

Draft

Company Law and the Myth of Shareholder Ownership

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In recent years, the rather arcane subject of corporate governance, meaning the governance of the public companies that dominate the economy,² has risen high on the political and legal agenda. Various reasons for this can be identified, prominent amongst them the debates, with which the governance issue has become entwined, about the virtues in relation to both social welfare and international competitiveness of different versions of capitalism and the corporation. As company lawyers are well aware, diverse opinions have emerged, with some advocating the adoption of a legal model of the company based around so-called stakeholding principles akin to those said to be found in Germany and Japan, while others seek to reinvigorate the traditional, shareholder-oriented, Anglo-American model.³ Despite these differences, however, there is widespread agreement that shareholders have an important role to play in ensuring good governance. For some, good governance requires a restoration of shareholder supervision and control.⁴ For others, including many supporters of 'stakeholding', it should not be judged purely in terms of maximising 'shareholder value' but still requires more 'committed' ownership by shareholders, if only to eradicate the danger of 'short-termism'.⁵ In keeping with this, the Labour government has recently asserted the need for more active and less fickle shareholding and has for some time been toying with the idea of making voting at company general meetings compulsory for institutional investors.⁶

Underlying this consensus is a shared assumption: that the shareholders of large corporations 'own' the companies concerned;⁷ or in the 'nexus of contracts' or 'agency' theory of the company, in what

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² This article uses the terms 'corporation' and 'corporate' to refer to large public companies, and 'corporate governance' to refer to the general control and accountability of corporate executives rather than issues of day-to-day management. Concern with corporate governance is a largely Anglo-American phenomenon.

³ Compare, for example, John Parkinson, 'Company Law and Stakeholder Governance' and David Willetts, 'The Poverty of Stakeholding' in Gavin Kelly et al (eds) *Stakeholder Capitalism* (London: Macmillan, 1997).

⁴ '[E]ffective, internationally competitive corporate governance requires the efficient discharge of the ownership role', Allen Sykes, 'Proposals for Internationally Competitive Corporate Governance in Britain and America' (1994) 2 *Corporate Governance: An International Review* 187 at 194.

⁵ See, for example, Will Hutton, *The State We're In* (London: Jonathan Cape, 1995).

⁶ See Margaret Beckett (President of the Board of Trade), speech to PIRC, 4 March 1998.

⁷ Company lawyers, while generally skirting this issue, sometimes acknowledge that shareholders are not 'owners' of the company in the usual sense of the word. They tend to assume, however, that they have a proprietorial interest in the company akin to ownership, hence, for example, the widespread references to 'the separation of ownership and control'. Non-lawyers tend to be less hesitant. In the *Financial Times* (27 April 1998), for example, it was recently suggested that the idea that shareholders own corporations was 'the most basic tenet of the Anglo-Saxon view of capitalism'. Confirming this, a City correspondent of the *Guardian*, commenting recently on the behaviour of the directors of Lonhro, suggested that they had 'forgotten ... [the] principle of company law ... that shareholders *own* the firm and directors merely *run* it' (her emphasis). *Guardian*, 18 April 1998.

amounts to the same thing, that the shareholders own not 'the company' but 'the capital', the company itself having been spirited out of existence.⁸ It is natural corollary of this assumption that the interests of shareholders should take priority, if not complete precedence, over all others; and that shareholders should, as of right, have a substantial, if not an exclusive, say in the running of companies. As a result, stakeholders and others seeking significant governance reform are, in effect, placed in the position of asking shareholders to give up some of their ownership rights, or of trying to persuade them to exercise them in particular ('socially responsible') ways, either by arguing that it will be in their own best long-term interests to do so, or by appealing to their altruism.

However, despite the general acceptance of the 'ownership' assumption, the legal nature of the share and shareholding are surrounded by uncertainty. As L.C.B. Gower says, the share does not readily fit into any 'normal legal category'.⁹ Company lawyers are clear what a share is *not* - apart from when a company is wound up, a rare occurrence in the case of a public company, it is not an interest in the corporate assets.¹⁰ But they are much less clear what it actually *is*. The question 'what ... is the exact juridical nature of the share', Gower observes, 'is ... more easily asked than answered'. It is, perhaps, for this reason that 'a definition of shares ... is something which text books have rarely attempted',¹¹ though given the importance in the modern world of the share as a form of property and its position at the heart of company law, mediating the relationship between companies and their shareholders, this is rather curious. Moreover, as many have pointed out, it is in many ways equally difficult satisfactorily to distinguish shareholders from debenture holders. In 'legal theory' they are 'rigidly separated', but 'in economic reality [they] merge into each other, ... [a] close examination of the rights conferred by [them] show[ing] the impossibility of preserving any hard and fast distinction between them which bears any relation to practical reality'.¹² Rarely are these problems explored in any depth, however, one of the unfortunate effects of the relatively uncritical acceptance of the 'ownership' assumption having been to foreshorten and substitute for analysis. This article seeks to lift the carpet of 'ownership' under which they have been swept and, in so doing, hopes to shed light on some of the conceptual and theoretical conundrums that beset modern company law and to clarify some of the issues underlying the governance debate.

⁸ In a company law equivalent of Mrs Thatcher's 'there is no such thing as society...', supporters of the 'nexus of contracts' theory argue that there is no such thing as the company only contractual arrangements between the individual actors involved in the firm. As I later explain, this circumvents rather than resolves the corporate ownership problem. For an exposition of the contractual theory of the corporation, see F. Easterbrook & D. Fischel, *The Economic Structure of Corporate Law* (Cambridge Mass: Harvard UP, 1991), chapter 1, and for an application of these ideas to British company law, see Brian Cheffins, *Company Law: Theory, Structure and Operation* (Oxford: Clarendon Press, 1997). For a critique arguing that 'the company' as constituted by these theories is composed not of a nexus of contracts but a miasmatic nexus of metaphors, see David Campbell, 'The Role of Monitoring and Morality in Company Law: A Criticism of the Direction of Present Regulation' (1997) 7 *Australian Journal of Corporate Law* 343.

⁹ Paul Davies, *Gower's Principles of Modern Company Law* (London: Sweet & Maxwell, 6th ed 1997) 299, 321. The most recent edition of Gower was produced by Paul Davies, but the sections referred to in this article are largely unchanged from early editions and I will, therefore, attribute the views expressed to Gower rather than to Davies.

¹⁰ *Short Bros v Treasury Commissioners* [1948] 1 KB 116.

¹¹ 10 *Company Lawyer* (1989) 140.

¹² Gower, n 9 above, 301. Paradoxically, this 'economic reality', recognition of which ostensibly weakens the claims of the corporate shareholder, finds some expression in 'nexus of contracts' theories of the company which seek to assert the ultimate supremacy of the shareholder interest.

Usury and the concept of partnership

'Of all the branches of law', Gower writes, '[company law] is perhaps the one least readily understood except in relation to its historical development'.¹³ Nowhere is this truer than in relation to the sharp theoretical line drawn within company law between the investors who 'in economic reality merge into each other' - the line between shareholders standing *inside* the company with rights *in* it and creditors standing *outside* the company with rights *against* it; between those who 'own' and those who are merely 'owed'. For this line can only properly be understood historically, by reference to the impact of the usury laws on the concept, and later the law, of partnership.

Although the term usury eventually came widely to be used to describe any extortionate bargain, in its original sense it involved loaning money for interest. The usurer was thus an antiquated version of what Marx later called the money capitalist, the only significant difference between usurer's capital and interest-bearing or money capital lying not in their form (both entail a movement from M - M'¹⁴) but in the social relations of production within which the money moves. Frowned upon in Greek and Roman times and completely prohibited in the Middle Ages, the taking of interest on loans was later permitted but rates of return regulated by statute, at which point usury came to be identified with the taking of excessive interest rather than with taking interest *per se*. To the modern mind, with its acceptance of the intrinsic productivity of money, this antipathy to 'investment', to money as capital, seems a rather anachronistic theological prejudice, a quaint, pre-modern, superstition. In this context, the survival of the usury laws into the nineteenth century¹⁵ appears rather odd, an example of law lagging behind economy. However, while the hostility to usury can be traced back to biblical sources¹⁶ and came to constitute one of the principal elements of canon law, it had social and political, as well as religious, underpinnings. These were influentially outlined by Aristotle¹⁷ and remain relevant today.

For Aristotle, exchange was central to the social intercourse which made community, the pre-requisite of human happiness, possible. By providing a standard of commensurability for unlike things, money facilitated exchange and thereby made an important contribution to social bonding. Usury, Aristotle argued, undermined money's ability to perform these functions and subverted the fairness in exchange which was 'the salvation of states'. It was, he claimed, 'unnatural', for money was inherently *unproductive*. Lacking genitals - 'organs for generating any other such piece', as Bentham put it¹⁸ - money was sterile and barren; of all the ways of getting wealth, 'money produced out of money ... was the most contrary to nature'. The usurer made money without working for it, taking, in the form of interest, part of the product of the labour of others. Moreover, Aristotle argued, usury was also unnatural in the sense that the acquisition of money tended towards infinity and endless multiplication, encouraging greed for its own sake. One could, like Midas, have an abundance of money and yet still perish from hunger. For Aristotle, therefore, usury undermined justice in exchange, corrupted market relations and subverted

¹³ Gower, n 9 above, 18.

¹⁴ Marx characterised the underlying motion which typified capitalist production as involving the circular movement of capital from the capitalist through the process of production back to the capitalist. He expressed this circuit as M - C - P - C' - M', where M represents money, C represents commodities (means of production and labour power), and P represents production. The ' represents an expansion in value, so that the difference in magnitude between M and M' marks the capitalists profit.

¹⁵ They were not finally repealed in Britain until 1854.

¹⁶ See, in particular, Luke, 6:35 (mutuum date nihil inde sperantes, 'lend, hoping for nothing thereby'); in the Old Testament, see Exodus, 22:25; Deuteronomy, 23:19; Ezekial, 18:17; 22:12; Nehemiah, 5:5.

¹⁷ Aristotle, *Politics* I, 8-10; *Nicomachean Ethics* V, 5.

¹⁸ Jeremy Bentham, *Defence of Usury* (1787), in *The Works of Jeremy Bentham, Volume III* (New York: Russell & Russell, 1962) 16.

the ethical roots of social, political and economic order.¹⁹ There were many later expressions of this view, among the most vivid that found in *The Divine Comedy*, in which Dante located usurers, their faces charred beyond recognition by fiery rain, in the seventh circle of the *Inferno* at the very edge of the second division of hell to reflect 'the degree to which [their] particular offense destroy[ed] communal life and the possibility of spiritual happiness...'.²⁰ In marked contrast to modern legal systems, Dante treated fraud more harshly than violence precisely because it eroded the trust and confidence without which community would disintegrate. The theory of usury which emerged in the Middle Ages was 'not, then, an isolated freak of casuistical ingenuity, but [a] subordinate element in a comprehensive system of social philosophy'.²¹

The legal antipathy to usury can be traced back at least as far as Roman law. However, not only did Roman law permit usury as long as the interest charged was not excessive, it distinguished potentially usurious contracts of loan (*mutuum*) from other transactions in which payment for the use of money was considered legitimate, prominent amongst them the contract of partnership (*societas*).²² Over time, as trade expanded and money came increasingly to be borrowed as well as lent as capital (rather than to meet an immediate material need), the legitimacy of many forms of 'investment' was established through an expansion of the scope of concepts such as partnership and a corresponding narrowing of the concept of the (potentially usurious) loan. The result was the legal constitution of many inactive providers of money as 'partners' rather than 'lenders', essentially on the grounds that they put their capital at risk. The concept of partnership that emerged - the 'one great and universal form of licit investment in commerce throughout medieval Europe' - entered scholastic thought 'largely in the form given it by Roman law'.²³ Despite their desire to prohibit usury, therefore, for most canonists and jurists 'there was a world of difference between usury, [profit obtained from] a contract of loan ..., and justifiable returns derived from partnerships, where there was a sharing of risk and venture of the capital'.²⁴ Nevertheless, there was much disagreement (and confusion) among them as to the status of some contractual arrangements in which money was provided in return for a reward, particularly those in which the liability

¹⁹ See Scott Miekle, 'Aristotle and Exchange Value', in David Key and Fred Miller (eds.) *A Companion to Aristotle's Politics* (Cambridge Mass: Blackwells, 1991), 156-181.

²⁰ Judith Schenk Koffler, 'Capital in Hell: Dante's Lesson on Usury' (1979) 32 *Rutgers LR* 609 at 619. The usurers were recognisable by virtue of the coats of arms on their purses, suggesting that the usurers that Dante had in mind were not petty consumption lenders but the great international merchant bankers of the day.

²¹ R.H. Tawney, *Religion and the Rise of Capitalism* (1926; Harmondsworth: Pelican, 1938) 145.

²² See Reinhard Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Oxford: Clarendon Press, 1996) 153-187, 451-473.

²³ John Noonan, *The Scholastic Analysis of Usury* (Cambridge Mass: Harvard UP, 1957), 133-134. There is general agreement that the antipathy to usury influenced the development of the concept of partnership, although the extent of this influence is controversial. In *Studien in der romanisch-kanonistischen Wirtschafts- und Rechtslehre bis gegen Ende des 17. Jahrhunderts*, (2 Vols, 1874 & 1883), Wilhelm Endemann argued that although they were essentially loans, certain contractual arrangements (especially *commendas*) were brought by the canonists within their theory of partnership in order to circumvent the usury prohibition, a view later attacked by (among others) W.J. Ashley in his *Introduction to English Economic History and Theory* (London: Longmans, Vol 1, 1894) 411-421. Either way, it is clear is that the antipathy to usury, which predated the canonists, exerted considerable influence over the categorization of money-lending arrangements, including partnerships. See A.L. Udovitch, 'At the Origins of the Western Commenda' (1962) XXXVII *Speculum* 198.

²⁴ Benjamin Nelson, 'The Usurer and the Merchant Prince: Italian Businessmen and the Ecclesiastical Law of Restitution, 1100-1550' (1947) Supplement to *Journal of Economic History* VII 104.

of investors to third parties was restricted.²⁵ In 'analysing and systematising the law of usury for the first time', however, the canonists not only 'provided a rational foundation for the dramatic growth of commercial and financial life during the Middle Ages',²⁶ they developed a very spacious theory of 'partnership' based around ideas of risk and ownership. It was encapsulated by Aquinas: He who commits his money to a merchant or craftsman by means of some kind of partnership does not transfer the ownership of his money to him but it remains his; so that at his risk the merchant trades, or the craftsman works with it; and therefore he can licitly seek part of the profit thence coming as from his own property.²⁷

According to this theory, if an investor of money shared the risk of a venture, the arrangement ceased to be a loan and became a partnership. As Patrick Atiyah points out, the concept of risk employed was rather odd for nobody who lends money is ever guaranteed to get it back.²⁸ Under the theory, however, if, this inherent risk apart, the investor was promised his money back with an additional sum above that legally permitted, the transaction was a loan and potentially usurious. If, on the other hand, the return was neither guaranteed nor fixed in advance but depended on the success, or otherwise, of the venture, the investor was deemed a risk-taking partner. Usury thus entailed the idea of *certain* gain. As Aquinas emphasised, the issue of risk was itself bound up with the issue of ownership. In a loan arrangement, it was argued, the money lender *transferred* ownership of his money to the borrower, took a fixed and guaranteed return, and dispensed with the risk to his property; whereas in a partnership the provider of money *retained* ownership of his property and thus put it at risk. This not only justified his return, it made it possible to attribute it to the goods which the money had been used to buy, rather than to the sterile and barren money itself.²⁹ In this way, over time, the usury laws contributed to the radical differentiation of two sorts of money investor: 'lenders' *outside* associations receiving interest; and 'partners' *inside* associations sharing profits.

The teaching of the canonists on usury was received in significant part into civil law, and in England, where 'any transaction which involved usury was clearly illegal in medieval common law', as late as the seventeenth century English law's conception of usury remained derivative of canon law.³⁰ As the economic foundations of society changed, however, there gradually emerged more and more ways in which the usury laws could be circumvented and more and more methods of investment recognised as legitimate by both the religious and secular authorities, either by official declaration or by acquiescence. With this, the morality and legality of taking a return on money lent was increasingly accepted as long as only a moderate amount of interest and not *turpes usurae* had been charged. In a series of statutes

²⁵ As in the *commenda* (from the Latin *commendare*, meaning to entrust), the precursor of the French limited partnership, the *societe en commandite*. For the canonists, the main problems arose out of pure rentier investment, especially where it was 'riskless'. They had no difficulty with arrangements in which investors of money were involved in the management of ventures, for their gains could be attributed to labour and their profits deemed a particular case of wages. See generally Noonan, n 23 above, 133-153; Ashley, n 23 above, 377-488; and John Baldwin, 'The Medieval Merchant Before the Bar of Canon Law' (1959) *Papers of the Michigan Academy of Science, Arts, and Letters* XLIV.

²⁶ Zimmermann, n 22 above, 173.

²⁷ Cited Noonan, n 23 above, 143; see also Ashley, n 23 above, 419.

²⁸ P.S. Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford: Clarendon Press, 1979) 130.

²⁹ Noonan n 23 above, 152.

³⁰ A.W.B. Simpson, *A History of the Common Law of Contract* (Oxford: Clarendon Press, 1987) 114-116, 514-516. For details on the reception of canonist principles into English law, see Ashley n 23 above, 382-385, 460-470.

passed in the sixteenth century, English law came effectively to permit the charging of interest of up to 10% per annum,³¹ by 1713, however, this had fallen to 5 per cent, the level at which it remained for the rest of the century.³²

The result was that during the eighteenth century, the formative period of the modern English law of partnership,³³ the usury laws, still 'feared and ... far from obsolete',³⁴ continued to influence the characterisation of different forms of 'investment' in English law. Thus, although the law of partnership 'presumed that each partner was an active trader in a joint concern [with] full power to act as agent of his fellow partners'³⁵, in accordance with the 'risk' theory of partnership the legal status of inactive providers of money vis-a-vis third parties was determined by reference to the content of their financial return rather than by reference to their involvement (or otherwise) in the running of the concern. As Blackstone J explained in *Grace v Smith*:

the true criterion (when money is advanced to a trader) is to consider whether the profit or premium is certain and defined, or casual, indefinite, and depending on the accidents of the trade. In the former case it is a loan (whether usurious or not, is not material to the present question), in the latter a partnership.³⁶

Thus 'lenders' who received interest (a return 'certain and defined') were distinguished from 'partners' who received a share in profits (a return 'casual, indefinite and depending on the accidents of trade'), although both received the return on their capital in the same *form* - as a reward for the mere ownership of money. It followed that any investor whose return, even if described as 'interest', varied with the profits of a business was liable to be deemed a partner and fully liable for partnership debts,³⁷ as were clerks or managers who received a share of profits in return for their his services.³⁸ Partners were also deemed to have an interest in the partnership assets. At common law, they were treated as joint tenants or tenants in common of personal property belonging to the partnership, and as tenants in common of partnership land; in equity, partnership property was treated as though held by all the partners on trust to be used for the proper business purposes of the partnership.³⁹ The law of partnership thus came to embody a

³¹ For a summary of these provisions, see Simpson, *ibid* 513-518.

³² There were exceptions, for example in relation to the East Indies and the Bank of England. 'Loans' could also be taken outside the ambit of usury by constructing arrangements (such as the 'bottomry bond' and the 'undervalued annuity') in which the principal was 'hazarded', see Sybil Campbell, 'Usury and Annuities of the Eighteenth Century' (1928) 44 LQR 473 at 490.

³³ The first partnership text, William Watson's *A Treatise on the Law of Partnership*, was published in 1794. Others, by Basil Montagu, Neil Gow and John Collyer followed early in the nineteenth century.

³⁴ See Sybil Campbell, 'The Economic and Social Effect of the Usury Laws in the Eighteenth Century' (1933) *Transactions of the Royal Historical Society* 197 at 204.

³⁵ Michael Lobban, 'Corporate Identity and Limited Liability in France and England 1825-67' (1996) 25 *Anglo-American Law Review* 397 at 399.

³⁶ (1775) 2 Blackstone 997.

³⁷ *Waugh v Carver* (1793) 2 Wm. Blackstone 23.

³⁸ *Hesketh v Blanchard*, 4 East 144. The principal advantage of partnership was that there was no ceiling on the permissible return on investment; the disadvantages the absence of a 'guaranteed' return and, with English law failing to embrace the limited partnership, potential liability to third parties to one's 'last shilling and acre'.

³⁹ This equitable right to have partnership property applied in a proper manner became known as the

distinction similar to that elaborated by Marx between money capitalists, those who contribute funds, and industrial capitalists, those who utilise those funds in the production process.⁴⁰ Lenders were, in effect, deemed money capitalists (and, therefore, potential usurers) because they transferred ownership of their property and it did not, therefore, change in form before returning to them: the movement of their capital was M - M'. The capital of partners, on the other hand, even those uninvolved in management, was conceptualised as having moved through a productive circuit, M - C - P - C' - M'.⁴¹ Indeed, even in relation to inactive rentier partners, there was some justification for this characterisation. Most early partnerships had been transient affairs, created for a specific trading venture after which assets were sold and proceeds distributed, enabling partners periodically to liquidate their investment and gain access to their capital. By the later eighteenth century, however, as industrial enterprises grew in number, many partnerships were becoming more permanent affairs, with the result that the money of rentier investors was often tied up in productive assets for a prolonged period, giving those investors the character of industrial rather than money capitalists, despite the passive nature of their investment and lack of managerial involvement. Nevertheless, while the usury laws were in force, there was a 'tendency ... to treat what was in truth a loan at usurious interest, and therefore illegal, as a contract of partnership and therefore legal'.⁴² Indeed, to some partnership lawyers writing later in the nineteenth century, some of these arrangements involved not true partnerships but loans, suggesting to them that the canonical justification of them and the theory of partnership upon which it was based was deeply hypocritical.⁴³

The personified company and shareholder ownership

In order fully to grasp the significance of these developments for company law, it is important to remember that what we now call 'company law' began life in the early nineteenth century as 'joint stock company law', meaning the body of law applicable to joint stock companies, and that until the latter half of the century, it was considered and treated as an adjunct of the law of partnership. Although founded upon the partnership principle of trading on a joint account, the joint stock company was distinguished from the 'ordinary' partnership on the basis of its economic, rather than its legal, characteristics. Crucially, the rentier investor, who could be accommodated within the ordinary partnership but who was largely peripheral to it, lay at the heart of the joint stock company. Characterised by large numbers of inactive shareholders, by increasingly specialist managers and by freely transferable shares⁴⁴ - the essential features of the modern 'public company' - joint stock companies could in law be incorporated or *unincorporated*. A joint stock company was a joint stock company irrespective of its legal status.⁴⁵

partner's lien. The modern view is that partners are beneficially entitled to the totality of the partnership assets.

⁴⁰ 'The employer of capital - even when working with his own capital splits into two personalities - the owner of capital and the employer of capital; with reference to the categories of profit which it yields, his capital also splits into capital *property*, capital *outside* the production process, and yielding interest of itself, and capital *in* the production process which yields a profit of enterprise through its function'. Marx, *Capital* Vol III (1894; London: Lawrence & Wishart, 1978) 375.

⁴¹ Or in the case of merchant's capital, M - C - M'.

⁴² Nathaniel Lindley, *A Treatise on the Law of Partnership, including its Application to Joint Stock Companies* (London: Maxwell, 4th ed 1878) 22-23.

⁴³ See Parsons, *Principles of Partnership* (Boston, 1889), cited Ashley, n 23 above, 416-417.

⁴⁴ See W.R. Scott, *The Constitution and Finance of English and Irish Joint Stock Companies to 1720* (Cambridge: CUP, 1909-12) vol 1 45-46.

⁴⁵ Charles Wordsworth's *The Law Relating to Railway, Canal, Water, Dock, Gas and Other Companies* (London: Benning, 6th ed 1851) opens with the statement that 'joint stock companies are *unincorporate* and *incorporate*'.

Correspondingly, early 'joint stock company law' texts examined the law relating to both incorporated and unincorporated concerns.⁴⁶

Equally importantly, for many years *all* joint stock companies, incorporated as well as unincorporated, were considered to be types of partnership. In the parlance of the eighteenth and early nineteenth centuries, they were 'public' partnerships, distinguishable from 'ordinary' or 'private' partnerships on quantitative rather than qualitative grounds.⁴⁷ Like ordinary partnerships, all joint stock companies tended, therefore, to be conceptualised as aggregates of individuals. Incorporation was seen as creating a separate legal entity, but the resulting 'body corporate' was thought to consist of 'several individuals, united in such a manner that they and their successors constitute but one person in law, a person distinct from that of any of the members, *though made up of them all...*'.⁴⁸ There was, as yet, no conception of 'the company', even if incorporated, as something with an existence entirely of its own, as an object *completely* separate from its shareholders. On the contrary, the shareholders *were* the company, hence the persistence for much of the nineteenth century of the view that directors were simply agents of 'the company' and subject to the control of the shareholders ('the company') in general meeting. Hence also the regular description of incorporated and unincorporated companies as 'theys', and the notion, exemplified by the 1856 Joint Stock Companies Act, that people 'formed themselves' into companies, with its implication that companies were made *of*, rather than *by*, them.⁴⁹

Crucially, while they were conceptualised in this way, the principles of the law of partnership, slightly modified, were thought to be applicable to companies, and as the early texts make clear this was considered true of incorporated, as well as of unincorporated, firms.⁵⁰ Incorporation was seen as offering joint stocks certain important legal privileges which took them to some extent outside the principles of the law of partnership, but it was not thought to provide a fully fledged alternative legal form.⁵¹ Nowhere was the perception of 'joint stock company law' as a branch of the law of partnership⁵² made clearer than in

⁴⁶ Thus, the first 'company law' text, Charles Wordsworth's *The Law Relating to Railway, Bank, Insurance, Mining and other Joint Stock Companies* (London: Butterworth, 1st ed 1836) covered both incorporated and unincorporated companies. An expanded second edition appeared the following year.

⁴⁷ See, for example, William Watson, *A Treatise of the Law of Partnership* (London: Butterworth, 2nd ed 1807), 3-5.

⁴⁸ J.W. Smith, *A Compendium of Mercantile Law* (London: Maxwell, 3rd ed 1843) 81.

⁴⁹ See generally Paddy Ireland, 'Capitalism Without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality' (1996) 17 *Journal of Legal History* 40.

⁵⁰ Wordsworth, for example, treats both incorporated and unincorporated joint stock companies as governed by the general principles of the law of partnership except where they had been 'superceded' or 'limited and restrained' by the granting of corporate privileges or status. Wordsworth, n 46 above (2nd ed 1837) 101, 172.

⁵¹ 'As to the points which belong exclusively to the conception of the business corporation [as opposed to the conception of corporations in general]', wrote Samuel Williston, 'the law has been formed very largely since 1800', 'History of the law of Business Corporations before 1800' (1888) 2 *Harvard Law Review* 105 at 113.

⁵² Wordsworth refers to joint stock companies as 'public partnerships', regardless of their legal status, and uses the terms 'partner' and 'shareholder' more or less interchangeably. His method of exposition is even more revealing. He presents what he calls 'the general principles of the law of partnership' as they apply to joint stock companies and then seeks to identify deviations from these principles in individual chapters on the companies occupying different fields of activity, see Wordsworth, n 46 above, (2nd ed 1837). Thus, Sealy's suggestion that partnership principles were invoked to fill the 'gaps' in company law is rather misleading. There were, in fact, more gaps than law, with the principles of the law of partnership

the title of Nathaniel Lindley's *A Treatise on the Law of Partnership, including its application to Joint Stock Companies*, first published in 1860. Indeed, Lindley continued for many years to describe company law as a 'mere statutory development' of the law of partnership⁵³ and not until the final decades of the century did it finally crystallise into a legal category in its own right. In the meantime, judges regularly turned to the rules of partnership when there was no case on companies to guide them, ceasing 'only when the idea of the legal personality of the company had permeated all the courts'.⁵⁴

In accordance with partnership principles, ownership of a joint stock company share was considered in law to bestow on the holder an interest in the assets of the company, with the shareholders of both incorporated and unincorporated companies conceptualised as the equitable owners of the company's assets, whatever they might be, realty or personalty. Shareholders were, then, not only 'the company', they were, quite literally, legally constituted as the 'owners' of its assets. In certain respects, this characterisation of shareholders as 'owners' was always rather strained, for as Adam Smith observed, 'the greater part of these proprietors seldom pretend[ed] to understand any thing of the business of the company; ... giv[ing] themselves no trouble about it, ... receiv[ing] contentedly such half yearly or yearly dividend, as the directors think proper to make to them'.⁵⁵ Indeed, there remained some ambiguity as to the precise nature and status of joint stock company shareholding, for some companies treated shareholders rather like lenders, paying interest on all paid-up capital from the outset, even in the period before the company had become productive and profitable.⁵⁶ However, in other respects there was a material basis for the assertion of a property nexus between shareholders and the company's assets, for although joint stock company shares were formally freely transferable, in theory enabling shareholders to liquidate their capital at will, throughout the eighteenth and early nineteenth centuries the market for shares was primitive.⁵⁷ In the absence of a developed share market, the money of shareholders, transformed into assets under the control of the company, was tied up, potentially for an extended period of time,⁵⁸ in the same way, though not to the same degree, as the capital of the rentier investor in a partnership.⁵⁹ Moreover, notwithstanding Smith's disparaging comments, compared to their latter-day counterparts eighteenth and early nineteenth joint stock company shareholders took a much greater supervisory interest in their investments.⁶⁰ Some companies even financially penalised

thought essentially applicable to all joint stock companies. See Len Sealy, 'Perception and Policy in Company Law Reform', in David Feldman & Frank Miesel, *Corporate and Commercial Law: Modern Developments* (London: Lloyds, 1996) 11 at 24.

⁵³ Lindley, n 42 above, 14.

⁵⁴ Geoffrey Hornsey, 'Alterations to the "Constitution" of Companies' (1949) 61 *Juridical Review* 263 at 270.

⁵⁵ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776, Oxford: Clarendon Press, 1976 ed by R.H. Campbell & A.S. Skinner) 741.

⁵⁶ G.H. Evans, *British Corporation Finance* (Baltimore: John Hopkins, 1936) 76.

⁵⁷ See Ireland, n 49 above.

⁵⁸ This was especially true of joint stock companies because of the fields of activity, such as canals and railways, in which they operated. In these areas levels of investment in fixed assets with a lengthy turnover time were high and it was often many years before operations commenced, let alone bore fruit.

⁵⁹ Thus, 'ordinary shares were viewed as akin to interests in partnerships', Jonathan B. Baskin, 'The Development of Corporate Financial Markets in Britain and the United States, 1600-1914: Overcoming Asymmetric Information' (1988) 62 *Business History Review* 199.

⁶⁰ In relation to canal companies, for example, see J.R. Ward, *The Finance of Canal Building in Eighteenth Century England* (London: OUP, 1974). Because the returns on corporate shares were by no

proprietors who neglected to attend general meetings in person or by proxy.⁶¹

The depersonification of the joint stock company and the emergence of autonomous company law

The early-to-mid nineteenth century, however, saw major changes in the economic nature of the joint stock company. The catalyst was a rapid growth in both the number and size of joint stock companies, particularly following the dramatic development of the railway system. Investment in railway companies was not only on a much larger scale than anything previously seen, it embraced groups hitherto uninvolved in investment and took a radically depersonalised rentier form.⁶² As a result, in the period after 1830 there emerged for the first time a developed market in joint stock company shares which transformed them into money capital - readily marketable commodities, liquid assets easily converted into money.⁶³ This transformation in the economic nature of the share was reflected in, and reinforced by, its legal reconceptualisation. Following the seminal 1837 case of *Bligh v Brent*,⁶⁴ it came to be held that shareholders had no direct interest, legal or equitable, in the property owned by the company, only a right to dividends and a right to assign their shares for value. By 1860, the shares of both incorporated and unincorporated joint stock companies had been established as legal objects in their own right, as forms of property independent of the assets of the company.⁶⁵ In constituting the share as a form of property in its own right, in stressing its monied character and in relieving it of any direct connection to the assets of the company, the Courts, in effect, reconstituted the circuit of the shareholders capital as M - M'. Moreover, with this, the capital of joint stock companies seemingly doubled. The assets were now owned by the company and by the company alone, either through a corporation or, in the case of unincorporated companies, through trustees. The intangible share capital of the company, on the other hand, was the sole property of the shareholder. A vital legal space thus emerged between companies - owners of assets - and shareholders - owners of shares.

The separation of shareholder from company inherent in the development of the share market⁶⁶ and the establishment of the share as an autonomous, liquid form of property was reinforced by other related changes. For example, Sealy suggests that as long as the liability of shareholders remained

means guaranteed, shares tended to be seen more as speculations than investments.

⁶¹ See A.B. DuBois, *The English Business Company after the Bubble Act, 1720-1800* (New York: Octagon, 1938) 319.

⁶² There is a large literature on the financial impact of the railways. See, for example, M.C. Reed, *Investment in Railways in Britain, 1820-1844* (Oxford: OUP, 1975).

⁶³ See Rudolf Hilferding, *Finance Capital* (1909, London: RKP, 1981), 109-110; Paddy Ireland, Ian Grigg-Spall and Dave Kelly, 'The Conceptual Foundations of Modern Company Law' (1987) 14 JLS 149. By this time, the view - propounded by Bentham and the founders of classical political economy, though not by Adam Smith - that the usury laws should be repealed on the grounds that money was a commodity like any other and that trade in it should be free of regulation, was gaining ground. The usury laws survived mounting criticism from these sources in the first decades of the nineteenth century, as well as various parliamentary attempts at repeal, but finally succumbed in 1854.

⁶⁴ (1837) 2 Y & C Ex 268.

⁶⁵ See Ireland, n 49 above.

⁶⁶ 'Shareholders who own equity in a company with publically traded shares tend not to be tied to the business in the same way as their counterparts in closely held firms ... individuals who buy equity in a public company rarely develop any links to the business by participating in management. As well, when investors decide to terminate the relationship and sell their shares they can usually do so readily', Cheffins, n 8 above, 51.

unlimited 'general meetings were diligently attended and matters of policy were actively debated', and that even after the introduction of general limited liability in 1855 'shareholders continued to take their role seriously'.⁶⁷ This exaggerates shareholder assiduity - the great majority of joint stock company shareholders had never in any meaningful sense acted like participating industrial capitalists *inside* the association. Nevertheless, there is no doubt that there was for many years some degree of supervision of company management by shareholders and that this steadily declined as the century progressed. Increasingly, investors moved from holding shares in one or a small number of companies in whose affairs they took an active interest to holding a diversified basket of securities, a development marked from the 1870's by the rise of financial intermediaries and of modern financial reporting.⁶⁸ Shareholders sought security not from an active monitoring of management but from the *de facto* limited liability provided by the rise of the fully paid-up share⁶⁹ and from risk-spreading. As they thereby became part of what J.H. Clapham called 'blind capital seeking its 5 per cent',⁷⁰ any significant involvement in management or managerial supervision more or less ceased. Professional managers were paid to run enterprises, and the great majority of shareholders were reduced to the status of functionless rentiers, receiving their income in the form (if not at the level) of interest - that is, as a return on their capital accruing with the mere passage of time. As the transformation of shareholders 'from active participant[s] to passive investor[s]' was completed, shareholders were not only clearly established (both in law and in economic reality) as money capitalists standing *outside* the company and the production process, the company, the sole legal and equitable owner of the firm's *industrial* capital, was itself 'depersonalised ... ceasing to be an association and ... becoming an institution'.⁷¹ Following the 1862 Companies Act, people no longer 'formed themselves' into incorporated companies, they 'formed' incorporated companies, objects external to them, made *by* them but not *of* them. In short, 'the company' was reified.⁷²

These changes in the economic (and legal) nature of the company and shareholding had profound effects on the developing law relating to joint stock companies. As the economic and conceptual expulsion of the shareholder was increasingly recognised, so too was the depersonified nature of 'the company' itself. This was reflected both in the Companies Acts 1844-62, which made corporate status with limited liability available on mere registration, and in the common law. The doctrine of *ultra vires*, for example, which developed principally to protect the integrity of the share as a form of property,⁷³ placed the newly reified 'company' in certain respects beyond even the unanimous collective will of shareholders.⁷⁴ More generally, there was a move from seeing directors as subject to the direction

⁶⁷ Sealy, n 52 above, 25.

⁶⁸ R.A. Bryer, 'The Late Nineteenth-Century Revolution in Financial Reporting' (1993) 18 *Accounting, Organisations and Society* 649; J.B. Jefferys, 'Trends in Business Organisation in Great Britain since 1856' (Ph.D, Univ of London, 1938), chapter 9.

⁶⁹ Until the later nineteenth century, the great majority of joint stock company shares were only partly paid-up. While this remained the case, shareholders remained liable to calls and, in that sense, retained a connection to the company. By the turn of the century, however, nearly all shares were fully paid-up. This not only completed the 'externalisation' of the investor, it meant that existing shares ceased to be sources of new capital. See P.L. Cottrell, *Industrial Finance, 1830-1914* (London: Methuen, 1980) 80-103.

⁷⁰ J.H. Clapham, *An Economic History of Modern Britain* (Cambridge: CUP, 1928), vol 1 388.

⁷¹ Sealy, op cit n 61, 24-6.

⁷² Otto Kahn-Freund, 'Industrial Democracy' (1977) 6 *ILJ* 65.

⁷³ See Lord Langdale in *Colman v Eastern Counties Railway Co.* (1846) 10 *Beav* 1.

⁷⁴ *Ashbury Railway Carriage & Iron Co. v. Riche* (1874) *LR* 7 *HL* 653.

and control of the company, meaning the shareholders in general meeting, to seeing them as a self-standing organ of the company as a separate, depersonified entity. This conceptual change was accompanied by a decline in the right of shareholders to intervene in the day-to-day running of companies and by a steady shift of power from general meeting to board.⁷⁵ As their 'ownership' rights were steadily eroded, shareholders 'surrendered a set of definite rights for a set of indefinite expectations'.⁷⁶

In underlining the externality of the shareholder, these economic and legal changes laid the foundations for the emergence of the modern doctrine of separate corporate personality. The 'complete separation'⁷⁷ of company and members that this entailed was not, as company lawyers tend to assume, inherent in the legal act of incorporation.⁷⁸ Rather, the legal meaning of incorporation in a business context was, rather, reinterpreted in the latter half of the nineteenth century to accommodate the radical *economic* separation of joint stock companies from their shareholders.⁷⁹ In heightening the qualitative differences between joint stock companies and 'ordinary' partnerships,⁸⁰ these changes also laid the foundations for the emergence of joint stock company law as a body of law in its own right, autonomous from the law of partnership. As Michael Lobban observes, from around mid-century, as 'the company came to be seen as more of an abstract entity and less a collection of equally liable partners', the unsuitability when applied to joint stock companies of partnership principles, with their presumption of active participation and agency,⁸¹ became ever clearer and a 'new company law regime' began to

⁷⁵ The shift can be seen in the different approaches adopted in *Isle of Wight Railway Co. v Tahourdin* (1883) 25 ChD 320 and *Automatic Self-Cleansing Filter Syndicate Co., Ltd. v Cuninghame* [1906] 2 Ch 34. Formally, despite the provision of highly influential model articles, British statute law (like that in the U.S., but unlike that on the continent) does little to mandate how corporations are to be organised, so that corporate governance is, theoretically, largely a matter for the company itself (meaning its shareholders) to determine. This encourages the misleading view, exemplified by 'nexus of contracts' theories, that the corporation is a creature of private contract and that the relation between shareholders and directors is one of principal and agent.

⁷⁶ A.A. Berle & G.C. Means, *The Modern Corporation and Private Property* (1932; New York: Harcourt Brace, revised ed 1967) 244.

⁷⁷ Gower, n 9 above, 79.

⁷⁸ Company lawyers tend mistakenly to assume that incorporation carries certain inherent, fixed consequences, among them a 'complete separation' of company and shareholders, arguing that this was not appreciated by early nineteenth century judges. Thus, Gower argues that '...it was not until *Salomon v Salomon & Co.* at the end of the nineteenth century that [the] implications [of corporate personlity] were fully grasped even by the courts', n 9 above, 77.

⁷⁹ The conceptual problems generated by these processes contributed to the late nineteenth century debates associated with Gierke and Maitland concerning the nature of corporate personality. Mary Stokes has recently revisited these debates, arguing that after 1862 company law vacillated between a contractual and a natural entity theory of 'the company', drawing on the natural entity theory - in which company and shareholders are radically separate - to legitimate limited liability; and on the contractual theory - whereby the company is the product of a contractual agreement between its owners - to endorse the power conferred by shareholders on directors. Eventually, she suggests, faced by the incoherence that resulted from this, 'academics in the early decades of this century adopt[ed] in their writing the natural entity conception of the company'. Mary Stokes, 'Company Law and Legal Theory', in William Twining (ed), *Legal Theory and Common Law* (Oxford: Blackwells, 1986) 155.

⁸⁰ See, for example, *Watson v Spratley* (1854) 10 Ex 222; *Baird's Case* (1870) LR 5 Ch App 725 (per James LJ); *Ashworth v Munn* (1880) 15 ChD 363.

⁸¹ See Lobban, n 35 above, 399.

emerge.⁸² However, with 'hoary old ideas of partnership continu[ing] to confuse thinking with regard to corporate enterprise', this took time.⁸³ It was not until the late 1880's, for example, that Lindley finally ceased subsuming his coverage of company law within his treatise on partnership and accorded it a volume of its own.⁸⁴

Company law and the problem of the share

Consideration of the historical circumstances of company law's emergence as an autonomous legal category establishes the close link between the conceptual structure of modern company law and the nineteenth century joint stock company. In the period after 1870, with the rise of the private company, 'company law' came to be applied not only to joint stock companies but to all forms of business organisation, sole traders and small partnerships included, a process legitimated by the famous decision in *Salomon*.⁸⁵ As, slowly but surely, it was detached from the joint stock company as an economic form of organisation, 'joint stock company law' became simply 'company law'. However, by this time its basic conceptual structure was already in place, and it was, of course, a conceptual structure designed and developed by legislature and courts with the joint stock company in mind.⁸⁶ Despite much subsequent company law reform, this structure has changed remarkably little, generating many conceptual problems. In short, a body of law designed for application to nineteenth century joint stock companies - single entity, national companies whose shareholders had been relieved of any meaningful ownership function - has come to be applied to both small private concerns, in which shareholders and company are often to all intents and purposes one, and to multi-unit, multi-divisional, multi-national corporations. As a result, the conceptual structure of company law has become ever more divorced from the economic realities to which it applies⁸⁷ and taken on a life of its own. Detached from its own history and material origins, it tends to be seen as flowing naturally and inevitably from the legal act of incorporation; as existing apart from *any* economic reality. This has not only facilitated its manipulation by capital, it has contributed to absurdities - most notably concerning the treatment of parent companies and their subsidiaries⁸⁸ - and to conceptual ossification.

⁸² Michael Lobban, 'Nineteenth Century Company Law Frauds in Company Formation: *Derry v Peek* in Context' (1996) 112 LQR 287 at 288, 312, 318-319.

⁸³ B.C. Hunt, *The Development of the Business Corporation in England, 1800-1867* (New York: Russell & Russell, 1936) 129-30. He describes partnership law as 'a barrier to the essential change that had taken place in the position of the ... typical shareholder, [who] was no longer an entrepreneur in the full sense of the word'.

⁸⁴ The fifth edition of his treatise on partnership appeared in 1888, the first edition of his treatise on company law, significantly entitled, *A Treatise on the Law of Companies, considered as a Branch of the Law of Partnership*, in 1889. By that time, a range of well-known company law treatises had appeared, including those of Buckley and Palmer.

⁸⁵ *Salomon v Salomon & Co Ltd* [1897] AC 22. See Paddy Ireland, 'The Rise of the Limited Liability Company' (1984) 12 *International Journal of the Sociology of Law* 239.

⁸⁶ In the early 1980's, when the government was considering what form a consolidated Companies Act might take, an explanatory note assumed that the formation of a company would naturally be followed by the raising of capital on the market, prompting Sealy to remark that 'the notional company which our lawmakers have in mind [appears] astonishingly, [to be] a company set in the nineteenth century', by which he meant a medium-sized public company. See Sealy, n 52 above, 26.

⁸⁷ See, for example, Philip I. Blumberg, 'The American Law of Corporate Groups', in Joseph McCahery et al (eds) *Corporate Control and Accountability* (Oxford: Clarendon Press, 1993) 305.

⁸⁸ See P.T. Muchlinski, *Multinational Enterprises and the Law* (Oxford: Blackwells, 1995) 322-45.

Consideration of the historical circumstances of its emergence also reveals company law's continuing failure to come to terms with the material conditions of its own creation. By the end of the 19th century, not only did shareholding no longer entail ownership of the corporate assets, in an era of general limited liability, fully paid-up shares and diversified holdings, it had ceased to be especially risky. Increasingly, shareholders wanted - and corporate managers provided - regular dividends from shares, with the result that shares (and diversified share portfolios) came widely to be seen as sources of steady income streams rather than as speculative financial instruments whose returns varied dramatically with the ups and downs of a business. In short, shares came to exhibit 'debt-like features'.⁸⁹ With corporate shareholders ever more 'passive and functionless, remarkable only in [their] capacity to share, without effort or even without appreciable risk, the gains of .. growth..',⁹⁰ the justifications for their residual 'ownership' rights became ever harder to discern. And yet, although its emergence as an autonomous legal category was premised precisely on a recognition of the 'complete separation' of shareholder from the joint stock company, company law, 'while stopping short of according shareholders ownership rights over corporations, nevertheless [continued to] vest significant property rights in the shareholders as residual claimants'.⁹¹ It still does, clinging on to the vestiges of shareholder 'ownership' and retaining for them their place at the centre of the governance stage. In this context, one does not have to look far for the sources of the conceptual difficulties that company lawyers have encountered in trying accurately to characterise and define the nature of the share and shareholding.

As Robert Pennington says, 'despite [their] familiarity with them ... [the courts] have found it extraordinarily difficult to define the legal nature of shares'.⁹² Indeed, there are marked differences of emphasis even among the minority of company lawyers who bother to attempt to do so. Because of the lack of any direct link between the share and the assets of the company - the term 'share' is 'something of a misnomer, for shareholders no longer share any property in common'⁹³ - some stress its contractual qualities. Pennington himself, for example, asserts that shares 'are simply bundles of contractual and statutory rights which the shareholder has against the company',⁹⁴ approvingly quoting in support the oft-cited definition offered by Farwell J in *Borland's Trustee v Steel Bros & Co Ltd*:

'A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se* in accordance with [s 14 of the Companies Act 1985]. The contract contained in the articles of association is one of the original incidents of the share. A share is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.'⁹⁵

The concept of the share in this decision, Pennington tells us, is clear. The contract contained in the company's memorandum and articles, and in the Companies Act 1985 'gives rise to contractual

⁸⁹ See Baskin, n 59 above, 232-6.

⁹⁰ J.K. Galbraith, *The New Industrial State* (Harmondsworth: Pelican, 1967).

⁹¹ Simon Deakin & Giles Slinger, 'Hostile Takeovers, Corporate Law, and the Theory of the Firm' (1997) 24 JLS 124 at 145.

⁹² Robert Pennington, *Company Law* (London: Butterworths, 6th ed 1990) 56.

⁹³ Gower, n 9 above, 300.

⁹⁴ Pennington, n 92 above, 135.

⁹⁵ [1901] 1 Ch 279 at 288.

obligations of each member as regards the company and every other member. The aggregate of these rights and obligations of a member is his shareholding, and when divided between the shares he holds, they constitute his shares'.⁹⁶ But Pennington is aware that there are problems with this view, not least because to assert, as he repeatedly does, that shares are simply bundles of contractual and statutory rights held by shareholders 'against the company' underlines the shareholder's externality to the company and blurs the distinction between them and debenture holders. Thus, he concedes that 'it is tempting to deduce from [the contractual nature of the share] that the relationship between [shareholder] and ... company is that of creditor and debtor'. While, he assures us, this is 'quite wrong',⁹⁷ he shows a marked reluctance either to describe the share as 'property' or the shareholder as an 'owner' of the company. The contractual rights which make up the share are of 'a peculiar nature' in that they are transferable and for that reason, he tells us, shares 'have been called "property"'. But he feels unable to endorse this view, merely commenting that it is 'innocuous enough, provided that it is remembered that they do not comprise any proprietary interest in the company's assets'.⁹⁸ He describes the conclusion to which he is drawn as 'disappointing', though 'confusing' might be more apt. 'The most that may be said', he says, is that 'shares in a registered company ... are a species of intangible movable property which comprise a collection of rights and obligations relating to an interest in a company of an economic and proprietary character, but not constituting a debt'.⁹⁹

More widespread is the view that shares constitute both property and a proprietary interest in the company. 'It is tempting to equate shares with rights under a contract', writes Gower, '[but] a share is something far more than a mere contractual right *in personam*'.¹⁰⁰ While it is doubtful 'whether the rights which a share confers on its holder can be classified as "proprietary" in the usual sense', it is clear that 'the share itself is an object of *dominion*, i.e. of rights *in rem* and not so to regard it would be barren and academic in the extreme'. As he says, for all practical purposes shares are recognised in law, as well as in fact, 'as objects of property which are bought, sold, mortgaged and bequeathed'.¹⁰¹ More problematic is giving legal substance to the view that the shareholder has a proprietary interest in the company. Although, like Pennington, Gower cites Farwell J's definition of the share, he stresses that while 'it lays considerable and perhaps disproportionate stress on the contractual nature of the shareholder's rights, [it] also emphasises the fact that [the shareholder] has an interest *in* the company'; that 'a share constitutes the holder a member of the company'.¹⁰² He does not, however, find it easy to specify the precise nature and basis of this proprietary interest:

The theory *seems to be* that the contract constituted by the articles of association defines the nature of the rights, which, however, are not purely personal rights but instead confer *some sort of* proprietary interest in the company though not in its property (emphasis added).¹⁰³

⁹⁶ Robert Pennington, 'Can Shares in Companies be Defined?' (1989) 10 *Company Lawyer* 144.

⁹⁷ Pennington, n 92 above, 135-136. A deduction encouraged by company balance sheets which show share capital as an item on the liabilities side together with the debts owed by the company.

⁹⁸ Pennington, n 92 above, 57.

⁹⁹ Pennington, n 96 above, 144. He notes that the definitional problems are not confined to English company lawyers.

¹⁰⁰ Gower, n 9 above, 300

¹⁰¹ 'They are indeed the typical items of property of the modern commercial era and particularly suited to its demands because of their exceptional liquidity'. This extract is in part taken from Gower n 9 above (4th ed 1979) 400.

¹⁰² Gower, n 9 above, 301, 299.

¹⁰³ Gower, n 9 above, 301.

Indeed, Gower expresses concern that an analysis of the 'proprietary and financial aspects of a shareholder's rights' might 'obscure the important fact that his shareholding causes him to become a member of an association'.¹⁰⁴ The problem, as this implicitly suggests, is that the basis for the privileged status of the shareholder as a 'member' is, indeed, 'obscure', hence Deakin and Slinger's observation that 'it is difficult to find support within company law for the widespread assumption ... that shareholders "own" the business...'.¹⁰⁵ Such difficulties multiply when one tries clearly to distinguish shareholders from debenture holders. As Gower acknowledges, the rigid theoretical separation between shareholders, with rights in the company as well as against it, and debenture-holders, with rights against the company but never in the company itself, collapses in contemporary 'economic reality'.¹⁰⁶ Sealy concurs:

The theoretical differences between being a creditor of the company and being a member are considerable from a legal point of view, but (at least in the case of a solvent and prosperous company) the practical consequences for investors, apart sometimes from tax considerations, are very similar an investment in debentures or debenture stock is very similar to an investment in shares: both are securities in the corporate sector of the economy offering different kinds of risk and different kinds of return.¹⁰⁷

The reality is, of course, that both debenture holders and shareholders are money capitalists, external to companies and to the production process itself. Disinterested and uninvolved in management, and, in any case, largely stripped (in law as well as in economic reality) of genuine corporate ownership rights, the shareholder is, as Berle and Means pointed out, 'not dissimilar in kind from the bondholder or lender of money'.¹⁰⁸ While, therefore, the relationship between shareholder and company is not exactly one of lender to borrower - the share is not, as some have suggested, a kind of loan - neither is it in any meaningful sense one of owner to owned. The share is a particular and distinctive form of money capital; property in the form of a claim on the company's profits.¹⁰⁹

Corporate governance and the myth of ownership

Ultimately, the conceptual pea-souper enveloping the share and shareholding arises from modern company law's failure to take separate corporate personality seriously enough, and its consequent attempt to straddle two essentially irreconcilable positions. On the one hand, through the doctrine of separate corporate personality in its modern form, company law expresses and reinforces not only the separate existence of 'the company' but the erosion, *de jure* and *de facto*, of the shareholder's ownership rights. As we have seen, historically these developments provided the basis for company law's crystallisation out from the law of partnership and its emergence as a separate legal category in its own right. It has also resulted in company law taking separate corporate personality very seriously in certain

¹⁰⁴ Gower, n 9 above, 302.

¹⁰⁵ Deakin & Slinger, n 91 above, 134.

¹⁰⁶ Gower, n 9 above, 299-301, 321.

¹⁰⁷ L.S. Sealy, *Cases and Materials in Company Law* (London: Butterworths, 6th ed 1996), 420-421. This is not, however, to say that there may not be important differences from the corporation's point of view between debt and equity.

¹⁰⁸ Berle & Means, n 76 above, 245.

¹⁰⁹ See David Kelly, 'Money Capital and Company law' (1990, unpub Ph.D thesis, Univ of Kent); C.B. Macpherson, 'Capitalism and the Changing Concept of Property' in Eugene Kamenka & R.S. Neale, *Feudalism, Capitalism and Beyond* (London: Edward Arnold, 1975).

contexts where it is hard to justify, for example in relation to the treatment of private companies and, more importantly, the subsidiaries of large corporations.

On the other hand, in other ways company law has failed fully to recognise the implications of the depersonification of the company and the reduction of the corporate shareholder to the status of a rentier investor with an interest very similar to that of a debenture holder. It has tried instead to hang on to the (always rather artificial) characterisation of corporate shareholders as 'insiders', 'members' and 'owners', continuing to grant to them exclusive residual 'ownership' rights - most crucially, of course, the right to vote in general meetings. It has done this notwithstanding the true economic nature of the share; notwithstanding the absence of any property nexus between shareholders and the company's assets; notwithstanding the radical externality of shareholders to 'the company' and their superfluosity to and disinterest in the process of production; notwithstanding the fact that there are serious question marks over the legitimacy of their residual control rights, as was well as over their desire, competence, and practical ability to exercise them; and notwithstanding the fact that company law itself has done so much to demote them from the status of owners. In short, company law has not taken separate corporate personality *really* seriously in contexts where it would be entirely justified so to do. Fuelled by the ownership myth and the legal remnants which sustain it, it continues rather to treat company and shareholders as in crucial respects synonymous. As a result of this 'anomalous hangover from earlier times', and despite the fact that 'the ... company has ceased to be a "they" and has come to be seen as an "it"', the law insists on treating 'shareholders, collectively, as [its] only legitimate constituency'.¹¹⁰ Fiduciary duties, in particular, still rest on this 'out-of-date assumption', with English law holding that the duty of directors is to act 'in the best interests of the company', interpreted to mean in the best interests of the shareholders.¹¹¹ It is not surprising, then, that when Sealy asks 'how have we lawyers handled th[e] notion that a company is a separate "person"?', his answer is 'very confusingly'.¹¹² The uncertainty surrounding the nature of the share and shareholding is just one of the many conundrums that have accompanied the incomplete depersonification of the company.

At present, the tendency among company lawyers is to deal with these problems by discrete omission. The legal nature of the share, if it is addressed at all, is usually afforded cursory treatment, with shareholders simply assumed, in some rather unspecific 'common sense' way, to be the 'owners' of the company.¹¹³ John Parkinson, for example, recognises that 'shareholders are not the owners of the company's assets as a matter of strict law', but quickly adds that 'they are in substance the owners by

¹¹⁰ Sealy, n 52 above, 26. Elsewhere, Sealy rightly attributes this identification of company with shareholders to the fact that by the time that the complete separation of company and members had been recognised, 'the principles of the director's fiduciary obligations were already well established on the basis that the members collectively *were* the company'. However, he goes on erroneously to suggest that this was, in turn, a product of the influence on the law of unincorporated deed-of-settlement companies in which 'the members *were* the company'. The identification of joint stock companies with their shareholders was not confined to unincorporated companies, but was a feature of all joint stocks in the pre-railway age. See L.S. Sealy, 'The Director as Trustee' (1967) 25 *Cambridge Law Journal* 83 at 89-90.

¹¹¹ Modified slightly by s 309 CA 85 which imposes on directors a duty to 'have regard' to employees. The supremacy of the shareholder interest in company law, mirrored in the City Takeover Code, is most clearly revealed, perhaps, by the restrictions placed on company directors (in the name of their duty to shareholders) who wish to frustrate takeover bids. See Deakin & Slinger, n 91 above, 124.

¹¹² Sealy, n 52 above, 16.

¹¹³ 'Ownership' here operates as what Felix Cohen called a 'magic solving word', as a form of 'transcendental nonsense', which curtails discussion of the difficult ethical and practical questions involved. See Felix Cohen, 'Transcendental Nonsense and the Functional Approach' (1935) 35 *Columbia Law Review* 809 at 820.

virtue of being the contributors of the company's capital'.¹¹⁴ In this context, his argument, although not denying the existence of 'the company', resembles that of 'nexus of contracts' theorists¹¹⁵ who seek to dispose of the problem of corporate ownership by reducing the company to a series of contractual relations so that it disappears as an entity capable of being 'owned'. The 'ownership of capital', these theorists quite rightly argue, 'should not be confused with ownership of the firm'.¹¹⁶ However, in disposing of one confusion - that shareholders 'own' the corporation - they substitute another, conflating, under the rubric 'capital', the assets owned by the company and the shares (rights to part of the corporate product, but not to the assets themselves) owned by the shareholders. In dissolving 'the company' and declaring shareholders the owners or 'contributors' or 'providers' of 'the capital', nexus of contracts theorists, in effect, appropriate for shareholders the corporate assets.¹¹⁷

Crucially, of course, the 'mistaken analogy'¹¹⁸ of shareholder ownership, whether of the company itself or of 'the capital', continues to cast a long shadow over the governance debate, serving as the main justification for the anachronistic retention by shareholders of exclusive governance rights and for the claim that public companies should be run predominantly, if not exclusively, in their interests.¹¹⁹ It has

¹¹⁴ John Parkinson, *Corporate Power and Responsibility* (Oxford: Clarendon Press, 1993) 34. Thereafter, discussion is relegated to a footnote in which it is noted that 'it can be argued that it is a mistake to regard shareholders as owners at all: they are mere investors...'

¹¹⁵ Of whom he is otherwise sharply critical, see John Parkinson, 'The Contractual Theory of the Company and the Protection of Non-Shareholder Interests', in David Feldman & Frank Meisel, n 52 above, 121.

¹¹⁶ E.F. Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 288 at 290.

¹¹⁷ Use of the term 'owners' tends to be avoided by these theorists precisely because the company (not the shareholders) owns the corporate assets. However, in dissolving the company as a genuinely separate entity and reducing it to a legal cipher which merely facilitates contracting between different groups, they collapse the distinction between assets and shares, lumping them together as 'capital'. In this way, shareholders, deemed the 'suppliers' or 'providers' of this 'capital', are clandestinely reconnected to the corporate assets, greatly strengthening their bargaining position in the notional contractual negotiations that are meant to take place between the parties involved in the corporation. This characterisation of shareholders as 'suppliers' of capital reveals the underlying nostalgia of these theorists and their reluctance to acknowledge the changes that have taken place in the nature of the corporation and corporate shareholding over the last century and a half. While valid two hundred years ago, the conceptualisation of shareholders as 'suppliers' of capital is now hopelessly outdated, the great majority of shareholders having long been engaged solely in the trading of titles to revenue, not the supply of capital. However, in peddling this sentimental view, which denies the reality of the corporation's autonomous existence and tries to bridge the gap between the corporate assets (owned by the company) and its shares (owned by shareholders), nexus of contracts theory circumvents the awkward questions surrounding the allocation of rights in and over the corporation as an autonomous, property-owning entity. See n 119 and text to n 170 below.

¹¹⁸ John Kay, 'The Stakeholder Corporation' in Kelly et al n 3 above, 125 at 131.

¹¹⁹ Those arguing that the company is a mere 'nexus of contracts' often claim to ground the exclusive corporate governance rights of shareholders not in their 'ownership' of the corporation (the corporation having been eliminated as an entity capable of being owned), but in contract and 'efficiency'. However, like all arguments based on efficiency (and, indeed, contract), these claims presume a pre-existing allocation of property rights, and in relation to the corporation and corporate governance it is precisely this prior allocation that is at issue. Given the transformation (in the wake of the changes in the nature of corporate shareholding) of the corporation from association to institution, how should rights in and over it

also done much to shape the debates about corporate governance, most importantly, perhaps, in causing the issue generally to be cast, following Berle and Means, in terms of a 'separation of ownership and control', with the result that the problem is characterised by many as little more than an administrative dilemma, an agency problem, potentially resolvable by a restoration of shareholder monitoring and supervision. Given the economic nature of corporate shareholding, this solution is not only of questionable legitimacy, it is, as many argue, unlikely to work. Thus, Easterbrook and Fischel deride proposals to enhance shareholder participation¹²⁰ and John Kay remarks that 'all experience suggests' that renewed shareholder involvement and supervision is 'not very likely to happen, and would not improve the functioning of corporations if it did'.¹²¹

As company lawyers are well aware, however, it has forcefully been argued in recent years that the growth in institutional investment and the related rise of the so-called market for corporate control has restored the old model, enabling shareholders effectively to re-assert their rights and, through that, to monitor management and ensure good governance. Despite the divisions of opinion on this matter,¹²² it is clear that in the U.S. the evidence of the growing influence of institutional investors is strong,¹²³ though its forms have changed somewhat in recent years. In the eighties, the emphasis was on take-overs and leveraged buy outs; more recently it has been on what some have called a 'political model of governance'¹²⁴ based on the development of longer term investor-corporation relations and generating the rise of what has variously been called a 'fiduciary' or 'investor' capitalism.¹²⁵ Although direct and public institutional investor involvement has thus far been less marked in Britain,¹²⁶ it is clear that there

be allocated? In their anxiety to uphold shareholder privileges, nexus of contracts theorists try to sidestep these issues, effecting a *de facto* allocation of corporate rights by sleight of hand, either by dissolving the corporation, collapsing the distinction between assets and shares, and declaring shareholders owners or 'suppliers' or 'providers' of 'the capital' (see note 133 above); or by arguing that the granting of exclusive governance rights to shareholders is the most efficient arrangement - an argument which is not only contentious (see Gavin Kelly & John Parkinson, 'The Conceptual Foundations of the Company: A Pluralist Approach', forthcoming, *Company, Financial and Insolvency Law Review*), but which uses the concept of efficiency to allocate property rights, rather than to evaluate arrangements based on a prior rights allocation.

¹²⁰ F. Easterbrook & D. Fischel, 'Voting in Corporate Law' (1983) 26 *Journal of Law & Economics* 395 at 396.

¹²¹ Kay, n 118 above, 126.

¹²² The literature is vast. See, for example, Michael Useem, *Investor Capitalism* (New York: Basic Books, 1996); Margaret Blair, *Ownership and Control* (Washington DC: Brookings Institution, 1995); G. Stapledon, *Institutional Investors and Corporate Governance* (Oxford: Clarendon Press, 1996); Paul Davies, 'Institutional Investors in the United Kingdom' in D.D. Prentice & P.R.J. Holland, *Contemporary Issues in Corporate Governance* (Oxford: Clarendon Press, 1993).

¹²³ See, for example, Useem, n 122 above; Doug Henwood, *Wall Street* (London: Verso, 1997) 246-300.

¹²⁴ J. Pound, 'The Rise of the Political Model of Corporate Governance and Corporate Control' (1993) 68 *New York University Law Review* 1003.

¹²⁵ On the idea of 'fiduciary capitalism', see R Monks & N. Minow, *Corporate Governance* (Oxford: Blackwell, 1995), and Teresa Ghilarducci et al, 'Labour's Paradoxical Interests and the Evolution of Corporate Governance' (1997) 24 *JLS* 26. On 'investor capitalism', see Useem, n 122 above.

¹²⁶ See Davies n 122 above; Matthew Gaved, *Ownership and Influence* (London: Institute of Management LSE, 1995).

has long been 'behind the scenes corporate governance' by financial institutions¹²⁷ and evidence is now emerging that U.K. fund management is becoming more Americanized.¹²⁸ Overall, it seems indisputable that the Anglo-American corporate world has changed considerably in the last couple of decades, with corporate conduct becoming 'more focused on rising share prices, and [on making] corporate performance more profitable'.¹²⁹ Even, therefore, if attempts by institutional investors directly and in detail to police business policy are the exception and likely to remain so, there can be little doubt that corporate managers are increasingly subject to institutional investor scrutiny and increasingly aware of the importance, not least in terms of their own survival, of maintaining share price and enhancing 'shareholder value'.¹³⁰ This is not, of course, to say that increased shareholder activism, with its ultimate sanction of takeover,¹³¹ works so as to weed out 'inefficient' or 'under-performing' managements and to further long-term productive development. On the contrary, there is much evidence suggesting otherwise.¹³² As Ghilarducci, Hawley and Williams observe, in the U.S. '[shareholder] activists, when they have been effective, have been concerned overwhelmingly with financial performance rather than long-term productive investment'.¹³³ The result, paradoxically, is that many now fear that the rise of institutional investment and the imposition on managers of capital market disciplines may be eradicating the 'ownership and control' problem, but in ways that bring a damaging increase in rentier power over corporate policy and threaten a new tyranny of money and finance.¹³⁴

Many are now, therefore, urging that separate corporate personality be taken more seriously. The economist John Kay, for example, favourably contrasts the European and Japanese conceptions of the corporation with those of Britain and America, and advocates recognition of the corporation as a

¹²⁷ See John Holland, *The Corporate Governance Role of Financial Institutions* (London: Certified Accountants Educational Trust, 1995).

¹²⁸ See *Financial Times* survey, 27 April 1998. Although many of the managers questioned cast doubt on the usefulness and value of the interventions made by fund managers, they confirmed that they had become more demanding. The survey suggests that U.S. investors are significantly increasing their U.K. holdings, which are now conservatively estimated to constitute a 10% stake in the U.K. market, and that their influence has had 'a far greater impact than the first two governance reports [Cadbury and Greenbury]'. More generally, there is considerable evidence of what Henry Kaufman has called 'the Americanization of global finance', See Henwood, n 121 above, 5. This appears to be reflected in the seeming undermining of the German and Japanese models, see M. Albert & R. Gonenc, 'The Future of Rhenish Capitalism' (1996) 1 *Political Quarterly* 184.

¹²⁹ Charles Craypo, 'The Impact of Changing Corporate Governance Strategies on Communities, Unions and Workers in the U.S.A.' (1997) 24 *JLS* 10.

¹³⁰ Meaning total shareholder return: dividends and capital appreciation. The concern with shareholder value has been heightened by the increasingly competitive nature of the institutional investment sector itself.

¹³¹ For a brief discussion, see D.D. Prentice, 'Some Aspects of the Corporate Governance Debate', in Prentice & Holland, n 122 above, 36-38.

¹³² Again, the literature is voluminous. For summaries, see Henwood, n 121 above, 278-282; Deakin & Slinger, n 91 above, 124. The reliance on capital market disciplines is itself a reflection of the decline in many sectors, in the wake of growing oligopolisation and monopolisation, of competitive product markets, see David Campbell, 'Adam Smith, Farrar on Company Law and the Economics of the Corporation' (1990) 19 *Anglo-American Law Review* 185.

¹³³ Ghilarducci et al, n 125 above, 29.

¹³⁴ See Paddy Ireland, 'Stakeholding in the Global Casino' (1997) 24 *JLS* 276.

`public body', as `an institution with personality, character, and aspirations of its own ... [whose] objectives encompass the interests of a wide-range of stakeholder groups - investors, employees, suppliers, customers and managers ...'.¹³⁵ Kay calls for the adoption of a German `stakeholding' conception of the company as `a community in itself and an organisation in turn embedded in a community', in which directors are cast in the role of trustees of the corporate assets, including its employees. We need, he says, `an organic model of corporate behaviour which gives to the corporation life independent from its shareholders or stakeholders' and which recognises it `as an end in itself'.¹³⁶ Many others, of course, have similarly advocated the adoption of a stakeholding conception of the company.¹³⁷ What is particularly interesting about Kay's argument is that it has led him to reformulate the nature of the governance problem in terms of ownership *per se*.¹³⁸ Evaluating the ownership claim of corporate shareholders using A.M. Honore's analysis of the nature of ownership,¹³⁹ he concludes that while they are unquestionably the owners of a corporation's shares, they can hardly be described as the owners of the corporation itself. Of Honore's eleven ownership tests, they only satisfy two unequivocally and three partially; six are not fulfilled at all.¹⁴⁰ The `obvious conclusion', he suggests, is that while `many individuals and groups [customers, shareholders, lenders, employees, directors] have rights and obligations around [public] companies', `none of these claims can plausibly be described as ownership'.¹⁴¹ Moreover, Kay is not alone in framing the issue in these terms. The management theorist Charles Handy similarly questions the idea that shareholders are `owners', likening them instead to racegoers placing their money on financial runners. `Punters or speculators they may be', he argues, `owners in any real sense they cannot be'.¹⁴² Although less sympathetic to stakeholding, he, too, argues that we need `to rethink what we mean by a company' and see it not as property but as a community.¹⁴³

¹³⁵ Kay, n 118 above, 126.

¹³⁶ John Kay & Aubrey Silberston, `Corporate Governance' (August 1995) *National Institute Economic Review* 84 at 86-91.

¹³⁷ See, for example, Parkinson, n 114 above; Will Hutton, n 5 above. In the U.S, see the essays in Lawrence E. Mitchell (ed), *Progressive Corporate Law* (Oxford: Westview Press, 1995).

¹³⁸ He is not alone in doing this. See, for example, Lynne Dallas, `Working Towards a New Paradigm', in Mitchell (ed) *ibid* 35.

¹³⁹ A.M. Honore, `Ownership' in A.G.Guest (ed), *Oxford Essays in Jurisprudence* (Oxford: Clarendon Press, 1961) 107-147.

¹⁴⁰ Honore outlines eleven characteristics of ownership, the presence of a sufficiency of which would justify the ascription of the term `ownership': possession, use, management, right to income, right to capital value, right to security, power to transmit, no limit of time on rights, duty to refrain from harmful use, right to use in satisfaction of judgement, right to residual control.

¹⁴¹ Kay, n 118 above, 131. The ownership position of shareholders in private companies is, in reality, if not in legal theory, very different.

¹⁴² Charles Handy, *Beyond Certainty* (Boston: Harvard Business School, 1996) 63. Rejection of the perception of shareholders as owners is also to be found among corporate managers, unhappy at growing institutional investor pressure: `Some [institutional investors]', one disgruntled director recently complained, `believe that they own the business. But they are traders in financial instruments', *Financial Times*, 27 April 1998.

¹⁴³ Charles Handy, *ibid* 68-70; Charles Handy, *The Empty Raincoat* (London: Hutchinson, 1994) 143-144, 152-153.

Rethinking corporate shareholding and corporate property rights

The question remains however, how, having recognised the 'existential corporation',¹⁴⁴ does one begin to give content to the idea of the independent corporate interest which underlies it? Like many others, Kay's concern is with furthering the independent *business* interest of the company; with what Lipton and Rosenblum call 'the interest of the corporation in its long-term success as a business enterprise'.¹⁴⁵ He therefore advocates managers who will further 'the broad purposes of the corporation, and not simply ... the financial interests of shareholders'. For him, the choice between different governance structures 'ultimately depends not on legal theory but on economic performance' and the purpose of the corporate manager should be to 'build a good business' which is internationally competitive.¹⁴⁶ But as Paul Davies points out, this particular attempt to free corporations from shareholder domination risks an unhelpful form of corporate reification. 'The notion of the corporation having an independent interest', he observes, 'serves to obscure the potential conflicts among the various groups of persons affected by the way the company is run, or worse, to disguise a policy of promoting the interests of one of those groups at the expense of the others'.¹⁴⁷ Arguably, the idea of the corporation's independent business interest entails not so much a genuine balancing of the interests of different 'stakeholder' groups, but a tempering of the *immediate* shareholder interest in such a way as to elevate the *long-term* shareholder interest, represented by the independent interest of 'the corporation'. In this context, stakeholding is likely to be endorsed only to the extent that long-term shareholder value is better enhanced by building better relations with employees, suppliers and customers.¹⁴⁸

Other versions of stakeholding seek a more radical detachment of 'the company' from its shareholders, one which recognises the corporation as a social institution and downplays the idea of it as a private, profit oriented 'business'. Thus, one finds calls for a 'new organisational paradigm' which recognises the 'productive organisation as a public institution with responsibilities which go beyond the residual claims of owners of capital';¹⁴⁹ for a conception of the corporation which embodies an 'enlarge[d] vision of the firm' as a 'political and social institution with its own organisational and industrial relations dynamics'.¹⁵⁰ However, the specific proposals for reform which have thus far emerged are relatively modest. They are generally aimed either at influencing or tempering shareholder behaviour, or giving greater 'voice' within companies to other 'stakeholder' groups. Thus, many seek to make shareholders more 'committed' and less 'short-termist', through, for example, quinquennial directorial elections which would effectively disenfranchise shareholders in the interim period.¹⁵¹ Others advocate locking shareholders into their bets by making it harder for them to switch corporate horses, for example by

¹⁴⁴ Handy, n 142 above, 69.

¹⁴⁵ Lipton & Rosenblum, 'A New System of Corporate Governance' (1991) 58 *Chicago Law Review* 187 at 189.

¹⁴⁶ Kay, n 136 above, 91; n 118 above, 132.

¹⁴⁷ Davies, n 122 above, 75.

¹⁴⁸ See Paddy Ireland, 'Corporate Governance, Stakeholding and the Company: Towards a Less Degenerate Capitalism?' (1996) 23 *JLS* 287.

¹⁴⁹ Hugh Collins, 'Organisational Regulation and the Limits of Contract', in Joseph McCahery (eds), n 87 above, 91 at 99. See also the work of John Parkinson, especially n 114 above.

¹⁵⁰ See Karl Klare, 'Comment: Untoward neutral principles - market failure, implicit contract, and economic adjustment injuries' (1993) 43 *Toronto Law Journal* 393.

¹⁵¹ Lipton & Rosenblum, n 145 above. For a discussion of this and similar proposals, see Prentice, n 129 above, 28-31.

levying taxes on securities trading.¹⁵² Still others propose changes in directors duties to encompass other corporate stakeholders.¹⁵³ More radically, some suggest giving board representation to 'stakeholders', perhaps through the introduction of two-tier boards.¹⁵⁴ However, while many of these proposals would, in different ways, erode still further the dwindling 'ownership' rights of shareholders, they fail fully to confront the ownership issue, leaving relatively untouched what Charles Handy has called the 'extraordinary privilege' accorded to corporate shareholders who, 'for the price of their bets, [are] given a vote from time to time in the auction ring as to who should own their horse', with the result, of course, that they need continuously to be wooed. In a context in which corporate managers, quite apart from their class predilections and share options, are increasingly subject to growing institutional investor, capital market and rentier power, it must be doubted whether attempts to enhance the power and rights of stakeholding groups, alone, will achieve a great deal.¹⁵⁵ Indeed, at present, notwithstanding the rise of stakeholding, we appear to be moving ever further from the realisation of a conception of the corporation as a social institution, for as John Gray points out, with the spread of neo-liberal ideology and contract culture, as an institution, the corporation, like many others, is being 'weakened' and 'hollowed out'.¹⁵⁶

For this reason, any attempt to realise a fully social conception of the corporation must begin with a fundamental re-evaluation of the nature of corporate shareholding and of shareholder rights. This necessarily entails dispelling not only the myth of shareholder corporate ownership, but other myths that serve to legitimate their governance rights. For example, it is often claimed that shareholders are 'risk-takers' deserving of reward as 'providers' of capital. But this misunderstands both the risks associated with and the nature of corporate shareholding. While equity investment is theoretically riskier than, say, investment in government stock, it is clear that, historically, equities have offered both low-risks investment and, in the medium to long-term, better average returns.¹⁵⁷ Even more importantly, the great

¹⁵² These proposals, associated with James Tobin, are aimed at reducing trading volume and deterring those trying to profit from every twitch in share prices.

¹⁵³ See, for example, Kay & Silberston, n 136 above, 94. Proposals to reform directors duties have a long pedigree. Sealy argued (many years ago) that a reappraisal of directors duties was 'long overdue, [for] the directors especially of large companies find themselves in the position of being expected as a matter of business to consider the claims of many competing interests, while being legally answerable to only one', see Sealy, n 110 above, 89-90.

¹⁵⁴ See Parkinson, op cit n 3, 152-3. See also Sally Wheeler, 'Works Councils: Towards Stakeholding' (1997) 24 JLS 44.

¹⁵⁵ See Paddy Ireland, n 148 above.

¹⁵⁶ John Gray, *False Dawn: The Delusions of Global Capitalism* (London: Granta, 1998) 72.

¹⁵⁷ For a summary of the evidence, see Roger Alcaly, 'How to Think About the Stock Market', *New York Review of Books* (June 1998) 22. The risks associated with equity investment have recently been thoroughly aired in the Courts in the context of the formulation of the rules concerning the assessment of damages for future pecuniary loss, an important aspect of which concerns the calculation of the rate of interest which the money awarded will earn. For some years, the practice of the courts was to employ a discount rate of 4-5% to reflect the long-term, after tax, rate of return on equities. This practice was challenged, however, by the Law Commission and the Ogden Report for under-compensating plaintiffs - the rate of return, it was argued, should be calculated on the basis that plaintiffs invest in the least risky securities (index-linked government securities) which would return 2-3% - only for the Court of Appeal to endorse the established view. Damage awards, it held, should be fixed on the assumption that plaintiffs will adopt a 'prudent investment strategy', interpreted to mean that they will invest in a basket of securities including a substantial proportion (about 70%) of equities (see *All ER Annual Review* 1997 538-541 for a summary). The House of Lords has, however, now overturned this decision, holding that plaintiffs are entitled to have their damages calculated on the basis that they will invest in 'risk-free' ILGS with a low average return of 2.5%. While equities, they argued, were 'the best long-term investment for the ordinary

majority of share dealings involve not issues raising capital for new investment but the buying and selling of titles to revenue issued long ago. As a whole the stock market today does little to raise capital for new investment. Between 1981 and early 1996, for example, U.S. nonfinancial corporations retired more stock (\$700 billion) than they issued, thanks to takeovers and buybacks.¹⁵⁸ It is also important to dispose of the suggestion that the shareholder interest is acquiring 'a new legitimacy' because it now represents, in part, the long-term savings of the more privileged members of the working class.¹⁵⁹ While for some this 'socialisation' of shareholding holds out the prospect of pension-fund socialism,¹⁶⁰ as Doug Henwood points out workers would be ill-advised 'to trade a few extra percentage points return on their pension fund, on which they may draw some decades in the future, for 30 or 40 years of falling wages and rising unemployment insecurity.' Given that the whole purpose of shareholder activism is to increase the profit share of national income and to claim a larger proportion of that profit for rentiers, he explains, 'any gains to people of modest means are accidental'.¹⁶¹ In short, shareholders should be recognised for what they really are - 'functionless investors'¹⁶², passive owners of claims to part of the labour of others with a resemblance to old-fashioned usurers - and not mistaken for dynamic, risk-taking, deserving, corporate 'owners'.¹⁶³

As Berle and Means noted many years ago, this places a question mark over the legitimate extent of shareholder rights. Having 'surrendered control and responsibility' over corporate assets, shareholders, they suggested, had 'surrendered the right that the corporation should be operated in their sole interest' and 'released the community from the obligation to protect them to the full extent implied in the strict doctrine of property rights'.¹⁶⁴ In fact, what is at issue here is arguably even more fundamental than Berle and Means realised, for the emergence of the modern depersonified corporation represents not merely a dilution of shareholder corporate property rights but the demise of the means of production as private property to which notions of 'ownership', with their connotations of exclusivity and exclusion, are applicable. Indeed, this is something that company law itself recognises, albeit partially, imperfectly and distortedly, in its constitution of the incorporated company as an autonomous, essentially depersonalised, property-owning legal person. It was for this reason that for Marx the rise of the modern corporation represented 'the abolition of capital as private property within the framework of capitalist

investor', because of possible short-term variations in their value this was not necessarily true for an injured plaintiff needing to live off the capital and income. See *Wells v Wells* [1997] 1 All ER 673 (CA); 24 July 1998 (HL). In fact, as we move closer to a world market in capital, and as investors diversify their financial holdings, the levels of return on investments, equities as well as governments bonds, seem to be showing clear signs of convergence, see Gray, n 156 above 61-2.

¹⁵⁸ Henwood, n 123 above. For this reason, the characterisation of shareholders, which underpins 'nexus of contracts' and 'agency' theories of the company, as 'suppliers' or 'providers' of capital is far too flattering to them and bears little relation to contemporary reality.

¹⁵⁹ See Davies, n 122 above, 69.

¹⁶⁰ See Richard Minns, 'The Social Ownership of Capital' (1996) 219 *New Left Review* 42.

¹⁶¹ Henwood, n 123 above, 293.

¹⁶² J.M. Keynes, *The General Theory of Employment, Interest, and Money* (1936), in *Collected Writings* (1936; London: Macmillans, 1973) vol VII, 376. 'Interest', he wrote, 'today rewards no genuine sacrifice'.

¹⁶³ In this context, perhaps, the need is to distinguish between genuine, socially beneficial, risk-taking which is deserving of reward and gambling which is not.

¹⁶⁴ Berle & Means, n 76 above, 312.

production itself ... private production without the control of private property¹⁶⁵. And that for Schumpeter it '[took] the life out of [private] property', marking the disappearance of 'the figure of the proprietor and with it the specifically proprietary interest' and illustrating how capitalism undermines its own institutional framework.¹⁶⁶ In this context, the share - 'the evaporation of the material substance of property'¹⁶⁷ - is best seen as an attempt to preserve corporate assets as objects for generating private profit despite even though they are no longer private property 'owned by shareholders';¹⁶⁸ and the current neo-liberal fashion for theorising the company as a 'nexus of contracts' best seen as an attempt not merely to preserve the share but to legitimate the tenuous claims of vestigial, rentier shareholders to a significant part of the social product. Despite the corporate vanishing trick that these theorists perform, however, the result of their desire to re-establish corporate assets as private property and to forestall recognition of the fact that in the corporate context 'ownership is a problem rather than a pre-supposition'¹⁶⁹ is an ungainly attempt to turn the clock back and to *repersonify* the corporation as an aggregate of capital-supplying individuals.¹⁷⁰

It is not, however, only the erosion of the means of production as private property and the consequent unsuitability when applied to corporations of traditional ideas of 'ownership' that points to the fundamentally *social* nature of corporate assets. Modern corporations - and the millions who participate in their activities worldwide and the many more millions who depend, directly and indirectly, on the success of those activities - are reflections and expressions of the general decline of production as a 'truly "private" economic activity'.¹⁷¹ They are aspects of the *socialisation* of production and of the growing economic interdependence that characterises modern capitalism. Increasingly, our collective material fate is inextricably bound up with the use we make of corporate assets. It is arguable, therefore, that not only are corporate assets no longer private property, but that, as the product of the collective labour of generations upon which we all depend, there are compelling grounds for designating them common property.

Ultimately, it is to these changes in the nature of corporate property and the process of production that stakeholders and others are alluding when they describe the corporation as a 'social' or 'public' institution. In this context, the immediate need is to dispel the residual identification of corporation with shareholders and to complete the process, begun last century, of corporate depersonification. This would not in itself provide answers to the difficult questions concerning the allocation of power and rights in and over corporations and their activities, but it would, by dispelling the ownership myth and the private property premisses upon which it is based, at least enable these questions to be asked.¹⁷² By facilitating

¹⁶⁵ Karl Marx, n 40, above, 436. For discussion of the political significance of this, see Shlomo Avineri, *The Social and Political Thought of Karl Marx* (Cambridge: Cambridge UP, 1968) 174-184.

¹⁶⁶ Joseph Schumpeter, *Capitalism, Socialism and Democracy* (1943; London: George Allen, 5th ed 1976) 139-42.

¹⁶⁷ Schumpeter, *ibid* 142.

¹⁶⁸ See David Campbell, *The Failure of Marxism* (Aldershot: Dartmouth, 1996) 238-248.

¹⁶⁹ Alain Pottage, 'Instituting Property' (1998) 18 OJLS 331 at 338.

¹⁷⁰ It is not, therefore, insignificant that in their attempt to reconstruct corporate relations these theorists rely heavily on the concepts of agency and contract, with the curious result that 'the corporation' as they conjure it up bears a closer resemblance to the personified joint stock company of the eighteenth and early nineteenth centuries (particularly the unincorporated variety) than it does to the modern depersonified corporation.

¹⁷¹ Schumpeter, n 166 above, 141-2.

¹⁷² As Joseph Singer points out, it is precisely because we need to resolve difficult issues of this sort that we ask questions about who is owner. See Singer, 'The Reliance Interest in Property' (1988) 40

recognition of the corporation not as an 'owner', nor as an object capable of being owned, but as a network of social and productive relationships, it would enable us to begin the process of reconceptualising the corporation and corporate property. It cannot be doubted that this - and the replacement of private, shareholder-centred mechanisms by more democratic, social mechanisms of governance that would accompany it - will be extremely difficult to achieve. Quite apart from the formidable political obstacles, as Sealy observes 'at present our company law lacks the conceptual ... tools ... to reflect our new perception of the [public] company as no longer a shareholders' collective, but an enterprise in which the interests of many stakeholders have to be balanced'.¹⁷³ We have to start somewhere, however, and we could do worse than to heed Handy's advice and demote shareholders to the status of 'mortgage men'.¹⁷⁴ Not only would this be more befitting their largely parasitical role, it would, by transforming share markets into betting shops rather than auctions and by loosening the grip of capital, help to create more space within which the implicit sociality of the corporation might be realised. In the meantime, with the residual 'ownership' rights of corporate shareholders still in place, corporate property will, through the share, continue to be 'a mutation of private property'¹⁷⁵ and a debased mutation at that. In this context, the fears of the ancient and medieval critics of usury seem ever more prescient, for as rentier investment and finance in its manifold forms asserts ever more forcefully its social power and right to part of the unpaid labour of others, we see growing injustice in exchange, a continuing upward redistribution of income (nationally and internationally), and a disintegration of the bonds that tie society together. In the corporate context, as financial markets demand, in the name of shareholder value and financial prudence, cutbacks in both public and private investment, we see increasing exploitation at work, a disregard for communities and the environment, a shortening of time horizons, and a secular decline in 'real' investment. As Deakin and Slinger rightly say, there is 'no guarantee of compatibility between a company law system aimed primarily at the protection of shareholder value and society's interest in maintaining a productive corporate sector'.¹⁷⁶ Or as Keynes put it, 'we cannot as a community provide for future consumption by financial expedients but only by current physical output'.¹⁷⁷ Ultimately, a society guarantees its future only by real physical and social investments. For this reason, the increased shareholder activism sought by many, including the present Labour government, is likely to prove to be the disease that purports to be the cure.

Stanford Law Review 614 at 637-641.

¹⁷³ Sealy, n 52 above, 28.

¹⁷⁴ 'Financiers', Handy argues, 'would, in effect, hold mortgages but could only intervene managerially if the business reneged on its payments. Some mortgages would carry no repayment obligation but, instead, a share of the income stream for perpetuity', n 143 above, 152-3.

¹⁷⁵ Jeremy Waldron, *The Right to Private Property* (Oxford: Clarendon Press, 1988) 57.

¹⁷⁶ Deakin & Slinger, n 91 above, 146. Efficiency in the production of profits is distinguishable from efficiency in the production of useful things.

¹⁷⁷ Keynes, n 162 above, 104. Elsewhere, Keynes wrote of 'the euthansia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital', *ibid*, 376.