form of economic co-ordination, with its suggestion that planning was already endemic in the capitalist economy, also had the

112. See eg E M Dodd 'The Modern Corporation, Private Property and Recent Federal Legislation' (1941) 54 Harv LR 917. More generally, see P Ireland 'Company Law and the Myth of Shareholder Ownership' (1999) 62 MLR 32.

113. This view was forcefully advanced by Thorstein Veblen during the early decades of the twentieth century: see eg his *The Theory of Business Enterprise* (New York: Scribner's, 1904) and *Absentee Ownership and Business Enterprise in Recent Times* (New York: Huebsch, 1923). See also F S Wood 'The Status of Management Stockholders' (1928) 38 Yale LJ 57; J Frank 'Book Review' (1933) 43 Yale LJ 989.

114. 'Introduction' to E Mason (ed) *The Corporation in Modern Society* (Cambridge, Mass: Harvard University Press, 1959; reprinted New York: Athenaeum, 1966) pp 2–6, 14–15.

potential to add fuel to this particular political fire, which is probably why it was largely overlooked by economists for so many years.[115]

As I have argued elsewhere,[116] contractual theories emerged as a response to these shareholder-threatening views and are best seen not as honest endeavours to grasp empirical reality but as attempts to provide an ideological defence of the rights of rentier shareholders and, more recently, to resist the growing calls for measures to dilute shareholder primacy. Their immediate intellectual origins are to be found in the 1950s and the work of Henry Manne, one of the founding fathers of contemporary law-and-economics. Fearing that the rise of managerialism and the corporate social responsibility movement threatened not only shareholder primacy, but capitalism as a whole, Manne began to construct a novel defence of shareholder rights which was markedly less dependent on the moral claims associated with traditional notions of ownership. Manne sought to transform the external, rentier nature of modern corporate shareholding from a vice which undermined the moral basis of shareholder rights, into a virtue which provided the basis for new instrumental legitimations. The lack of loyalty and financial orientation of corporate shareholders, Manne argued, had created a 'market for corporate control', a market which operated so as to compel corporate executives to pursue profit-maximising policies, thus ensuring productive efficiency for the benefit of all.

It is far from clear even now, 40 years later, whether the market for corporate control operates in anything like the way claimed. Indeed, there is considerable evidence that it does not: the stock market in recent years has hardly been an accurate predictor of corporate performance. Its importance lies less in its empirical accuracy, however, than in its ideological utility. Irrespective of the evidence about the way in which the stock market actually operates, the claims made for the contribution of the market for corporate control to economic efficiency are 'among the least restrained to be found in agency theory'.[117] Assertion of the existence and efficacy of this market and of a close correlation between corporate managerial efficiency and the market price of a corporation's shares is one of the bedrocks of contractualism. The significance of Manne's purported discovery of the market for corporate control thus lies above all else in its assertion that corporate managers are subject to market disciplines and that it is, 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 has become 'the fundamental concept of agency theory' precisely because, theoretically at least, it placed the managerially controlled company 'back under the market'.[118]

Crucially, this (re)marketisation of the corporation provides instrumental justifications for shareholder rights. As John Parkinson points out, once it is established (or presumed) that a particular set of arrangements (corporate or other) are the product of free market contracting, it follows for law-and-economists that they are, by definition, just and efficient. Contractualism thus offers a defence of

115. L Putterman and R S Kroszner 'The Economic Nature of the Firm: A New Introduction' in Putterman and Kroszner, n 7 above, pp 16–17.
116. See Ireland, n 111 above.
117. Campbell, n 94 above, at 362.
118. Campbell, n 94 above, at 359.

shareholder corporate rights which is seemingly less reliant on the moral claims associated with troublesome ideas of shareholder corporate ownership,[119] and which emphasises instead their role in ensuring productive efficiency. From this perspective, the recent attempt to depict (joint stock) corporations as nexus-of-contracts – the retro attempt to *re*contractualise them – emerges as part of a more general, ideological project aimed at providing instrumental justifications for the private appropriation by shareholders of corporate surpluses which are the products of an increasingly *social* production process. The essential claim being made by contractualists is that, however things might appear, corporations are *not* public institutions and *not* publicly constituted entities, but are, rather, the products of voluntary, private, contractual exchanges.[120] It follows, they argue, that any public regulation of these private, contractual arrangements potentially interferes with the natural and beneficent processes of market selection. There is, therefore, more than a whiff of Social Darwinism to contractualism, contract and the market allegedly breeding out inefficient institutional forms and ensuring that only the fittest survive: as long as the state doesn't interfere, the invisible hand will operate so as to purify the corporate species. Indeed, these processes – expressions of the belief in an autonomous, politically neutral, purely 'economic' rationality and the hegemony of market-based institutions – are regarded by many as generating global convergence on a superior, shareholder-oriented, stock market-based, Anglo-American model of company law and corporate governance,[121] something which acted in the 1990s as a justification for active encouragement of its adoption worldwide.[122] It also, of course, happens to have the happy consequence of potentially opening up new markets for rentier investors seeking the highest possible returns.[123]

119. Though questions of ownership, as we have seen, are difficult to circumvent and have a habit of re-entering through the theoretical back door: see eg Hart, n 8 above, discussed in Ireland, n 111 above, pp 152–168.
120. It is for this reason that contractualists are so insistent that the benefits (for investors) of incorporation, including limited liability, could be achieved entirely 'privately' through contract with little or no assistance or interventions from the state. For an example of the historical distortions to which this leads, see H Manne 'Our Two Corporate Systems: Law and Economics' (1967) 53 Va LR 259 at 270–275. Hansmann and Kraakman have recently observed that it would 'effectively be impossible' to create through contract the affirmative asset partitioning (the two main elements of which are priority of claims and liquidation protection) which is the 'core characteristic of a legal entity': see n 16 above. As L C B Gower noted many years ago, it is equally 'clear that without the legislative intervention, limited liability [defensive asset partitioning] could not have been attained in a satisfactory and clear-cut fashion ...': see Davies, n 17 above, p 46.
121. 'The principal elements of this emerging consensus are that ultimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of the shareholders; other corporate constituencies such as creditors, employees, suppliers and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance..' See H Hannsmann and R Kraakman 'The End of History for Corporate Law' (2001) 89 Geo LJ 439 at 443. See also n 4 above.
122. See eg G Avilov, B Black, D Carreau, O Kozyr, S Nestor, S Reynolds 'General Principles of Company Law for Transition Economies' (1999) 24 J Corporation Law 190.
123. Not least because of pension funds and other institutional investors seeking to place 'social security capital'. See R Minns *The Cold War in Welfare: Stock Markets versus Pensions* (London: Verso, 2001); and also the text accompanying nn 201–204 below.

This corporate Darwinism is prominent in the work of Easterbrook and Fischel. Taking it for granted that corporate law and corporate governance is and should be about investor protection, they open their book with an attack on the claim that this goal is best achieved by (public) regulation rather than by markets and contract (private ordering). Corporate law, they argue, is simply 'a set of [contractual] terms available off-the-rack' which enables 'participants in corporate ventures' to save on the costs of contracting,[124] reducing transaction costs by emulating those provisions that the parties would have contracted themselves. Hence the claim that it is 'trivial'.[125] Although it contains some mandatory rules, it is and should be essentially enabling, maximising choice and volition.[126] Thus US states, it is argued, simply offer different sets of off-the-rack contractual terms and different options for investor protection (various bodies of rules on voting, fiduciary duties, derivative litigation and so on) from which shareholders can choose. In seeking to emphasise choice, equality and market selection in the determination of governance structures, Easterbrook and Fischel, like many contractualists, begin their analysis not with established corporations, but with newly created enterprises whose hypothetical founders are musing about whether to incorporate or not, what kinds of claims to issue, to whom to allow voting rights, and how to organise the firm. They concede that, in reality, passive investors in established corporations do not, in fact, consciously choose one corporate contract over another, but they argue that choices about governance structures are nevertheless effectively made by investors or their expert representatives when they buy and sell shares in the stock market. The price of a company's share, they claim, 'reflects the effects, good or bad, of corporate law and contracts', expressing 'the value of the firm's governance and related rules ...', making it possible for competition among firms to 'weed out the practices that do not assist investors'. The firms and governance arrangements which survive are thus those which have proved their worth in the market. Even financial market regulation is arguably superfluous, or worse, hence the questioning of whether the mandation of corporate disclosure and prohibition of insider trading should be sustained.[127] In short, law doesn't matter.

124. Easterbrook and Fischel, n 6 above, p 34.

125. See B Black 'Is Corporate Law Trivial? A Political and Economic Analysis' (1990) 84 Nw ULR 542.

126. According to Easterbrook and Fischel, mandatory terms prescribed by law are prima facie undesirable because by preventing parties from contracting for other preferred arrangements they increase transaction costs and 'halt the process of natural selection and evaluation' by the market. Unless there is a strong reason to believe that regulation has a comparative advantage over market competition in evaluating the effects of corporate contracts, therefore, 'there is no basis for displacing actual arrangements ...': Easterbrook and Fischel, n 6 above, p 32.

127. This claim originates in the Coase theorem which suggests that when property rights are well defined and transaction costs are zero, market participants will organise their affairs in ways which ensure efficient outcomes. The argument is that financially sophisticated parties can write contracts that are more detailed and attuned to particular circumstances (and therefore more efficient) than regulators: see F Easterbrook and D Fischel 'Mandatory Disclosure and the Protection of Investors' (1984) 70 Va LR 669, extracted in Romano, n 43 above, p 303; and J Macey 'Administrative Agency Obsolescence and Interest Group Formation' (1994) 15 Cardozo LR 909. This belief has generated a spate of work purporting to explain 'regulation' (by implication, tendentially unnecessary and anomalous) by reference to public choice theories about interest groups and 'rent-seeking'. Where regulation is thought necessary, 'regulatory competition' is favoured in order to introduce a market element: see eg R Romano *The Advantage of Competitive Federalism for Securities Regulation* (Washington DC: AEI Press, 2002).

Crucially, Easterbrook and Fischel tell us, this 'removes from the field' some of the 'interesting questions' that have hitherto concerned legal scholars, such as 'what is the goal of the corporation? Is it profit, and for whom? Social welfare more broadly defined?' In their view, the market-contractual nature of corporate governance structures and the very fact that those which survive have survived establishes, a priori, their 'efficiency', enabling these questions to be dismissed with a conversation-stopping 'who cares?'.[128]

III. COMPANY LAW THROUGH THE PRISM OF FINANCIAL PROPERTY

Corporations as private associations

In contractual theory, then, corporate shareholders are portrayed as the possessors of essentially pre-political property rights over a factor of production, 'capital', conceptualised sometimes as money, sometimes as the tangible assets of the firm. Using these pre-existing rights, they negotiate further contractual rights with their fellow shareholders, with directors and, in the fictional guise of the corporation, with outside third parties, while at the same time retaining residual control rights. Property is thus seen as creating discrete, vertical relationships between individuals and the things they own, and contract as creating voluntary, horizontal relationships between individual property-owners. The role of the state is simply to protect property and enforce contracts. It is conceded that shareholders receive a little legislative help, in the form of the provision of a set of standard, off-the-peg contractual terms, but nearly all the effects and benefits of incorporation, it is claimed, could be obtained contractually with a minimum of state assistance. Depicted in this way, corporations are deemed to be fundamentally 'private' affairs, the non-coercive products of agreements voluntarily and consensually entered into by a range of private property owners, even if investor protection also requires, as it is now increasingly conceded, a certain amount of regulatory intervention.

On this basis, contractual theory offers two related legitimations of the Anglo-American corporate status quo. The first treats individual liberty as an end in itself and seeks to avoid political scrutiny of consequences, separating processes and outcomes, and politics and law. Corporations, it is argued, are expressions of individual freedom, networks of contracts freely entered into by individual property owners: any state intervention in or regulation of corporate affairs is thus prima facie an intrusion into individual contractual liberty and, as such, justifiable only in exceptional circumstances. The second is less reliant on ideas of natural right and is overtly consequentialist: as the products of freedom of contract and market selection, prevailing corporate governance arrangements, supported perhaps by a modest amount of pro-investor regulation, ensure an 'efficient' allocation of resources. The two legitimations are, of course, linked in that what allegedly makes the arrangements arising out of market exchange 'efficient' is precisely that they are the supposed expressions of individual choice and volition: even if we do not want to protect the rights of shareholders (whether in property or contract)

128. Easterbrook and Fischel, n 6 above, pp 35–36.

for their own sakes, we should do so for reasons of productive efficiency and competitiveness.[129]

It is not, perhaps, surprising, given their backward looking depiction of the corporation, that many of the arguments made by contractualists echo those made by the nineteenth and early twentieth-century proponents of laissez-faire. In many ways contractualism is little more than old-fashioned laissez-faire adapted for the contemporary corporate context, a reflection of resurgent neo-liberalism. Like contemporary neo-liberalism, of course, laissez-faire met with considerable resistance, both within the academy and beyond. Indeed, the turn-of-the-century debates that surrounded laissez-faire saw the emergence in the US of what has been called the 'first great law and economics movement'.[130] On this occasion, however, its proponents were generally on the other side of the ideological fence, expressing scepticism not only about the capacity, but about the very notion of a 'private' 'economic' sphere composed of 'free' markets. In seeking to uncover the complex social and legal foundations of the market, institutional economists like Richard T Ely and Thorstein Veblen, and legal realists like Robert Lee Hale, questioned its portrayal as a largely self-sustaining, private realm of freedom to be contrasted (unfavourably) with a public, state-based realm of regulation and coercion. Their work continues to provide a powerful critique not only of laissez-faire, but of contemporary neo-liberalism. Indeed, it has particular relevance in the corporate context, for their analyses of property and property rights, and especially of intangible income rights such as the share, casts further doubt on the contractual account of the corporation and suggests that the questions about corporate purposes that contractualists are so anxious to dismiss cannot be cast aside in quite so perfunctory a manner.

Property as a legal construct

The development and spread of capitalist relations in the eighteenth and nineteenth centuries saw the emergence of an increasingly sophisticated system of credit and 'a dazzling variety'[131] of intangible forms of wealth, many of them titles to revenue like the joint stock company share. As we have seen, although originally classified as choses in action, by the nineteenth century many of these income rights had, in the words of Sir William Holdsworth, 'changed their original character' and become 'very much less like merely personal rights of action and very much more like [freely transferable] rights of property'.[132] Although in the UK their precise legal classification was rarely considered to

129. It is also argued that it follows that the distribution of wealth resulting from market arrangements is not only justifiable but in some sense 'natural'.
130. H Hovenkamp *Enterprise and American Law, 1836–1937* (Cambridge, Mass: Harvard University Press, 1991).
131. Horwitz, n 71 above, p 150.
132. Holdsworth, n 23 above, p 543. Marx examined how this character-change occurred in his analysis of the rise of what he called 'fictitious capital', outlining the (historical) conditions in which titles to revenue (such as the share) developed a capital value of their own separate from the value of the productive assets from which their value was derived, see Ireland, Grigg-Spall and Kelly, n 63 above.

be of much interest, practical or academic, in the US their designation as 'property' (or otherwise) was central to determining how far they were protected under the constitution. This regularly forced the courts into considering not only their nature, but the nature of property in general.

Until the nineteenth century, property tended to be conceptualised as concrete, tangible objects: the prevailing conception was, in the words of one writer, 'physicalist'.[133] However, with the growth in these new, intangible forms of wealth and of markets for them, there was 'a consistent tendency toward generalisation and abstraction of the idea of property', as a result of which the old physicalist conceptions derived from land were displaced. Property was increasingly defined much more broadly to embrace not only tangible objects, but anything with exchange value: it was, so to speak, dephysicalised, though this was masked by the tendency to reify every 'thing' to which the label 'property' was attached.[134] Many writers – from Hume to Blackstone, from Bentham to Mill – had already come explicitly to argue that far from being natural, property rights were the positive creation of the state. But it was soon further being suggested that 'property' referred not to physical objects at all, but to legally constituted 'bundles of rights' and that anything which interfered with the market value of these rights-bundles was an interference with 'property'.[135] However, while this 'propertisation' of these forms of wealth often enabled the wealthy to obtain greater protection for their rights and interests, the expansion and abstraction of the idea of property that it entailed threatened to become the source of property's conceptual undoing. In this respect Wesley Hohfeld was a key figure.

Focusing particularly on the distinction between rights in rem and rights in personam, Hohfeld argued that what we loosely refer to as 'rights' are in fact a number of distinct legal capacities or entitlements, which he broke down into four groups: right, power, privilege and immunity. On this basis he developed a complex typology of jural correlatives in which each legal capacity of a rights-holder was defined by a corresponding non-capacity among non-rights-holders. Influenced by the detachment of the concept of property from concrete, tangible objects, he then applied this typology to a range of legal relations, including the rights in rem traditionally understood as rights to 'things' (and therefore as property rights), arguing that these too were actually complex bundles of rights, privileges, powers and immunities. Properly conceptualised, Hohfeld insisted, rights in rem were not rights to things, but were, rather, like all rights, rights against persons, any right over a tangible thing entailing a duty owed by someone else to the rights-holder. Rights in rem thus established

133. K Vandevelde 'The New Property of the Nineteenth Century: The Development of the Modern Concept of Property' (1980) 29 Buffalo LR 325.

134. It came to be suggested in the US that property was, for the purposes of constitutional protection, 'every valuable interest which [could] be enjoyed as property and recognised as such'. Thus, in the realm of eminent domain, eg, there was pressure to redefine the nature of interference with property rights in highly abstract terms, 'not as an invasion of some physical boundary but as any action that reduced the market value of property'. See Horwitz, n 71 above, pp 145–147.

135. This was particularly important in the US, where it therefore became arguable that any such interferences were potential 'takings' under the constitution.

not vertical relationships between people and things, but reciprocal horizontal relationships between people and other people. Conceptually, this had potentially radical implications. It clearly suggested, for example, that the traditional distinction between rights in rem and rights in personam, in which the former were seen as involving rights to things and the latter rights over people, had been incorrectly drawn. According to Hohfeld, the distinction between them was not one of subject-matter but one of scope, of the number of persons affected: rights in rem were 'multital', rights in personam were 'paucital'. It was the extent of the jural relations that they entailed that distinguished rights as in rem rather than their association with some object of ownership.[136]

In many ways, however, popular though the bundle of rights conception of property associated with Hohfeld has become, the disconnection of the idea of property from 'things' and from the substance of rights remains counter-intuitive. Indeed, recently James Penner has sought to rehabilitate the traditional view that property is a right to things, arguing that, though not the things themselves, the concept of property necessarily entails some notion of 'things' which can be the objects of property rights. 'For an owner to have a right to a thing', he argues, 'there must be a distinguishable owner and a distinguishable thing'.[137] However, although he is a self-confessed conceptual separatist about property and contract who insists that they must be 'strictly distinguished', in making his arguments Penner does not abandon the claim that property is a relationship between people. On the contrary, as we have seen, he seeks to distinguish personality-rich relationships in which it 'fundamentally matters who the parties to the relationship are' from personality-poor relationships in which it does not, arguing that the role of property as a concept is precisely 'to distinguish personality-rich legal relations from those which are not'. Property relations are personality-poor, property rights being only contingently connected to particular people and usually capable of being freely transferred to others, something which contributes to their experienced 'thingness' and reification.[138] Penner thus claims both that property 'isolates a particular area of human practice dealing with things as opposed to the practice of dealing with other people' and that it is concerned with relationships, albeit those which are personality-poor rather than personality-rich. Like Marx, therefore, when he asserted that capitalist social relations take reified and fetishised forms – capital is not a thing, he argued, but a social relation – Penner seeks to encompass both the social-relational and the thingness aspects of property. Indeed, the parallels with Marx highlight the radical political potential of this approach, for it suggests not only that property is a (reified) social relation, a myriad of personal rights between individuals, but that property rights, as

136. W N Hohfeld 'Some Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1913) 23 Yale LJ 16 and 'Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1917) 26 Yale LJ 710.
137. Penner, n 26 above, at 801–803: 'Property is a normative relation between an individual, or co-owners, and others which has as its focus and justification the exclusive determination of the uses to which a thing may be put.'
138. Penner, n 26 above, at 801–817.

'creations of law',[139] are contingent and eminently changeable. It was this insight that animated the work of Robert Hale.

Robert Hale and the idea of private government

For Hale and the realists, the work of Hohfeld made it clear that markets too are legal constructs, not merely because many of the rules and practices governing bargaining conduct are legal in nature,[140] but because property – a pre-condition of market exchange – itself involves the legal constitution of rights into personality-poor (transferable) bundles only contingently related to particular people. Moreover, Hale observed, the exclusionary and relational nature of property means that markets are as much spheres of coercion as spheres of freedom. In markets, he argued, people exercise not 'voluntary freedom' but 'volitional freedom': they do not make completely uninhibited free choices but choices that are circumstantially limited.[141] These limitations are the products not of direct physical compulsion, but of a wide range of background constraints, among the most important of which are those arising out of (legally constituted and protected) property rights. These give their holders the crucial right to exclude and withhold, enabling them to determine whether or not the use of their 'things' by others is lawful and to impose terms on those others as the price of making it so: in protecting property, law is 'intervening to restrict what would otherwise be the liberty of the non-owner'.[142] Property rights not only exert pressure on people to make contracts – 'in order to acquire certain legal rights [they] d[o] not now possess, or to escape certain legal obligations with which [they are] now burdened'[143] – they shape their relative bargaining power and the choices available to them when they do. Law, Hale argued, 'endows some with rights that are more advantageous than those with which it endows others ... [And] it is with these unequal rights that men bargain and exert pressure on one another ..., giv[ing] birth to the unequal fruits of bargaining'.[144] Property rights thus give

139. To use Holmes' famous phrase in *International News Service v Associated Press* 248 US 215 at 246 (1918).

140. Though not all of them. For an illuminating account of the many extra- and non-legal aspects of trading activity and market construction, see H Collins *Regulating Contracts* (Oxford: Oxford University Press, 1999) pp 97–126. Collins stresses the importance of trust and non-legal sanctions in the constitution of markets and the existence, therefore, of 'flourishing markets where no effective state power exists to impose legal obligations'. He recognises, however, that a 'normative system of property rights ... is presupposed in all trading activity' and identifies private law as the mechanism for allocating property entitlements.

141. R L Hale 'Coercion and Distribution in a Supposedly Non-Coercive State' (1923) 38 Pol Sc Q 470. The work of Hale and some the ideas sketched in this section are discussed in greater detail in P Ireland 'Property, Private Government and the Myth of Deregulation' in S Worthington (ed) *Commercial Law and Commercial Practice* (Oxford: Hart, 2003) pp 85.

142. R L Hale 'Economic Theory and the Statesman' in R G Tugwell *The Trend of Economics* (New York: Knopf, 1924) p 215.

143. R L Hale 'Law Making by Unofficial Minorities' (1920) 20 Col LR 451 at 452.

144. While potentially providing 'just a[s] strict protection of each person's property rights, and just as little governmental interference with freedom of contract': see R L Hale 'Bargaining, Duress and Economic Liberty' (1943) 43 Col LR 603 at 628.

coercive governing power to private individuals, the amount of coercive power they have being largely determined by the extent of their property ownership. As a result, although the rights and duties created by contract are created volitionally, it does not follow that they are not in an important sense coerced, for in market exchange the parties exert pressure on one another by virtue of their capacity to withhold or threaten to withhold their property.[145] Markets, he concluded, are not and never can be coercion-free zones. They are, rather, 'structures of mutual coercion' in which every party is constrained and coerced by other parties. Adam's Smith's system of liberty is thus in reality a 'complicated network of restraints, imposed in part by individuals, but very largely by the government itself at the behest of some individuals on the freedom of others ....'[146] Like it or not, even allegedly non-coercive, free market, neo-liberal or laissez-faire economic systems are 'in reality permeated with coercive restrictions of individual freedom'.[147]

Crucially, Hale observed, although the coercive power derived from the possession of property rights is *privately* exercised, it is *publicly* constituted. Property rights are legal constructs and in enforcing them the state effectively carries out the mandate of property owners.[148] For this reason, he suggested, all legal rights to the possession, use and exchange value of property are best and most accurately regarded as delegations by the state to private individuals of discretionary power over the rights and duties of others.[149] They are a form of 'private government', delegations of public authority to 'unofficial minorities'.[150] Government is thus a private as well as a public phenomenon, although not always recognised as such. 'In matters of everyday life', he wrote, 'our liberty is restricted by requirements laid down by those who have superior economic power. These stronger persons are not called rulers, or governors, nor are their dictates known as laws or ordinances, however great the pressure which forces obedience'. Indeed, very often the power of these economic superiors 'is not thought to be "government" at all, nor is liberty thought to be curtailed by it'.[151] But because of the legally constituted and legally backed coercive power embodied in private property rights, individuals are in reality 'no less subject to state power in ostensibly non-regulatory, laissez-faire regimes than in openly regulatory ones'.[152] Hale and the realists concluded, therefore, that the public-private, state-market dichotomies and the notion of 'natural', market-based laws of distribution that underlay nineteenth and early

145. Hale, n 141 above. See also R L Hale 'Economics and Law' in W F Ogburn and A Goldenweiser (eds) *The Social Sciences and their Interrelations* (London: Allen & Unwin, 1927) p 137.
146. R L Hale 'Economic Nationalism versus Representative Government' (unpublished manuscript), cited in B Fried *The Progressive Assault on Laissez-Faire* (Cambridge, Mass: Harvard University Press, 1998) p 50.
147. Hale, n 142 above, p 470.
148. R L Hale 'Force and the State: A Comparison of Political and Economic Compulsion' (1935) 35 Col LR 149 at 198.
149. Hale, n 148 above, at 149.
150. Hale, n 143 above.
151. R L Hale, cited in N Duxbury 'Robert Hale and the Economy of Legal Force' (1990) 53 MLR 421 at 435.
152. M Kelman *A Guide to Critical Legal Studies* (Cambridge, Mass: Harvard University Press, 1990) pp 321–322.

twentieth-century laissez-faire ideology – and which continue to underlie much contemporary neo-liberal ideology, including corporate contractualism – simply do not stand up to critical scrutiny. Today, as in the nineteenth century, resource allocation is increasingly presented as essentially a function of 'the market', seemingly rendering it unnecessary for governments to have particularly clear or definite notions as to how incomes should be distributed. In reality, however, the productive and distributional effects produced by markets are not the neutral and value-free outcomes of unregulated private activity, or natural laws of distribution. They are, rather, the products of the many legal policy choices which create the network of pressure and counter-pressure which makes up the structure of mutual coercion. Legal 'regulation' is, therefore, both ubiquitous and inevitable, from which perspective 'deregulation' appears as little more than a euphemism for the extension of state-constituted, state-backed, 'private' governing power.

It followed for Hale that the choice facing policy makers is not between market-contractual freedom (private) and state coercion (public), or between regulation (public) and no-regulation/deregulation (private), for all societies are, inevitably, characterised both by extensive regulation and coercion. Every pattern of (volitional) freedom has a correlative, publicly constituted pattern of coercion; every lawful economic power is in certain crucial senses a political power; every economic inequality a political inequality. Policy decisions cannot, therefore, coherently be derived from bald claims based upon mistaken, naturalistic, reified conceptions of property – conceptions in which legal regulation is presented as something externally imposed by the state on property owners rather than as something inherent in and constitutive of property and property rights themselves. Nor can they coherently be derived from the binary logic associated with the traditional freedom/coercion, public/private dichotomies of free market liberalism. Or, indeed, from abstract, a priori notions of market efficiency which (among many other things) take largely for granted the nature and form of rights, and the ways in which they have been constituted and allocated.[153] None of these things are capable in and of themselves of shedding decisive light on the choices that confront courts and legislatures trying to adjudicate between competing social claims. On the contrary, as Hale recognised, they seek to circumvent the wide-ranging, rational, policy debates that are demanded. The critical questions are not whether to back freedom or coercion, the public or the private, but which structures of rights, coercion and volitional freedom to adopt in particular contexts.

Regulation and the constitution and maintenance of financial property

Nowhere is the legally constructed nature of property and property rights more apparent than in the case of the intangible forms of wealth, like the joint stock

153. Among the influences on Hale was Richard T Ely who had earlier observed that there was a tendency among economists to treat private property as a 'natural' institution, see R T Ely *Property and Contract in Their Relation to the Distribution of Wealth* (New York: Macmillan, 1914). Hale himself noted that the role of property law in wealth distribution was almost entirely ignored in standard economic texts, see Fried, n 146 above, p 78.

company share, which began to proliferate in the eighteenth and nineteenth centuries, for these forms of property do not involve rights over concrete things whose existence as objects is independent of law. On the contrary, there is no tangible 'thing' to act as an object of property in these cases, for these forms of wealth consist primarily of income rights, hence their original classification as choses in action. In these instances the objects of property themselves are legal constructs. Moreover, as we have seen, for the bundle of rights comprising the joint stock company share to become fully autonomous objects of property, they had to be socially and legally constructed in very particular ways. This entailed more than just a permissive legal endorsement of commercial practice and the 'private', contractual arrangements that it spawned:[154] it required processes of asset partitioning and *de*contractualisation. Before they could become property in their own right – 'things' capable of freely circulating in the marketplace – the rights making up the share had to be transformed by courts and legislature into unencumbered, personality-poor, freely assignable bundles.[155] This demanded their severance from obligation and responsibility, and the erosion of their original contractual, *personam* nature. This was a fundamentally *public* process and a controversial and overtly political one too, involving the promotion of very particular interests and important derogations from traditional notions of contractual obligation and individual responsibility: while obligations and responsibilities were shed, income and residual control rights were retained. In the words of the Edinburgh Review, the acts of parliament which offered corporate (and other) privileges to companies and shareholders 'qualif[ied] and dispense[d] with the general law'.[156]

Radical legal intervention was – and is – needed not only to constitute these property forms, however, but to maintain them and to secure their integrity. Because of their essential nature as intangible income rights, corporate shares are unusually vulnerable forms of property, so much so that Bernard Black was recently prompted to describe the existence of securities markets as 'magical', for 'investors pay enormous amounts of money to strangers for completely intangible rights, whose value depends entirely on the quality of the information that the investors receive and on the sellers' honesty'.[157] This vulnerability stems in part from the so-called

154. Thus, Penner argues that 'certain kinds of property right' – he is writing of patents and copyright, but the argument could easily be extended – 'are not conceptual creatures of contract ... the law of contract does not create property rights ...': Penner, n 26 above, at 814.

155. As Penner says, 'there is not a world of "things" out there all ready to be appropriated as property'. 'Thing' in the context of property is, rather, a 'term of art', which 'restricts the application of property to those items in the world which are contingently related to us, and this contingency will change given the surrounding circumstances ...': n 26 above, at 807.

156. 'Private Bill Legislation' in (1855) Edinburgh Review 152, January. This was, of course, precisely Edward Cox's point: see n 40 above.

157. B Black 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48 UCLA LR 781 at 782. 'Sellers' here refers to the companies concerned, it being assumed that shareholders are providers of capital rather than buyers and sellers of titles to revenue.

'agency problems' associated with absentee ownership: the rentier owners of corporate shares are not generally well-equipped to protect themselves, contractually or otherwise, from errant managers. It stems also, however, from the very nature of shares as a property form; from the source and nature of their value. The value of corporate shares is derived not from their concrete properties as physical objects or from the value of the tangible assets owned by the companies concerned, but from their anticipated future earning power, from a capitalisation of the dividends which are expected to accrue to them in the future.[158] Thus, while the value of the tangible assets of companies tends to remain relatively stable, at least in the short term, share values often fluctuate alarmingly. Indeed, there are frequently huge gulfs between the market and book values of companies, between the value of their tangible assets and their value in the stock market.[159] One consequence of this, as history has repeatedly shown and as we have seen only too clearly recently, is that shares are a form of property unusually vulnerable not only to oscillations in value, but to manipulation, fraud and speculation.[160] The result is that the security and integrity of financial property, like shares, requires a wide range of legal and other interventions aimed at trying to eliminate deceit and swindling, and to ensure that their market values reflect with reasonable accuracy their income-generating

158. See *Short Brothers v Treasury Comrs* [1948] AC 534; and Ireland, Grigg-Spall and Kelly, n 63 above.

159. In 1996, eg, at a time when IBM's total market capitalisation was $70.7 billion, Microsoft's was $85.5 billion even though the company owned a mere $930 million in plant, equipment and tangible property compared with IBM's $16.6 billion: see J Rifkin *The Age of Access* (London: Penguin, 2000) pp 50–51. As Rifkin points out, this gulf is widening still further as a result of the growing importance of intangible, intellectual property forms.

160. In a bumper year for corporate scandals, 2002 saw five of the biggest ten bankruptcies in US corporate history: Enron, Global Crossing, United Airlines, Conseco and WorldCom. At the last count, the latter's earnings between 1999 and 2001 had been overstated by about $9 billion. As privatisation in Eastern Europe has made only too clear, however, corporate fraud and self-dealing are no longer confined to the West, nor in the East are they confined to Soviet 'kleptocrats', as evidenced by the ongoing scandal surrounding the operations of the Harvard Institute for International Development (HIID) and the financial economist and corporate governance specialist, Andrei Shleifer. The HIID was paid over $40 million by the US Agency for International Development (USAID) to advise the Russian government on privatisation and economic 'restructuring'. While directing the project and dispensing advice, however, Shleifer and another HIID employee, Jonathan Hay, invested hundreds of thousands of dollars (directly and indirectly through family members) in Russian companies. This led USAID to terminate its contract with HIID and led the US government and a US mutual fund company to launch actions for damages against Harvard, Shleifer and Hay alleging, inter alia, fraud and contractual violations of conflict-of-interest clauses. Harvard removed Shleifer from the project, but retained him as an economics professor. It also disbanded the HIID, though it rapidly reappeared, along with most of its staff, under a new name. The suit with the company was settled quietly by the University in November 2002, but the suit with the government, who are claiming triple damages of $102 million under the False Claims Act, is proceeding towards trial. See J Wedel *Collision and Collusion: The Strange Case of Western Aid to Eastern Europe* (New York, Palgrave, 2001) ch 4. Shleifer has recently been appointed an inaugural fellow of the European Corporate Governance Institute.

potential. These have been forthcoming in large part because of the economic and political power of their owners. Some have occurred within company law – as recently as 1980 a whole new tranche of provisions aimed at protecting shareholders from fraud were enacted in what is now Pt X of the Companies Act 1985, reforms to which have recently been proposed by both the Law Commission and the Company Law Review[161] – but many have occurred on the fringes of or, indeed, outside company law as traditionally defined, taking the form of such things as the development of ever more sophisticated accounting standards and ever more rigorous securities regulation.[162]

Indeed, following the troubled and at times downright calamitous attempts to create financial property forms and to transplant Anglo-American corporate law and securities markets into Eastern Europe, there has, according to one commentator, been 'a paradigm-shift ... in the manner in which financial economics views corporate governance' in which much greater emphasis is placed on the previously heretical 'possibility that regulation can outperform private contracting'.[163] It is argued that the earlier claim that financial contracting renders regulation largely irrelevant needs radically to be revised. Not only does 'law matter', extensive regulation is now said to be indispensable to the successful creation and maintenance of financial property forms and, therefore, of securities markets. Thus, the financial economists La Porta, Lopez-de-Silanes, Shleifer and Vishny not only recognise, but emphasise that the rules protecting investors come from a wide range of different sources, 'including company, security, bankruptcy, takeover and competition laws' and 'stock exchange regulations and accounting standards'; and that the enforcement of these rules, which is 'as crucial as their contents', is carried out not only by the market participants themselves, but by a wide range of regulators. Moreover, many of the rules are, of necessity, not privately and contractually negotiated, but mandated: 'the rights of investors are protected and sometimes even specified by the

161. See Law Commission, n 2 above, pp 60–235; CLR, n 108 above, at 135–139.
162. The origins of securities regulation can be traced much further back into history: see S Banner *Anglo-American Securities Regulation: Cultural and Political Roots, 1690–1860* (Cambridge: Cambridge University Press, 1998). But it was not until the passing in 1933 of the Securities Act in the US that it began to take its modern form and to grow in prominence and scope. Legal provision for a comprehensive system of securities regulation in the UK was finally made in 1986, with the enactment of the Financial Services Act 1986 and the establishment of the Securities and Investment Board.
163. J C Coffee 'Privatization and Corporate Governance: The Lessons from Securities Market Failure' (1999) Columbia Law School Center for Law and Economic Studies, Working Paper 158, examining the effects of the radically different approaches taken to securities regulation in Poland and the Czech Republic. For examples of the changing attitude among financial economists to regulation in the context of investor protection, see La Porta, Lopez-de-Silanas, Shleifer et al (2000), n 4 above; and E Glaeser, S Johnson and A Shleifer 'Coase versus the Coasians' (2001) 116 Q J Economics 853.

legal system.' In short, private contracting alone is insufficient to ensure the integrity of financial property.[164]

In similar vein, Black, with Shleifer one of the architects of Russian privatisation, has revised his earlier claim that because of the power of contract and the market, corporate law is 'trivial',[165] elaborating in great detail the complex legal and institutional underpinnings of strong securities markets. He distinguishes two as of particular importance: the provision of good information about the value of a company's business – meaning its ability to generate a regular stream of future profits – and the control of self-dealing by 'insiders'. The problems of informational asymmetry, Black argues, have been partially solved by 'a complex set of laws and private and public institutions' in which 'reputational intermediaries' – accounting firms, auditors, investment banks, law firms, stock exchanges and so on – play a key role. These intermediaries are, in turn, policed by the government and by a range of self-regulating organisations. Black's list of the 'core institutions' involved makes only too clear the complexity of these processes: a well-staffed and skilful securities regulator; a sophisticated, efficient, speedy and honest judicial system; procedural rules which facilitate investor actions; extensive financial disclosure; accounting and auditing rules which ensure a flow of reliable information; competent law-makers to keep rules up to date; sophisticated accounting and investment banking professions; securities or other laws which establish accountant liability to investors for misleading financial statements; a stock exchange with meaningful listing standards and a willingness to delist when necessary; rules which impose civil and criminal liabilities on companies and insiders for making false or misleading disclosures; rules ensuring market 'transparency'; professional security analysts and an active financial press; a professional culture of disclosure and honesty. Black provides a similarly lengthy list of prerequisites for preventing self-dealing by insiders and indeed blames the absence of a suitable infrastructure for controlling self-dealing for the disaster in Russia, admitting that in the rush to privatise, for which he was partly responsible, control of the largest productive enterprises was handed

164. See La Porta, Lopez-de-Silanas, Shleifer et al (2000), n 4 above. Their argument is that when the legal system does not offer adequate protection to outside investors 'corporate governance and external finance do not work well'. Their emphasis on the wide range of legal rules and regulations protecting outside investors stands in sharp contrast to the traditional law-and-economics perspective on financial contracting. See also Glaeser, Johnson and Shleifer, n 163 above, which draws on the experiences of Poland and the Czech Republic to argue that in certain circumstances enforcement by regulators who have stronger incentives and greater specialism is to be preferred; and K Pistor, M Raiser and S Gelfer 'Law and Finance in Transition Economies' (2000) Harvard Center for International Development, Working Paper 49 (arguing that creating a legal framework which protects external investors is insufficient to attract capital: 'effective legal institutions' are indispensable).

165. Recognising the evident 'tension' between his current and earlier work, he remarks: 'I did not claim then that all of securities law (as opposed to corporate law) was trivial, and I would find less of securities law trivial today that I might have then': Black, n 157 above, at 783.

over to crooks.[166] An adequate supporting institutional framework for securities markets, he now argues, takes years to build, as a result of which he advocates for places like Russia not only privatisation at a much slower pace, but selective renationalisation in the interim.[167]

It is significant, however, that while Black tends to couch his analysis in terms of (securities) *markets* and their preconditions, Shleifer and his various collaborators increasingly couch theirs in terms of the protection of *property*. Shleifer now argues, for example, that the rise of regulation in the US was an 'efficient response' to the inadequacies of private contracting as a mechanism for protecting property rights in the late nineteenth and early twentieth centuries. 'Government-enforced regulations', he now concedes, may be a 'more efficient' way of protecting property than private litigation. As a result, private contracting and government regulation are characterised as simply 'alternative institutional arrangements' for '*securing property rights*' and the key question identified as 'what is the optimal strategy?' to achieve this end, to which the answer, we are told, is very often 'regulation'.[168] Revealingly, regulation is defended not as a means to 'efficiency' as an end in itself, but as an efficient means to the end of investor (property) protection. While this shift in focus from markets to property and this recognition of the vital importance of regulation represents an analytical step forward, however, the objects of financial property continue to be treated as unproblematic, pre-regulatory givens. It is still not acknowledged that these property forms are not merely protected by but are the *products* of regulation. As their historical genesis shows only too clearly, financial property forms like shares are regulation all the way down.

In many ways, the recent UK Company Law Review, in underlining the centrality of information and disclosure to the protection of corporate

166. For critical accounts of what 'privatisation' and 'transition' have actually entailed in Russia, see S F Cohen *Failed Crusade: America and the Tragedy of Post-Communist Russia* (New York: Norton, 2000); and P Reddaway and D Glinski *The Tragedy of Russia's Market Reforms* (Washington DC: US Institute of Peace, 2001). As Cohen makes clear, most academic (and journalistic) accounts of 'transition' in Russia in the 1990s represented a triumph of ideology over scholarship. 'In my own experience', he writes, 'the words *collapse*, *disintegration*, *tragedy* come more readily to the minds of most Russians than does *transition* ...' and 'looting would be a more apposite description than "privatization"': p 44. To Black's credit, while he still insists that the plan for Russia that he helped to draw was 'plausible', his confession of error has been pretty unequivocal. 'Mass privatization', he writes, 'was motivated, in important respects, by faith', so much so that as late as 1998, when the evidence against was mounting, some key western advisors, like Shleifer and Vishny, were still believers: 'they and we were wrong': see Black, n 10 above, at 1797.
167. Black, n 157 above, at 847; Black n 10 above, at 1797–1803. 'We have learned', Black writes, 'that Western-style capitalism is more fragile than we thought'. Coffee also recommends a radical change of pace: see n 163 above.
168. E Glaeser and A Shleifer 'The Rise of the Regulatory State' (2003, forthcoming) J Economic Literature. They argue that in the period between 1887–1917, regulation became an increasing efficient strategy for securing property rights. See also R La Porta, F Lopez-de-Silanes and A Shleifer 'What Works in Securities Laws?' (unpublished manuscript, October 2002), arguing that 'the evidence suggests that investor protection delivered by both public regulation and private enforcement is associated with better securities market development': p 35.

shareholders in Anglo-American, dispersed-shareholding corporations, echoes Black. When it comes to reform of the mechanisms for protecting *corporate* shareholders, the Review looks not to private, contractual devices, but to regulatory devices such as greater disclosure and reporting, and higher accounting standards, things which it openly admits are much less relevant to shareholders in private companies.[169] The externality of corporate shareholders (including institutional investors) from companies is assumed: it is not expected that they will intervene in the 'normal management of companies' for they are 'not qualified' to do so. It is, however, hoped that they can be persuaded and cajoled into monitoring managers, and that they will invoke their 'reserve powers' and 'take appropriate action ... in times of crisis'. The aim of reform is, therefore, to provide shareholders with 'timely and high quality information to enable them to assess the performance of the company and the directors' stewardship of the assets'. As companies are increasingly reliant on intangible assets such as the skills and knowledge of their employees, their business relationships and their reputation, this entails creating a reporting regime which provides information on these matters.[170] And as investors need to be able to assess not only past but likely future performance, it must also offer information about 'future plans, opportunities, risks and strategies', for these are 'just as important as the historical review of performance which forms the basis of reporting at present'.[171] The Review therefore proposes that most public companies and large private companies be required to publish expansive Operating and Financial Reviews as part of their annual reports. Crucially, the Review emphasises that many of the disclosure and reporting requirements are highly 'technical' and that their effectiveness will, therefore, 'depend on expert and continuous development to reflect changing market conditions, financial and managerial techniques and business priorities'. For this reason, the institutional framework supporting company law needs to be strengthened so as to provide not only for the regular updating of the existing law, but for 'flexible, expert, responsive ... rule-making and enforcement', especially in relation to reporting and accounting requirements. The Review therefore proposes that 'a new institutional structure' be built upon the existing regime for financial reporting and the work of the Financial Reporting Council, Accounting

169. 'We are concerned here with public and large private companies ... these issues do not tend to arise for small private companies'. Indeed, the Review proposes deregulatory measures in the areas of capital maintenance and accounting and audit for private companies, because 'they do not have access to the capital markets, and have, therefore, limited economic influence and demand less rigorous protection for shareholders as owners of the company', CLR, n 108 above, at 24–25, 49, 75–83.
170. This has been used as a way of smuggling a modest stakeholding dimension into corporate governance through the back door. Thus, the Review's recommended statement of directors' duties suggests that directors must 'take account of long-term as well as short-term consequences; and that they must recognise, where relevant, the importance of relations with employees, suppliers, customers and others ...', CLR, n 108 above, at xviii.
171. CLR, n 108 above, at 38–39, 49, 58.

Standards Board and Financial Reporting Review Panel.[172] It further notes, as do Black and Shleifer, that additional institutional support is provided by securities regulation ('capital markets law' in Europe), a body of law which is ineradicably 'public' in nature and whose 'central fact', as Ben Pettet observes, 'is the pervasive influence of the state'.[173]

One can, therefore, begin to understand why Tarrasova, Black and Kraakman argue that in the developed capitalist world, company law plays a 'relatively small' role in protecting corporate investors[174] and why a number of US commentators now argue that the key to the good investor protection provided by common law systems 'seems to lie not in their corporate law, but in their shared system of securities regulation'.[175] One can also understand why the Company Law Review decided to 'think small first' and to make the private company the starting point for reform.[176] For while this might appear at first glance to be a rather perverse inversion of history, which makes the main focus of company law not the joint stock companies for which it was originally designed but the private companies which rather rudely invaded it towards the end of the nineteenth century, it makes some sense. Not only do private companies greatly outnumber the (joint stock) corporations which dominate modern economic life, the protection of the income (property) rights of rentier

172. CLR, n 108 above, at xx, 59–60, 89, 95–97. As a result of a number of post-Enron governmental initiatives, the government also ordered reviews of the arrangements for audit and accountancy regulation and the regulatory regime of the accountancy profession. See Co-ordinating Group on Audit and Accounting Issues *Final Report* URN 03/567 (January 2003) and Review of the Regulatory Regime of the Accountancy Profession *Final Report* URN 03/589 (January 2003). These came on top of Derek Higgs' recent review of the role and effectiveness of non-executive directors and Sir Robert Smith's review of combined code guidance for audit committees. The government's response to these reports is to be found in the parliamentary speech of Patricia Hewitt, the Secretary of State for Trade and Industry, on 29 January 2003. In the US, the collapse of Enron is being attributed, inter alia, to 'gatekeeper' failure, meaning the acquiescence of accountants, auditors, lawyers, debt rating agencies and so on in accounting irregularities: see Coffee, n 11 above. Others, however, while recognising the role of accounting and audit failure, also point to the rise of the modern shareholder-value norm, to the stock-options culture aimed at aligning manager-shareholder incentives, and to the anti-regulatory zeal of some fundamentalist contractualists: see Bratton, n 11 above.

173. Pettet, n 65 above, pp 6–9, 333ff. See also La Porta, Lopez-de-Silanes and Shleifer, n 168 above; and Glaeser, Johnson and Shleifer, n 163 above, noting, amongst other things, the key role of disclosure mandated by securities laws in investor protection.

174. B Black, R Kraakman and A Tarassova *Guide to the Russian Law on Joint Stock Companies* (Boston: Kluwer, 1998) p 15.

175. See Coffee, n 163 above, critically reviewing the assorted works of the financial economists, La Porta, Lopez-de-Silanos, Shleifer and Vishny in the context of privatisation in Poland and the Czech Republic. Anglo-American shareholding structures, he argues, may be rooted in particular (and highly effective) systems of securities regulation rather than in particular systems of corporate/company law, and this might explain the differences between the shareholding patterns in common law countries (where dispersal is the norm) and civil law countries (where blockholding persists). On this basis, it is suggested that securities regulation rather than company law may prove to be the principal area of future convergence.

176. The Review calculates that in March 2000 they outnumbered public corporations by 1.3 million to 12,400.

corporate shareholders increasingly takes place on the fringes of, or beyond, the boundaries of company law as traditionally drawn, something which merely serves to underline the decidedly non-contractual, public and regulatory qualities of so many of the devices utilised to this end.

Interest-bearing capital and the myth of deregulation

The vulnerability of intangible property in the form of income rights such as shares and bonds extends beyond the risks associated with fraud and speculation, however, and as a result so too do the regulatory demands that they make. As their value is derived from anticipated future revenues, they are potentially affected, individually and collectively, by any changes in the productive (and other) processes responsible for generating the income streams concerned. They are unusually vulnerable, in other words, to everything from changes in trade and labour regimes, to changes in financial and taxation policies, to changes in the balance of political and class power, to changes in particular markets as well as in general economic conditions – shares especially so, in that they provide no right to an income, merely a privilege to receive one in certain circumstances. As Robert Hale noted, the owners of these property forms are reliant upon large numbers of people 'conduct[ing] themselves in a manner advantageous to [them]' and continuing to do so indefinitely into the future.[177] Their financial integrity therefore requires an extraordinarily wide range of legal and other interventions aimed at preserving the general social and productive relations responsible for ensuring a continuing flow of returns. In short, these are high-maintenance property forms which demand remarkable levels of general economic and social regulation; they are, perhaps, even more 'magical' than Black appreciates. Indeed, as they have acquired greater social significance (not least in relation to the provision of pensions for the middle classes in wealthier countries[178]) and become increasingly international and mobile in character as investors (particularly institutions from Britain and the US) scour the earth in search of better returns, the political pressure for more effective support for them from a wide range of agencies at both the national and international levels has steadily grown. These are property forms in increasing need of a very particular (new) world order. For confirmation, one only has to look at the nature and extent of the policy demands made by institutions such as the IMF and World Bank as pre-conditions of providing governments with the financial assistance they need in order to continue to service their debts.

177. See R L Hale 'Value and Vested Rights' (1927) 27 Col LR 523. In Hale's terms, the value of these property forms is dependent upon a network of 'vested rights'.

178. Though it should not be forgotten that even within these countries ownership of shares and other financial property forms remains highly concentrated. In the US, eg, by 1995 more adults (51.3 million) owned financial assets than ever before, but 71% of households still owned no shares at all or held less than $2,000 in any form, including mutual funds, popular employer-sponsored retirement '401k' plans and traditional pensions. See J Gates *The Ownership Solution* (Reading, Mass: Addison-Wesley, 1998) p 4; Investment Company Institute and Securities Industry Association *Equity Ownership in America* (1999); and also the text accompanying nn 200–204 below.

Indeed, the case of sovereign debt is particularly revealing of the social relations which underlie financial property. The fact that they represent private claims to part of the product of what are fundamentally *social*, productive activities rises uncomfortably to the surface when the IMF and World Bank intervene to try to ensure that the interest on debt continues to flow. It is only too clear who benefits and who suffers when they demand 'adjustments' and 'austerity programmes' involving reductions in social spending, privatisation of resources, export-led growth, wage freezes, the removal of subsidies to domestic industry, and so on: the principal function of many states has become that of collecting taxes to service debt.[179] It is, therefore, deeply paradoxical that the growth and spread of these legally constituted financial property forms – the maintenance of whose security and value increasingly demands such extensive support both nationally and internationally – should be so closely associated with neo-liberalism and the rise of 'deregulated', 'free' markets. Preservation of the social relations which enable all money to act as capital and to command interest – and thereby to lay claim to part of an increasingly global social product – entails extraordinarily far-reaching legal and other 'regulation' of social life, including of states themselves. In these circumstances it is equally paradoxical that some should still be trying to assert the fundamentally private nature of corporations and the need to protect them *from* (certain kinds of) regulation, while continuing to insist – in the face of environmental degradation, increasingly grotesque inequalities in wealth and the co-existence of growing overcapacity and waste with growing poverty – that existing exclusively shareholder-oriented corporate structures are 'efficient' and operate for the benefit of society as a whole rather than for the benefit of a privileged minority. And, of course, that interest-bearing capital should be given whatever regulatory support it requires.

IV. CHALLENGING VESTED RIGHTS

The retreat from contractualism

Contractualists would, then, have us see corporations through the prism of contract, when they are better understood through the prism of financial property. They would have us see corporate shareholders as providers of capital embroiled in complex networks of contracts, when they are better seen as rentier buyers and sellers of revenue rights, passive recipients of income streams,

179. The link between (the payment of interest on) financial property and the exploitation and suffering of the poor, so evident in the financial crises which have afflicted countries such as Argentina, Brazil, Mexico, Russia etc, is hardly new. Thomas Pakenham recounts how, when Ismael Pasha, Khedive of Egypt, defaulted on the interest due on his foreign loans in 1880, the European powers established an international commission to protect the bond-holders who had made a fortune lending money to him at extortionate rates of interest. Led by Britain and France, they moved in to depose Ismael and 'to rescu[e] Egypt – and the bond-holders'. The interest remained extortionate, but 'the real sufferers were the fellahin, the Egyptian peasants, who paid the interest with or without the encouragement of the courbash'. The courbash is a whip made of buffalo-hide. See T Pakenham *The Scramble for Africa* (London, Abacus, 1992) pp 78, 124, 128.

external to the productive process.[180] And they would have us see company law as a largely 'trivial' body of law which simply provides a set of contractual terms available 'off-the-rack', 'supplement[ing] but never displac[ing] actual bargains' struck by shareholders,[181] when it actually plays a crucial role in the *constitution* of financial property forms such as shares – income rights divested of obligation or responsibility – and a more modest one in seeking to ensure their continued integrity. As a result, contractual analyses do not do a great deal to help us better understand either corporations or company law as it applies to them. Nor, perhaps, are they intended to. For in urging us to adopt this way of seeing, they seek above all else to legitimate existing corporate arrangements and to immunise from critical scrutiny the income rights and residual control rights which enable a small minority worldwide to exercise growing coercive power over, and to appropriate a grossly disproportionate part of the fruits of, an increasingly socialised productive process. Their message is clear: there is no need for a fundamental re-examination of existing arrangements as their market-contractual nature ensures that they are essentially 'efficient'. From which it follows that any moves to dilute shareholder primacy or to introduce 'stakeholding' elements, drawing perhaps on the less shareholder-oriented German and Japanese models of the corporation, should be fiercely resisted.[182]

Analytically, however, the contractual account of corporations has begun to unravel. In recent years, in the wake of Enron et al and the problems encountered in 'transition' economies, it has become increasingly difficult to conceal the limitations of private contracting: the indispensability of extensive legal and other regulation to the construction and maintenance of financial property is ever more evident. It has become clear that while contractualists are, therefore, right to assume that company law is about the protection of financial property and the interests of investors, they are quite wrong to claim that investors are largely responsible for protecting themselves using 'private', contractual mechanisms. Although realisation of this has softened the out-and-out contractualism of US corporate scholarship, however, it has left untouched its unwavering and uncritical commitment to the maximisation of shareholder-wealth: good investor protection is regarded as synonymous with good corporate governance; and shareholder wealth maximisation as synonymous with 'efficiency'.[183] But the ideological camouflage is thinning. As regulation is increasingly advocated not as a means to efficiency as an abstract end in

180. It is worth noting that this is true even in the 'blockholding', concentrated share-ownership systems of Europe, where financial institutions rarely perform with any vigour the monitoring roles that are sometimes (theoretically) ascribed to them: see the discussion in J C Coffee 'Liquidity versus Control: The Institutional Investor As Corporate Monitor' (1991) 91 Col LR 1227. See also n 76 above.

181. Easterbrook and Fischel, n 6 above, p 34.

182. On stakeholding, see eg J Kay and A Silberston 'Corporate Governance' (1995) National Institute Economic Review 84; J Parkinson 'Company Law and Stakeholder Governance' in G Kelly, D Kelly and A Gamble et al (eds) *Stakeholder Capitalism* (London: Macmillan, 1997).

183. There is, of course, an important 'progressive' strand of US scholarship which is less relentlessly shareholder oriented. See eg the contributions to L Mitchell (ed) *Progressive Corporate Law* (Boulder: Westview, 1995); and L Mitchell *Corporate Irresponsibility: America's Latest Export* (New Haven: Yale University Press, 2001).

itself, as a mechanism for dealing with 'market failure', but as an efficient means (and, indeed, precondition) to the very specific and concrete end of protecting investors and financial property,[184] corporate governance appears less a realm governed by a transhistorical economic logic (contract and market-generated 'efficiency') than a realm of policy choice (purposeful public regulation). In short, the growing recognition of the role of regulation in constituting and maintaining financial property forms not only highlights the limitations to private contracting, it brings to the fore the political dimensions of corporate governance.[185] This

184. It is now recognised, eg, that financial property interests are (at least at present) configured differently in different places and that their protection may, therefore, require different strategies in different contexts. Thus, John Coffee questions the claim that the explanation for the failure of dispersed-shareholder corporations to emerge in continental European jurisdictions is to be found in weaker investor protection (see La Porta, Lopez-de-Silanas, Shleifer et al, n 4 above), arguing that the regulatory regimes of civil law systems may, in fact, simply be designed to offer protection against the specific kinds of abuse – such as abuse by a dominating parent company – suffered when financial property ownership is concentrated: see Coffee, n 163 above. Appreciation of complexities of this sort has thrown the convergence debates into some disarray. Thus, while some still hang on to an Anglo-American superiority thesis, others now argue that convergence is likely to be functional rather than substantive in nature, and others posit the possible emergence of a hybrid best-governance practice, which draws on different governance regimes; still others posit an 'equal competitive fitness' hypothesis: see W W Bratton and J McCahery 'Comparative Corporate Governance and the Theory of the Firm: The Case against Global Cross-Reference' (1999) 38 ColJ Transnat L 213. See also the essays in J McCahery, P Moerland, T Raaijmakers et al (eds) *Corporate Governance Regimes – Convergence and Diversity* (Oxford: Oxford University Press, 2002).

185. In the US some of the political aspects of governance have been highlighted by Mark Roe, who, along with Lucian Bebchuk, has for some time argued that political forces shape and constrain economic evolution and that so-called 'path dependency' is capable of tempering or overcoming the economic forces pushing for convergence towards the US model: see eg L Bebchuk and M Roe 'A Theory of Path Dependence in Corporate Governance and Ownership' (1999) 52 Stan LR 127. Observing that there are many European countries where concentrated ownership ('blockholding') persists despite 'high quality' corporate law, Roe suggests that one of the main reasons for this is to be found in the disposition of class forces within them. Social democracies are characterised by 'anti-shareholder ideologies', he says, with the result that both the shareholder-primacy norm and 'shareholder-wealth maximization institutions' are weaker. This, he argues, loosens the ties between managers and shareholders, which in turn encourages blockholding (for defensive reasons) and acts as an impediment to the emergence of dispersed-shareholding corporations and developed securities markets. It also, he suggests, has significant distributional consequences: what is lost by shareholders 'may be gained on the shop floor'. Although Roe tends to treat these political factors as *constraints* on the operation of a non-ideological, market-based, efficiency-producing economic rationality divorced from politics, he concedes that 'the solidarity and equality in these nations may make more citizens happier', and that these societies 'may in the long run be more stable and productive than they would be otherwise'. Although the internal structure of public firms may be weaker for shareholders in social democracies, therefore, 'life may well be better for more people', so it is 'hardly a reason to condemn [them]'. See M Roe 'Political Preconditions to Separating Ownership from Control' in McCahery, Moerland, Raaijmakers et al (eds), n 184 above; 'Corporate Law's Limits' (2002) 31 JLS; 'The Shareholder Wealth Maximization Norm and Industrial Organization' (2001) 149 U Penn LR. For an interesting discussion of Roe's work in the British context, see B Cheffins 'Putting Britain on the Roe Map: The Emergence of the Berle and Means Corporation in the United Kingdom' in McCahery, Moerland, Raaijmakers et al (eds), n 184 above.

makes it much harder to dismiss the questions that stakeholders have sought to raise. If corporate governance is as much a matter of regulation as of private contracting (and inevitably so), as much a political as an economic matter, it seems perfectly appropriate to ask in whose interests and for what purposes should we regulating?

Revising corporate property

In highlighting the need to consider the interests not only of shareholders but of other corporate constituencies, stakeholders have redirected attention towards the crucial issue of regulatory purpose and, in particular, towards the initial constitution and allocation of rights in and over corporations. If their analyses have been blunted by a tendency to want to add new rights rather than to take existing rights away, by a reluctance directly to question the established rights of shareholders,[186] they have nevertheless mounted a serious and welcome challenge to the obsessive focus on shareholder wealth maximisation. As Robert Hale would doubtless have pointed out, however, a questioning of vested rights and the existing beneficiaries of public regulation cannot be avoided if we are to engage in serious and open-minded policy debate.

Hale was not against private property per se, but he did see it as in urgent need of revision: if property is not revised methodically by its friends', he argued, 'it is likely to be revised unmethodically by its enemies'.[187] He saw property rights as contributing vitally to individual freedom and autonomy, as well as providing potentially valuable mechanisms for creating incentives, stimulating productive activity and regulating consumption. He insisted, however, that we recognise that they are *social* institutions and, as such, mutable and contingent devices to be deployed for a range of different purposes. For this reason, he objected strongly to the use of arguments based upon abstract notions of 'natural' right and freedom of contract, particularly when they substituted for the complex, context-specific deliberations that the legal creation and disposition of state-backed, power-granting, coercive, private rights demands. Policy formulation, in Hale's view, needed to encompass complex questions of social welfare, productive efficiency, individual liberty, justice and wealth distribution. He called therefore for a 'frank examination' of the functions of private property in order to 'work out a body of law for the revision of property rights where they need revision, and for their preservation where they need preserving'. Policy deliberation needed to encompass the initial constitution and allocation of rights, not merely the ex post 'regulation' of existing rights otherwise treated as unproblematic givens.

Hale conceded that the results of such a process might be radical, but argued that if this were so 'it would be because on a piecemeal and candid review, many of the incidents of property would prove themselves without

186. For an elaboration of this point in the context of a critique of stakeholding, see P Ireland 'Corporate Governance, Stakeholding and the Company: Towards a Less Degenerate Capitalism?' (1996) 23 JLS 287.
187. R L Hale 'Rate Making and the Revision of the Property Concept' (1922) 22 Col LR 209 at 216.

justification'.[188] The rights of property had to 'prove themselves on examination in each particular case and submit to modification where a balance of gain for the public can be reasonably expected'.[189] He recognised that such an examination would undoubtedly impact on vested rights, but observed that 'the more perfect the guaranty against any loss of property value, the greater the burden on the non-propertied classes',[190] words even truer now than then. In this context, he drew an important distinction between 'property-for-use and property-for-power', arguing that 'when the owner of things uses those things himself, the legal arrangement which restricts the liberty of the non-owners promotes an interest of a very different sort from that promoted when the owner does not himself use the things owned'.[191] In the case of property-for-power, of which income rights were a prime example, the function of property rights is not to promote the interests of owners in personal use of the things owned, but to enhance their bargaining power and to enable them to 'squeeze an income out of the community'.[192] At present, he observed, 'some men have law-given rights over others which enable them to collect large incomes from the community, others have law-given rights which enable them to collect little or nothing at all'.[193] For this reason, he believed income rights needed to be subjected to particularly close scrutiny.

In light of the massive regulation which already surrounds the protection of corporate income rights, and of the distributional and other consequences of trying to maintain and, indeed, extend them in their current forms, we need more than ever the 'frank examination' called for by Hale. We need to look critically and open-mindedly at the ways in which both income and control rights in and over corporations are constituted and allocated, taking account of a wide range of policy concerns, including their impact on wealth creation and productivity, on working conditions, on the channels into which industry flows, on social welfare and on income distribution.[194] As Hale noted, although economics can help us to trace the consequences of different courses of action,

188. Hale, n 187 above, at 216.
189. R L Hale 'Political and Economic Review' (1924) 10 American Bar Association J 51.
190. R L Hale 'Value and Vested Rights' (1927) 27 Col LR 523 at 528.
191. Hale, n 145 above, pp 136–137, drawing on L T Hobhouse 'The Historical Evolution of Property, in Fact and in Idea' in Bishop of Oxford (Introduction) *Property: Its Duties and Rights* (London: Macmillan, 1915).
192. Hale, n 141 above, at 489.
193. Hale, n 142 above, at 215. 'Most of our present distribution of wealth is the result of the relative power, latent or active, of various individuals and groups. The power itself is derived in part from law's more or less blind and haphazard distribution of favours and burdens, in the shape of powers over others and obligations to others', Hale, n 143 above, at 455.
194. 'The owner of every dollar', Hale observed, 'has, by virtue of his law-created right of ownership, a certain amount of influence over the channels into which [productive activity is directed]'. Today, it is more obvious than ever that those with the most money exercise the most control over these channels and that the less pressing needs of the rich have far greater influence over them than the more pressing needs of the poor: Hale, n 141 above, at 490–491. For an analysis of the relationship between and distributional impact of different models of finance and production and different approaches to social welfare and social security, see R Minns *The Cold War in Welfare: Stock Markets versus Pensions* (London: Verso, 2001).

it cannot alone give decisive answers to the policy questions involved. Ultimately, 'the final judgement is an ethical one'.[195]

In conducting such a re-examination we would not be navigating completely uncharted territory: there is work that can be drawn upon to help to map a route forward. In his 1961 book, *The Responsible Company*, for example, 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. Crucially, he recognised that meaningful reform required erosion of the residual control rights of shareholders and, with this, erosion of the existing proprietary foundations of company law: the conception of the public company that he had in mind was unattainable as long as such companies were seen as private property. He frankly admitted, therefore, that 'a certain subordination of the shareholder interest would be required' to realise his conception, something he considered perfectly justifiable. Observing that they were no longer major providers of new corporate capital and that the risks they took were now minimal, Goyder likened them at various points to money-lenders, creditors and userers, arguing that their rights in corporations and claims over corporate income ought to be limited. In his view, corporate shareholders were entitled, at most, to a fair return on their investment, on which basis he advocated voluntary dividend limitation or, if this proved ineffective, limitation by statute. He even questioned the legitimacy of their claim to a perpetual return. Mooting the possibility of the compulsory amortisation of risk capital, he observed that historically it had long been thought 'contrary to natural justice to demand a perpetual yield of interest'; there was much to be said for the view that 'the perpetual share is unnatural and contrary to the underlying principle of law itself, which is that of right or justice'. Although he still held to the view that the shareholder interest was the most important – profitability was, for Goyder, still the primary test of a company's health – it was not the only one that needed to be considered. When companies 'went public', their nature changed: they became public institutions with social responsibilities and duties to discharge, not least towards a range of other groups entitled to corporate membership and corporate rights.[196] A few years later, K W (later Lord) Wedderburn, lamenting the lack of radicalism of the Jenkins Committee report, argued a similar case. Company law, he insisted, 'should *not* treat the shareholder as a "proprietor" entitled to control'. On the contrary, there was 'no reason not to equate [the shareholder's] position with that of a well secured creditor' because for the vast majority 'the function that made them in law "members" ha[d] in reality disappeared'. As a result, while the case for workers' corporate membership was strong, only in companies where shareholders genuinely helped to make management accountable should they retain their status as 'members or proprietors'.[197] Ideas of this sort, which recognise the divisibility not only of income but also of control rights are worthy of revival. Indeed, in light of the current concern with executive pay and its seeming lack of connection to performance (let alone to the pay of ordinary workers), it might

195. Hale, n 142 above, at 225.
196. G Goyder *The Responsible Company* (Oxford: Blackwell, 1961) pp 21, 79, 105.
197. K Wedderburn *Company Law Reform* (London: Fabian Society, 1965).

be time to dust off the Bullock report and reconsider its proposals for the introduction of worker directors.

Some concluding thoughts: property, pensions and sofas

Some years ago, newspapers in Britain featured an advertisement depicting a man lying on a sofa. We were told that, contrary to appearances, he was working and, indeed, working highly profitably. The small print explained that this was because he had been wise enough to invest his money in a particular financial institution, with the result that as he lay there, seemingly idle, he was in fact making a great deal of additional money thanks to the prudent investments that had been made on his behalf. His money was, so to speak, working for him, albeit in places and ways of which he almost certainly had no knowledge and little interest. Moreover, it was working incessantly, for money, as another advertisement recently pointed out, 'never sleeps'.

In reality, of course, the man lying on the sofa was *not* working. But someone, somewhere, certainly was. Indeed, it was these unknown others, dotted no doubt around the globe, working in unknown industries, for unknown wages and in unknown conditions,[198] who were generating the wealth to which the sofa-bound man was entitled to lay (partial) claim by virtue of his ownership of income rights like the joint stock company share. In its way, therefore, the sofa in the advertisement was curiously revealing of the fetishised nature of financial property and interest-bearing capital (money appears to make more money by itself) and the social relations underlying it (it is only able to do so when certain social relations prevail). It was also revealing of the *ir*responsibility that is built into the prevailing structure of corporate rights and the regulatory institutions that support them, for it is precisely the no-obligation, no-responsibility, no-liability nature of corporate income rights which enables their owners to relax on sofas, blissfully ignorant of and uninterested in precisely how the dividends and interest accruing to them is generated. As Harry Glasbeek observes, 'the shareholders in ... corporations have little financial incentive to ensure that the managers involved behave legally, ethically, or decently . . . [because] in law, [they] are personally untouchable ...'[199]

198. 'If I were to trace back where my dinner came from', writes David Harvey, 'I would become aware of the myriads of people involved in putting even the simplest of meals on the table. Yet I can consume my repast without having to know anything about them. Their conditions of life and labour, their joys, discontents and aspirations remain hidden from me. This masking arises because our social relations with those who contribute to our daily sustenance are hidden behind the exchange of things in the market place ... There is no trace of exploitation upon the lettuce, no taste of apartheid in the fruit from South Africa': *The Urban Experience* (Oxford: Blackwell, 1989) p 8. This experience was, of course, the basis of Marx's idea of commodity fetishism.

199. H Glasbeek *Wealth By Stealth: Corporate Crime, Corporate Law and the Perversion of Democracy* (Toronto: Between the Lines, 2002) p 129. Glasbeek's book offers an excellent and sustained analysis of the structures and consequences of corporate irresponsibility. The 'driving goal' of the 'irresponsible [sofa-bound] shareholder' is profit maximisation, so it is hardly surprising that corporations are 'criminogenic', disposed by their nature to engage in unethical and criminal activity. See also Mitchell (2001), n 183 above, arguing that limited liability breeds irresponsibility and describing the US corporation as the 'perfect externalizing machine'.

Challenging the rights vested in shareholders will, of course, be very difficult for some to imagine, let alone endorse. It will also be very difficult to achieve politically, not least because although ownership remains heavily concentrated in the hands of a small minority,[200] in recent years the number of those possessing modest amounts of financial property has increased as a result of the growth in private pensions. Indeed, pension funds of various sorts have figured prominently in the new stock market and corporate governance culture, strengthening financial property's political power-base and influence at both the national and international levels, and leaving their mark on many aspects of social and economic policy. As more and more people have been encouraged to purchase income rights for their retirement,[201] the needs and demands of financial institutions have become one of the major forces behind the push for the extension of Anglo-American, stock market-based shareholding structures and the dismantling of any residual stakeholding elements in governance worldwide. The search for profitable outlets for the growing volume of what Richard Minns calls 'social security capital' has increased the pressure for the creation of more and more publicly tradable financial property, fuelling the demand for more privatisation and the opening up (creation) of (new financial) markets.[202] Paradoxically, what is usually demanded to this end is *more* rather than less 'regulation', regulation aimed at creating new financial property, at facilitating its ease of movement and at protecting it from fraud, manipulation and, increasingly importantly, from any government interventions which, whatever their social purpose, might adversely affect its value by threatening the income streams flowing to it. In Hale's terms, the effect of the regulatory changes which have been taking place has been to increase the coercive power of financial property owners – their ability to withdraw and withhold or to move their property with impunity – enabling them to increase the income they 'squeeze out of the community'. Slightly less pejoratively, Minns argues that the purpose of pension funds is to enable some 'future pensioners' to claim, through their ownership of financial property, 'a greater share of world economic growth'.[203] From this perspective, the convergence towards Anglo-

200. See n 178 above; and also K Phillips *Wealth and Democracy* (New York: Broadway Books, 2002), which offers a wealth of statistical information; and R Blackburn *Banking on Death or Investing in Life: The History and Future of Pensions* (London: Verso, 2002) p 6. The economist Edward Wolff, assessing the recent tax plans of President Bush, estimated that the top 10% in the income spectrum hold approximately 85% of the value of taxable stocks and mutual funds; the top 1% hold about 49%.

201. Particularly those in countries where state-provided pensions are minimal and/or shrinking: the US, UK, Netherlands, Ireland, Switzerland, Australia, Chile, South Africa and Canada all now have pension arrangements which are significantly reliant upon private investment. For an account of the different models for pension provision, see Minns, n 123 above, pp 1–22.

202. Minns, n 123 above, pp 31–34. The problem is that the returns on investments in the developed world have fallen, partly because of reduced profitability (see Brenner, n 9 above) and partly because increasing demand, particularly from institutional investors, has pushed the prices of income rights up. Emerging markets are seen as potential sources of higher yield financial property, hence the increased flows of private capital into developing countries. It is not insignificant, perhaps, that in certain quarters the terms 'developing countries' and 'emerging markets' are used interchangeably.

203. See Minns, n 123 above, pp 132, 137.

American structures for which some see growing evidence[204] seems rather less efficiency-oriented than some would have us believe.

If the changes that these pressures have wrought have often been disastrous for many of the non-propertied, particularly those living in developing countries or countries overtaken by financial crises, they have been far from unequivocally beneficial to the new labour aristocracy composed of those (like myself) who own modest amounts of financial property. For, in contributing to the spread and intensification of the dynamic and destructive logic of capitalism, the growing power of financial property exemplified by the rise of institutional investment and private pensions has come at a price, even in the developed world: reduced job security, increased workloads, shrinking welfare states, declining state pensions and so on.[205] More secure, decently paid, satisfying and enjoyable working lives have been traded for the hope of a reasonable income on retirement, a hope which, amidst a growing pensions crisis, looks for many increasingly forlorn. The attainability of financial security on retirement – a retirement which now seems likely to come somewhat later in life – is in doubt even for many among the privileged minority as both interest rates and yield ratios fall, generating a sharp decline in the income generated by investment portfolios and annuities. It remains to be seen whether this can be reversed (and, if so, at what cost) or, if it cannot, what the future social, economic and political consequences might be. It may not preface Keynes' 'euthanasia of the rentier',[206] but it is quite possible that even in the prosperous, developed regions of the world, those who have a strong vested interest in the preservation of shareholder primacy and shareholder income rights, at least in their present forms, will diminish in number. It is not insignificant, perhaps, that some corporate governance specialists in the US are now arguing that the Anglo-American, shareholder-oriented, stock market-based, public corporation may be incompatible with social democracy.[207]

In the meantime, we need to re-examine the way in which we understand corporations and company law, and to recognise that because of the radically different economic natures of incorporated companies, company law cannot intelligibly be understood as a single, unified entity. Broadly speaking, we

204. See the essays in McCahery, Moerland, Moerland, Raaijmakers et al (eds), n 184 above. See also C Lane 'Changes in Corporate Governance of German Corporations: Convergence to the Anglo-American Model?' (2003) Centre for Business Research (University of Cambridge) Working Paper 259.

205. See W Seccombe 'Contradiction of Shareholder Capitalism: Downsizing Jobs, Enlisting Savings, Destabilizing Families' in L Panitch and C Leys (eds) *Socialist Register* (Rendlesham: Merlin, 1999) p 76. It is also far from clear whether the Anglo-American system of finance and production actually encourages the future productive growth upon which retirement provision ultimately depends: see Minns, n 123 above, esp ch 6, for a discussion of the evidence.

206. Keynes disapproved of money making money and anticipated the possibility of the 'marginal efficiency of capital in equilibrium' (its profit) falling 'approximately to zero'. 'A little reflection', he went on, 'will show what enormous social changes would result from a gradual disappearance of a rate of return on accumulated capital ... It would mean the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative, oppressive power of the capitalist to exploit the scarcity of capital'. See D E Moggridge *Maynard Keynes: An Economist's Biography* (London: 1992) pp 220–221, 376.

207. Roe, n 185 above.

now have two very different bodies of company law. One contract-based; one property-based. One dealing with smaller private companies in which shareholding is personality-rich and central to which, as the courts have increasingly recognised, is the enforcement and protection of the essentially in personam, contract-based rights of shareholders; and another aimed at protecting the personality-poor income (property) rights of rentier shareholders in large, publicly quoted, joint stock corporations.[208] The boundaries of this second body of *corporate* company law need to be redefined. As Ben Pettet observes, for example, although securities regulation is not usually considered part of company law, this makes little sense given that securities regulation is one of the most important ways in which the law seeks to protect corporate shareholders.[209] However, to admit into corporate company law securities regulation and the many legal and other regulatory institutions and processes designed to secure the integrity of corporate income rights would undermine attempts to insist upon the fundamentally private, contractual nature of corporations and highlight the accuracy of Hansmann and Kraakman's assertion that 'at its core organizational law is property law, not contract law'. Indeed, it is likely to do so in ways rather more radical and disturbing than they intended.[210] For to focus on the role of company law in the constitution of financial property and on the highly complex and costly legal and institutional processes whereby these property forms (and their value) are maintained might draw one into the social-relational aspects of corporate property and, in doing so, reorient the debates about corporate governance. It might lead us to take seriously the separate legal personality of the corporation as an asset-owning entity – the basis of the no-obligation, no-responsibility shares owned by shareholders – and, with it, the 'complete separation' of corporations and shareholders. And it might highlight the sharp contrast between the fundamentally social nature of productive activity in contemporary capitalism and the continued private appropriation of productive surpluses. In short, it might serve to shift the focus of the debates on corporate governance towards precisely the terrain that the contractualists are so anxious we vacate.

208. In reality, of course, not all companies will readily fit either of the two categories: what we have is a spectrum and difficult questions of classification will inevitably arise, as the Company Law Review recognised. An approach to the study of company which in certain respects resembles what is proposed here was pioneered by Tom Hadden in his *Company Law and Capitalism* (London: Weidenfeld & Nicolson, 2nd edn, 1977).
209. See Pettet, n 65 above, pp 6–9, 331ff.
210. Hansmann and Kraakman, n 8 above.