



Ireland, P. (2018). Corporate Schizophrenia: The Institutional Origins of Corporate Social Irresponsibility. In N. Boeger, & C. Villiers (Eds.), *Shaping the Corporate Landscape* (1 ed.). Hart Publishing.  
<https://www.bloomsburyprofessional.com/uk/shaping-the-corporate-landscape-9781509914302/>

Early version, also known as pre-print

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Draft

## Corporate Schizophrenia: The Institutional Origins of Corporate Social Irresponsibility

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A few years ago, shortly after the scandal surrounding Libor had begun to break, I attended a seminar on corporate social responsibility. Libor was the latest in a long list of corporate scandals to come to light and I couldn't help wondering why academics seemed more interested in corporate social responsibility than corporate social *irresponsibility*. Since then, of course, the scandals have continued to come thick and fast. Accounting scandals (Tesco, Toshiba) have piled up on top of tax avoidance scandals (Google, Amazon, Facebook, Starbucks, Apple), and an assortment of other improprieties (Volkswagen cheating with its emissions tests, Exxon Mobil apparently deliberately misleading the public about its research into climate change). Scandals of this sort are not, of course, new, but corporate irresponsibility does seem to be scaling new heights. In seeking an explanation, some would no doubt point an accusatory finger at the ideology of 'maximizing shareholder value'. And with good reason. But in recent years, shareholder-value ideology has receded without any noticeable impact on corporate behavior. Indeed, placing too much emphasis on its baleful effects risks causing us to overlook the more deeply rooted institutional foundations of corporate irresponsibility. This paper explores these foundations. The potential for irresponsibility, it argues, is inscribed in the corporate legal form as currently constituted and thus in the property rights structures of contemporary capitalism. Paradoxically, it suggests, so too is the possibility of more 'socialized' corporations. While, therefore, experimentation with alternative organizational forms is vitally important to social transformation, with so many key productive resources under the direct or indirect control of corporations, so too is radical reform of the corporate legal form.

### The Railtrack Cases

I'm going to begin my exploration of the institutional roots of CSI by examining a couple of cases decided in autumn 2005. Both involved Railtrack, the group of companies created by the government to manage the rail infrastructure after privatisation in the early 1990s.<sup>1</sup> In the first, decided in September, Railtrack was fined £3.5 million for the safety breaches which led to a crash at Hatfield in 2000 in which four people died and over 70 were injured. Hatfield was the third major crash in the five years after privatization: at Southall in 1997, six people died and 150 were injured; at Ladbroke Grove in 1999, 31 people died and 523 were injured. All three accidents were attributed in significant part to factors under Railtrack's control, in the case of Hatfield to cracks in the rails which the company had known about for two years but not got round to fixing.<sup>2</sup> The Southall and Ladbroke Grove crashes were attributed variously to inexperienced and inadequately trained drivers, faulty equipment, poorly located signals, poor maintenance, failure to invest in safety enhancing technologies

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<sup>1</sup> Railtrack was sold to the private sector in May 1996. By 2005, it had been replaced by the state-controlled, non-profit company, Network Rail, a company limited by guarantee and formed in 2002.

<sup>2</sup> *Train Derailment at Hatfield: Final Report by Independent Investigation Board*, 110

and so on. In the Hatfield case, the court condemned Railtrack's attitude and safety record: it was, the judge said, the 'worst example of sustained negligence in a high risk industry that he had ever seen'.<sup>3</sup>

The second case, *Weir & Others v Secretary of State for Transport & the Department of Transport*, was decided a month later. It too arose out of the Hatfield crash, albeit indirectly. Hatfield forced Railtrack to check for cracks across the railway system and this led to speed limits and line closures. As a result the company hemorrhaged money and was soon in serious financial difficulty, its shares plunging from an earlier high of over £17.50 to £4.00. The government considered various options, before settling on receivership. In October 2001 Railtrack plc was placed into administration and trading in the company's shares, now virtually worthless, suspended.<sup>4</sup> Initially, the government refused to pay compensation, but two shareholder action groups were formed and the large institutional shareholders exerted intense pressure on the government.<sup>5</sup> An offer of £2.50 per share was eventually made<sup>6</sup> which the institutions and one of the action groups accepted, clearly reckoning they'd done as well as they could in the circumstances. But the other shareholder group, the Railtrack Private Shareholders Action Group (RPSAG), representing nearly 50,000 smaller shareholders, rejected the offer.

The members of RPSAG organized and raised a total of nearly £4m to hire lawyers to sue the government in the largest class action seen in British law. It was a phenomenal effort on their part.<sup>7</sup> Motivated by the belief that their property had been expropriated by the state, they expended a huge amount of time, energy and money bringing the case to court. They argued that the Secretary of State involved, Steven Byers, was guilty of breaches of the European Convention on Human Rights (expropriating property without proper compensation) and of misfeasance in public office (abusing his powers to engineer back door re-nationalization). They were supported by many in Parliament and the media, particularly the *Daily Telegraph* and *Evening Standard*, who shared the shareholders' view that their property had been stolen. Nobody, however, was quite sure what the stolen property was. Some suggested it was the shareholders' shares; others that it was the company's assets; still others it was 'the company' itself. 'We the shareholders owned RTK [Railtrack]', claimed one shareholder; 'Railtrack Group owns Railtrack plc and we shareholders own both' claimed another.<sup>8</sup> Yet another accused the Government of plotting

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<sup>3</sup> <http://www.telegraph.co.uk/news/uknews/1519644/Fined-13m-but-Hatfield-rail-firms-given-21m-costs.html>

<sup>4</sup> The shareholders had shares in Railtrack Group plc, whose main operating subsidiary, Railtrack plc, was the company placed into administration. Under European rules, had the company been re-nationalized shareholders would have been entitled to about £8 per, the average price of the shares over the previous three years. Prior to suspension, the company's shares were trading at £2.80; the three year average price included the £17.68 high.

<sup>5</sup> See Louise Butcher, 'Railways: Railtrack administration and the private shareholders, 2001-05', *HC Standard Note* SN/BT/1076, 10/8/2010, p7.

<sup>6</sup> The Government was particularly concerned about the reaction of the bondholders and large US institutions. In their internal communications, the small shareholders were variously (rather contemptuously) described as 'grannies who might lose their blouses' and 'little old ladies'.

<sup>7</sup> See 'Railtrack Shareholders – What kept us going', *Private Investor*, Issue 109, Dec/Jan 2006, p 3-4

<sup>8</sup> <http://boards.fool.co.uk/possible-amount-of-compensation-9347245.aspx?sort=whole>.  
<http://boards.fool.co.uk/railtrack-plc-v-railtrack-group-6956032.aspx?sort=whole>.

to 'steal [the] company from its rightful owners'.<sup>9</sup> In similar vein, the *Daily Telegraph* wrote of the 'expropriation of Railtrack's owners'.<sup>10</sup>

The case was lost. The claim that there had been a *de facto* expropriation was dropped during the course of argument and the shareholders' other claims decisively rejected by the judge.<sup>11</sup> The abandonment of the expropriation claim was unsurprising: its weakness had led the lawyers representing the other shareholders to settle. In law, the company as a separate legal entity owns the corporate assets, not the shareholders. The shareholders own shares and in this case they were more or less worthless. Moreover, the idea that the shareholders of large public corporations like Railtrack 'own' the company is legally unsustainable. As many have pointed out, using Honore's 'incidents of ownership' as a yardstick, shareholders possess few of the rights of corporate owners.<sup>12</sup> It nevertheless remains an important and powerful part of our everyday, taken-for-granted common sense. 'Back when I was a law student in the early 1980s', Lynn Stout recounts, 'my professors taught me that shareholders "own" corporations ... [A]t the time ... this made sense enough to me'<sup>13</sup> The significance of this should not be underestimated, for legally unsustainable though it may be, it played a key role in the Railtrack cases and perpetuates the idea of shareholder primacy as a simple matter of property right. Thus when the law asserts that directors are legally bound to promote the 'interests' or 'success' of 'the company', this is usually interpreted to mean the interests of the company's shareholders.

### Corporate Schizophrenia

The Railtrack cases are illustrative of the schizophrenic nature of our ideas about corporations and their relationship with their shareholders.<sup>14</sup> They show that in some contexts the existence of the corporation as a separate legal person is taken very seriously indeed, both in law and common sense. Thus, not only were Railtrack's shareholders not

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<sup>9</sup> <http://boards.fool.co.uk/i-am-a-little-slow-this-morning-the-telegraph-9348450.aspx>

<sup>10</sup> *Daily Telegraph*, 'The Bad Old Days', 15/1/2002. A few years later similar claims were made by the shareholders of the collapsed bank, Northern Rock. They had been 'robbed', they argued, when the Bank of England abused its position of lender of last resort to enable the government to expropriate the bank's assets: see Joanna Gray, 'Northern Rock shareholders' challenge to basis of compensation in nationalisation considered in high court and court of appeal', 17 *Journal of Financial Regulation and Compliance* (2009), 467. The shareholders, a mixture of hedge funds and small holders, initiated proceedings against the government but the case was lost in both the High Court and Court of Appeal and when the European Court of Human Rights unanimously dismissed their case as manifestly ill-founded and inadmissible: *Dennis Grainger and others v UK* (Application No. 34940/10). The Chairman of the Northern Rock Shareholders Action Group, Chris Hulme, declared the decision a violation of property and ownership rights: <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9445059/European-court-rejects-Northern-Rock-shareholders-case.html>. Two hedge funds led the action, claiming that shareholders should have received £4 a share given the bank's substantial assets: see Marion Dakers, *Daily Telegraph*, 30/4/15: <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11574454/Northern-Rock-shareholders-hit-out-at-Milibands-inaction.html>. But the accountancy firm, BDO, concluded the shares were worthless at the time of nationalisation: see Phillip Inman, *The Guardian* 1/3/16: <https://www.theguardian.com/business/2010/mar/30/northern-rock-shareholders-valuation>.

<sup>11</sup> *Weir and others v Secretary of State for Transport and another*, [2005] EWHC 2192 (Ch).

<sup>12</sup> See, for example, John Kay, 'The Stakeholder Corporation', in Kelly, Kelly & Gamble, *Stakeholder Capitalism* (Palgrave Macmillan, 1997); Paddy Ireland, 'Company Law and the Myth of Shareholder Corporate Ownership', (1999), 62 *MLR*, 32.

<sup>13</sup> Lynn Stout, *The Shareholder Value Myth* (Berrett-Koehler, San Francisco, 2012), v.

<sup>14</sup> In this article the term 'corporation' is generally used, as it is in everyday usage, to refer to publicly quoted companies. The schizophrenia alluded to here is rather different from that alluded to by William Allen in his 'Our Schizophrenic Concept of the Business Corporation', 14 *Cardozo LR* (1992), 261.

held legally liable for the company's appalling safety record, nobody seems to have considered them morally responsible for it either. The same was true of the shareholders of the banks involved in the financial crash and the shareholders of BP after Deepwater Horizon. Few considered them morally, let alone legally, responsible for the damage caused by, or debts of, the corporations concerned, and the shareholders themselves showed no signs of remorse or guilt - it was 'the company', a completely separate (property-owning) legal person, that was responsible, not them. In the Railtrack case this sense of separation was manifested in the fact that while Railtrack's shareholders expended a lot of time, energy and money trying to remedy what they saw as the theft of their property, they did nothing to address the company's dreadful safety record. Indeed, in blogs they made it clear that they thought this nothing to do with them<sup>15</sup>, and in court their lawyer explicitly argued that they were in no way responsible for what he called 'the sins of the company'.<sup>16</sup> On the other hand, the cases also show that in other contexts the existence of the company as a separate legal person is largely ignored. Thus, the shareholders themselves and many media commentators clearly saw Railtrack as an *object of property* owned by its shareholders, hence the belief that the shareholders had been robbed and the idea, embedded in legal thought, that as 'things' owned by their shareholders, corporations should be run in their interest as a matter of simple property right. In these contexts, far from being regarded as 'completely separate', large corporations and their shareholders are treated as more or less synonymous.<sup>17</sup>

As a result of this corporate schizophrenia, shareholders are able to assert, in a manner which is generally seen as perfectly appropriate and legitimate, 'ownership' claims over corporations which enable them to insist on the maximisation of their returns. At the same time they are seen as bearing, in a manner thought equally appropriate and legitimate, no responsibility for the wrongs committed and damage caused by these corporations. Moreover, there is a clear link between these schizophrenic ideas and the problem of corporate irresponsibility. As Railtrack's CEO, Gerald Corbett, conceded in a radio interview shortly after the company's Hatfield conviction, there was a tension between the shareholder interest and the company's public service obligations. 'The only way we can make profits', he confessed, 'is by *not* doing the things we should to make the railways better'<sup>18</sup> He might of course have added, 'and safer too'.

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<sup>15</sup> One RPSAG member wrote: 'And enough of the rants about safety – if BP can safely run a thermal hydrogen cracker 2 miles from the secondary school in Grangemouth, then Railtrack could most certainly run the railways': <http://boards.fool.co.uk/i-think-its-more-appropriate-to-note-that-the-8173639.aspx>.

<sup>16</sup> See Commons Standard Library Note, SN 01076, 'Railways: Railtrack administration and the private shareholders, 2001-2005' (10/8/10): <http://www.parliament.uk/business/publications/research/briefing-papers/SN01076/railways-railtrack-administration-and-the-private-shareholders-20012005>.

<sup>17</sup> On 'complete separation', see Gower & Davies, *Principles of Modern Company Law* (9<sup>th</sup> ed., 2012), 35-38. Under s172 of the UK Companies Act 2006, the 'success of the company' is identified with 'the benefit of the members as a whole'. See also John Parkinson, *Corporate Power and Responsibility* (OUP, 1993), 74-92.

<sup>18</sup> Interview on the *Today* programme, BBC Radio 4, 17/12/99, cited in Brendan Martin, 'The High Public price of Britain's private railway', *Public World*, November 2010. In similar vein, *National Commission on the BP Deepwater Horizon Oil Spill* concluded that the disaster was ultimately traceable to a string of decisions to ignore standard safety procedures to cut costs: see National Commission on the BP Deepwater Horizon Oil Spill and Offshore Drilling, *Deep Water: The Gulf Oil Disaster and the Future of Offshore Drilling* (Jan 2011).

Some degree of mental splitting<sup>19</sup> is, of course, inherent in the corporate legal form and the doctrine of separate corporate personality. But history suggests that corporate schizophrenia in the extreme form described above is a historical and legal product. Clues as to its institutional origins are to be found in an article written by Edward Warren, a Harvard Law Professor, in the 1920s. In a discussion of 18<sup>th</sup> and 19<sup>th</sup> century English joint stock companies (JSCs), Warren complained about the poor grammar of contemporary English judges and lawyers. What irked him was that they kept referring to incorporated companies as 'theys', as though were made up of their shareholders, and to the assets of those companies as though they belonged to those shareholders. They failed, in other words, to recognise the existence of the corporation as a separate property-owning entity, an 'it'.<sup>20</sup>

Warren was right: eighteenth and nineteenth century English judges and lawyers did refer to JSCs as 'theys' as if they were composed of shareholders. He was, however, wrong to suggest that this practice was confined to the English – their US counterparts did likewise<sup>21</sup> – and equally wrong to suggest that these practices were the result of poor grammar or conceptual error. Warren clearly thought the act of incorporation *always* created a property-owning corporate entity which was radically separate from its shareholders. History makes it clear, however, that the perceived nature of incorporated companies and their relationship with their shareholders changed during course of the nineteenth century. Put simply, there was a move from a conception of corporations as their shareholders merged into a single, legally distinct body – as *personified* legal persons, separate entities made up of their flesh-and-blood members (and therefore 'theys') - to a conception of them as *de-personified* legal persons, reified 'things', 'its', cleansed of shareholders. It was only in the mid-late nineteenth century and early-twentieth centuries that this de-personified conception of the corporate entity began to crystallise and references to corporations with singular verbs and nouns 'come to dominate, and the plural constructions that typified the first half of the century gradually disappear'.<sup>22</sup> The question is: what underlay this shift?

### **Company Law and the Joint Stock Company**

Pointers to the answer are to be found in one of the differences between the UK and the US: what in the UK is called 'company law' is referred to as 'corporate law' in the US. Nowadays, this difference is treated as of little consequence: the subject matters of company law and corporate law are basically the same. But its historical origins are revealing. Both 'corporate law' and 'company law' were nineteenth century constructs, the first books on which were published in the 1830s: Joseph Angell and Samuel Ames' *The Law of Private Corporations Aggregate* appeared in 1832, followed in 1836 by Charles Wordsworth's *The Law Relating to Railway, Bank, Insurance, Mining and Other Joint Stock Companies*.<sup>23</sup> But

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<sup>19</sup> The term 'schizophrenie', derived from the Greek 'skhizein' (to split) and 'phreno' (mind), was coined in 1910 by Swiss psychiatrist Eugen Bleuler.

<sup>20</sup> E H Warren, 'Safeguarding the creditors of corporations' 26 *Harvard Law Review* (1923) 509.

<sup>21</sup> In the early nineteenth century, American judges also 'frequently refer[red] to corporations as "theys" rather than its': see E M Dodd, *American Business Corporations until 1860* (Harvard UP, 1954), 66. This has been confirmed by Naomi Lamoreaux: 'Partnerships, Corporations and the Limits on Contractual Freedom in US History', in Kenneth Lipartito & David B Sicilia, *Constructing Corporate America* (OUP, 2004) p29.

<sup>22</sup> Lamoreaux, *ibid*, 44-45.

<sup>23</sup> Joseph Angell & Samuel Ames, *Treatise on the Law of Private Corporations Aggregate* (Boston: Hilliard, Gray, Little & Watkins, 1<sup>st</sup> ed., 1832); Charles Wordsworth, *The Law Relating to Railway, Bank, Insurance Mining, and Other Joint Stock Companies* (Butterworth, 1<sup>st</sup> ed., 1836; 2<sup>nd</sup> ed., 1837).

they were rather different in orientation and approach. Like both corporate law and company law texts today, Angell and Ames' treatise was organised around the corporate *legal* form, embracing all associations with corporate status. Nowadays, of course, this means businesses of all economic types, from large multinationals to medium-sized firms to small corner shops, all of which can (and do) become incorporated companies. In the eighteenth and for much of the nineteenth century, however, the term 'company' was an abridgement of 'joint stock company' and as the title of Wordsworth's book suggests, 'company law' (such as it was) was an abridgement of 'joint stock company law'. Crucially, in eighteenth and early nineteenth century Britain some JSCs were incorporated, but many were not: JSCs were defined not by reference to their *legal* status but by reference to their *economic* nature. Organised around the JSC *economic* form rather than the corporate legal form, Wordsworth's book encompassed all JSCs regardless of their legal status.<sup>24</sup>

Adam Smith described the key characteristics of the ideally typical JSC in *Wealth of Nations* when he distinguished the JSC from the 'private co-partnery'.<sup>25</sup> The ideally-typical private co-partnery or partnership was based around a small number of closely-related individuals who were active participants in the firm. In law, this was reflected in the principles of mutual agency (whereby partners could bind one another), joint asset ownership (whereby partners were joint owners of the partnership property), and joint and several unlimited liability. For inactive 'investors' who opted to become partners rather than creditors in search of returns better than those available from government debt and usury-capped loans, legal principles like unlimited liability were a problem. But the prevailing view was that by ensuring that partners were active and alert, and success rewarded and failure punished, unlimited liability not only accorded with the natural principles of justice and 'the market' but operated in the public interest by ensuring that firms were run efficiently. The 'partnership system of commerce' was widely regarded as the foundation of British economic success.<sup>26</sup>

By contrast, JSCs were based around a capital fund and had many more members, most of whom were inactive, their interest in the firm being largely, if not wholly, financial. The 'proprietors' of JSCs, Smith wrote, 'seldom pretend to understand anything of the business of the company; ... and give themselves no trouble about it, but receive contentedly such half yearly dividend or yearly dividend as the directors think proper to make to them'.<sup>27</sup> As this suggests, JSCs were the precursors of today's large corporations and vehicles not only for productive activity, but for *rentier* investment. It followed that JSCs were characterised by a separation of ownership and management, and by (more or less) freely transferable shares. Indeed, it was the size, nature, and changing character of their memberships that made the possession by JSCs of corporate privileges so desirable. It also, Smith argued, rendered them inherently less efficient than owner-managed firms. Populated by passive,

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<sup>24</sup> The same was essentially true of American 'corporate law', though the situation was more complicated because capital shortages meant individual states were more willing to grant corporate privileges to facilitate the formation of firms that would foster development. However, the link between incorporation and JSCs remained: see Angell and Ames, v-vi.

<sup>25</sup> Adam Smith, *Wealth of Nations* (1776, Liberty Fund 1982, ed by Campbell, Skinner & Todd), Volume II, 731-758. The section on JSCs appeared in the 3<sup>rd</sup> edition, published in 1784.

<sup>26</sup> See Paddy Ireland, 'Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility', (2010) *Cambridge Journal of Economics*, 837.

<sup>27</sup> Smith, note 25, 741.

*rentier* shareholders and led by directors managing ‘other people’s money’, JSCs were likely to be characterised by ‘negligence and profusion’. He concluded nevertheless that there were certain circumstances in which facilitating JSC formation was in the public interest. Thus, JSCs should be granted ‘exemptions from the general law’ (like limited liability) where the capital required was beyond the capacity of a private partnership; where the risks were unusually great; where there was an identifiable public benefit; and where the operations of the business could be reduced to a routine.<sup>28</sup>

Smith’s ideas about the legitimate scope of the JSC shaped state policy and public opinion well into the nineteenth century with the result that throughout this period corporate privileges were granted sparingly, forcing many JSCs to operate as unincorporated concerns.<sup>29</sup> The story was very different in the US, where states granted corporate privileges much more readily, hence the different approaches and scopes of the Angell & Ames and Wordsworth books. It is nevertheless clear that even in the UK JSCs were from their inception associated with corporate status and privileges, even if not all JSCs were able to secure them. When incorporation and limited liability were made freely available, in 1844 and 1855 respectively, the link became even stronger, for thereafter nearly all JSCs were legally obliged to incorporate. As a result, in the business context, the JSC and the corporate legal form became more or less co-extensive. It was only towards the end of the century and the rise of the ‘private’ company that the link was broken. Thereafter, ‘company law’ came to encompass not only JSCs but all incorporated firms, irrespective of their economic natures.

### **Accommodating the *Rentier***

In empirical reality, at this time the line between the private partnership and the JSC was fuzzy. A lot of firms emerged with relatively large memberships, some degree of separation of ownership and management, and transferable shares. Some were incorporated, others not. But many of these firms were more in the nature of ‘extended partnerships’ than ‘pure’ JSCs, their shareholders often having more than a purely financial interest and involvement in the enterprise.<sup>30</sup> Indeed, even if they aspired to be pure money capitalists, members of these firms were hampered by the legal restrictions on share transfers, the absence of a developed share market, and by the legal conceptualization of shares in both incorporated and unincorporated companies as equitable interests in the company’s assets. Moreover, shares at this time were rarely fully paid up and the resulting residual liabilities created ties between both shareholders and companies, and between shareholders *inter se*.<sup>31</sup> These material realities were reflected in the tendency, which continued well into the nineteenth century, to treat shareholders as ‘partners’ and to treat JSCs, incorporated as well as unincorporated, as types of partnership. In the jargon of the day, JSCs were ‘public’, rather than ‘private’, partnerships. As a result it was regarded as more or less axiomatic that *all* joint

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<sup>28</sup> Smith, note 25, 757-58

<sup>29</sup> As late as 1840 one finds a series of leading articles in *The Times* denigrating JSC shareholders as wanting to ‘make money in idleness’ and arguing that JSCs were ‘inconsistent with the solid and proper principles of trade’ and partnership’: 9 October 1840; 22 October 1840. There was, the paper added, ‘only one more quality wanting to make the morsel wholesome as well as tempting’ to the idle *rentier* - limited liability: see James Taylor, *Creating Capitalism* (2006).

<sup>30</sup> See Mark Freeman, Robin Pearson & James Taylor, *Shareholder Democracies* (2012).

<sup>31</sup> With shares only partly paid up, there were good reasons for shareholders to be concerned about the financial wherewithal of their fellow members.



stock companies were governed by the general law of partnership except in the important respects in which, in the case of incorporated firms, the latter had been `superceded' or `limited and restrained' by the instrument of incorporation. Another result, noted by Warren, was that JSCs were seen, like partnerships, as aggregates of individuals - as 'theys'. Even when a JSC acquired corporate status, the separate corporate entity was still seen as composed of people – as a *personified* legal person.<sup>32</sup> In these circumstances the sense of 'complete separation' from the company felt by Railtrack's shareholders was simply not possible.

The second half of the nineteenth century, however, saw the emergence of much 'purer' JSCs and much 'purer' money capitalist shareholding, a development driven by the rise of railway companies which needed to raise huge amounts of capital by contemporary standards. The result was the appearance of companies populated by thousands (rather than tens or hundreds) of pure *rentier* investors and the emergence for the first time of a developed share market. This changed the character of the JSC and JSC shareholding and prompted a series of modifications to the law of partnership as it was applied to JSCs the cumulative effect of which was to accommodate and offer protection to shareholders.<sup>33</sup> In Robert Flannigan's words, a 'sustained effort' was made 'to design ... arrangements that exposed passive investors to something less than the general liability of principals'.<sup>34</sup> The legislative changes, and in particular the introduction of incorporation by registration and general limited liability, are well-known. However, a series of judicial changes were also made to the law of partnership as it applied to JSCs: the partnership doctrine of mutual agency was abandoned and the doctrine of ultra vires was reformulated, for example.<sup>35</sup> In this context it is not, perhaps, insignificant that more and more of the law-makers, legislative and judicial, were themselves becoming members of the shareholding class.

One of the key judicial changes was the radical re-conceptualisation of the nature of the JSC share. From the 1830s, the courts began to treat shares not as interests (legal or equitable) in the assets of companies but as intangible rights to profit; and to treat shareholders not as asset-owners but as money-providers. Shareholders in both incorporated and unincorporated companies came to be seen, in the manner of creditors, as *transferring* ownership of their money to a company, which then invested it in assets which it ('the company') wholly (legally and equitably) owned.<sup>36</sup> Henceforth there were two quite separate forms of property: the assets owned by 'the company' (incorporated or not) and the shares (rights to profit) owned by the shareholders. In this way, all JSCs, incorporated and unincorporated<sup>37</sup>, came to be seen as property-owing entities quite separate from their share-owning shareholders. This was exemplified by a change of wording in the 1856 and 1862 (Joint-Stock) Companies Acts. Whereas the 1856 Act permitted seven or more shareholders to 'form *themselves* into a company', the 1862 Act permitted them to 'form a company', suggesting that the latter was an entity made *by*, but

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<sup>32</sup> See Paddy Ireland, 'Capitalism without the capitalist', 17 *Journal of Legal History* (1996) 40. On the application of partnership principles to JSCs, see Wordsworth, 35, 64, 101-4.

<sup>33</sup> See Paddy Ireland, 'Property and contract in contemporary corporate theory', 23 *Legal Studies* (2003), 453.

<sup>34</sup> Robert Flannigan, 'The Political Imposture of Passive Capital', (2009) 9 *Journal of Corporate Law Studies*, 139 at 146-47.

<sup>35</sup> See Ireland, note 33.

<sup>36</sup> *Bligh v Brent* (1836), 2 Y&C Ex 268.

<sup>37</sup> *Watson v Spratley* (1854), 10 Ex 222.

not *of*, them. This was an important step in the gradual shift from a conception of the JSC as a legal person composed of its shareholders to a conception of the JSC as a reified entity cleansed of and external to them.<sup>38</sup>

As part of these processes, shareholders – increasingly seen not as active ‘partners’ but as passive ‘investors’ – gradually handed over many of the rights and obligations traditionally associated with ownership to directors and managers. The introduction of limited liability had, of course, made this much less risky. By the end of the century, the risks had been further diminished as high denomination, partly paid-up shares which put the personal assets of shareholders at risk were replaced by lower denomination, fully paid-up shares. *De jure* limited liability thus became *de facto* no-liability. With the residual liabilities attached to JSC shares all but eliminated, the remaining connections between companies and their shareholders, and between shareholders and third party creditors, were severed. This completed the separation of shareholders from companies, paving the way for the full reification of the company and emergence of the doctrine of separate corporate personality in its modern form. The institutional foundations of corporate irresponsibility were now in place.

Fully paid-up shares have enabled shareholders to detach from the companies in which they hold shares with minimal risk. Not only do they no longer perform managerial functions, they are no longer burdened with residual liabilities. All they ever stand to lose is the money spent on their shares and they have, of course, mitigated this risk by delegating management of their money (as well management of the company) to others and by diversifying their investments. In this context, the complete detachment felt by Railtrack’s shareholders from the company - at least in the context of liability for the company’s debts and responsibility for its safety record – is perfectly understandable. Although they have been relieved of responsibility and liability, however, shareholders have retained certain key proprietary rights, most notably the power to dismiss directors. Shareholder retention of these crucial residual control rights, together with the emergence of the conception of the company as a de-personified, reified ‘thing’ (an ‘it’), underpins the idea - part of our common sense, as the Railtrack cases vividly illustrate - that the company is an object of property ‘owned’ by its shareholders.

### **The Janus-Faced Shareholder: Owner or Creditor?**

Corporate shareholding is, then, a very odd legal phenomenon. Shareholders have acquired a ‘novel status’<sup>39</sup> in which they are simultaneously ‘insider-owners’ with residual proprietary rights, able to elect and dismiss directors and insist that the company is run in their exclusive interests; and ‘outsiders’ who, like creditors, have transferred ownership of their property to this separate legal entity and become responsibility- and liability-free.

The Janus-faced nature of corporate shareholding is reflected in the difficulty company lawyers have capturing the legal nature of the share. One of the most oft-cited definitions, that of Farwell J in *Borland's Trustee v Steel Bros & Co Ltd*, sought to encompass both the

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<sup>38</sup> Ireland, note 26, 846.

<sup>39</sup> Robert Flannigan, ‘Shareholder Fiduciary Accountability’ [2014] *Journal of Business Law*, 1 at 6.

proprietary and contractual dimensions of the share, describing it as '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*'.<sup>40</sup> This foregrounds the contractual dimensions ('liability', 'covenant') of shares while noting their proprietary dimension ('interest'). In similar vein, for Robert Pennington shares 'are simply bundles of contractual and statutory rights which the shareholder has against the company'. Pennington is aware that this suggests that the relationship between shareholders and companies 'is that of creditor and debtor', but assures us that this is 'quite wrong'. Being transferable, he says, the contractual rights which make up the share are of 'a peculiar nature', which this has led to them being called property. Discomforted by this, but not wanting to dismiss it out of hand, Pennington says this view is 'innocuous enough, provided that it is remembered that they do not comprise any proprietary interest in the company's assets'. Pennington concludes that shares 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'. This covers all the bases but is about as clear as mud.<sup>41</sup>

Others, struggling with the same problem, have placed much greater emphasis on the proprietary qualities of shares. Gower, for example, thought Farwell's definition laid 'disproportionate stress on the contractual nature of the shareholder's rights' and sought to highlight Farwell's claim that the shareholder has an 'interest *in* the company', arguing that this underlined the 'insider' status of shareholders by constituting them as 'members of the company'. Gower recognised that it was 'tempting to equate shares with rights under a contract', but insisted that a share was 'something far more than a mere contractual right *in personam*'. It might not be possible to classify 'the rights which a share confers on its holder ... as "proprietary" in the usual sense', but it was 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'. 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.' Gower knew, however, that this mixing of rights *in rem* with rights *in personam* didn't make it easy to specify the precise nature of this proprietary interest: 'The theory', Gower argued, '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'.<sup>42</sup> This view was recently endorsed by Lord Miller. 'It is customary', he argued, 'to describe [a share] as "bundle of rights and liabilities" and this is probably the *nearest one can get* to its character, provided that it is appreciated that it is more than a bundle of contractual rights .. These rights ... are not purely personal rights. They confer proprietary rights in the company though not in its property'.<sup>43</sup>

The Janus-faced nature of shareholding lies at the heart of contemporary corporate irresponsibility. Shareholders have been relieved, like creditors, of responsibility for

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<sup>40</sup> [1901] 1 Ch 279 at 288.

<sup>41</sup> Robert Pennington, *Company Law* (London, Butterworths, 7<sup>th</sup> ed., 1995), 56-57, 135-36; Robert Pennington, 'Can Shares in Companies be Defined?' (1989) 10 *Company Lawyer* 144.

<sup>42</sup> LCB Gower, *Principles of Modern Company Law* (4<sup>th</sup> ed 1979), 299-301, 400.

<sup>43</sup> *HM Commissioners of Inland Revenue v Laird Group plc* [2003] UKHL 54 at para 35

corporate wrongs and debts, but permitted to retain residual proprietary rights which enable them to ensure that corporations are run in their exclusive interests. They are able, therefore, to draw revenues without actually doing anything and to insist on the maximisation of those revenues without having to worry about how they are generated, safe in the knowledge that, like creditors, they will be held neither legally liable nor morally responsible for corporate debts and misdemeanours. As Harry Glasbeek says, 'corporate shareholders have little financial or other incentive to ensure that managers behave legally, ethically or decently .... Because in law they are personally untouchable...'.<sup>44</sup> This was, of course, was only too evident in the Railtrack cases.

#### The Corporate Revolution: Towards Socialization or Financialization?

Corporate social irresponsibility was not, however, the inevitable outcome of the rise of the JSC and passive *rentier* shareholding. As many late C19th and early C20th commentators recognized, the 'corporate revolution was double-edged, containing within it two very different possible futures. The first, rooted in the residual proprietary rights attached to shares, involved the emergence of increasingly "financialized" corporations and an increasingly 'financialized' capitalism. The second, rooted in the increasingly creditor-like nature of shareholding, involved the emergence of less profit-oriented and more 'socialized' corporations and an increasingly 'socialized' capitalism. Historically, we have at different times headed in both directions.

These alternative futures figured in the work of writers as diverse as Marx, Hilferding, Veblen, Lippmann, Tawney, Laski and Keynes. Marx, for example, saw the rise of the JSC as a potentially 'progressive' development which was evidence of the way in which advancing technology was causing business enterprises to assume the form of 'social' rather than 'private undertakings'. The rise of the JSC, he argued, marked the beginning of the supersession of the means of production as private property and the 'abolition of capital as private property within the framework of capitalist production itself'. Echoing Smith, Marx also recognized the diminution of the shareholder to something resembling a creditor, observing that in JSCs the 'actually functioning capitalist' was transformed into 'a mere manager, administrator of other people's capital', while the 'owners of capital' were transformed into 'mere money capitalists' who received their rewards in the form of interest, 'as mere compensation for owning capital that now is entirely divorced from function in the actual process of production'. JSCs thus entailed 'private production without the control of private property'. Moreover, with shareholders redundant, there was no reason why management functions couldn't be delegated to workers managing their own firms. This led Marx explicitly to link the growing number of JSCs to the rise of the co-operative movement 'The capitalist stock companies', he wrote, 'as much as the co-operative factories, should be considered as transitional forms from the capitalist mode of production to socialism' whereby capital would be 'reconverted' into the property of associated producers, 'outright social property'. The only distinction was that 'the antagonism is resolved negatively in the one and positively in the other'.

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<sup>44</sup> Harry Glasbeek, *Wealth by Stealth* (Toronto, Between the Lines, 2002), 129.

On the other hand, Marx also recognized that one of the immediate effects of these developments had been an ‘enormous centralization’ of money capital in banks in their ‘capacity of representatives of all money lenders’. These institutions had become ‘the general managers of money-capital’, the representatives of ‘capital in general’. This, he observed, had created a ‘financial oligarchy’, a ‘new financial aristocracy’ with ‘money power’. Moreover, because their value inevitably involved speculations about the future, JSC shares encouraged gambling. The rise of the JSC had thus been accompanied by the development of a ‘whole system of swindling and cheating’, centring on ‘corporation promotion, stock issuance, and stock speculation’. This new ‘class of parasites’ had ‘the fabulous power not only to periodically despoil industrial capitalists, but also to interfere in production in a most dangerous manner’.<sup>45</sup> For Marx, then, while the rise of the credit system and JSC were potentially steps on road to socialisation, their immediate effect had been productively dysfunctional ‘financialization’.

A number of later commentators also recognized the double-edged nature of the rise of the corporate economy. Rudolf Hilferding, for example, noted the reduction of the shareholder to something resembling a creditor (shares, he said, represented ‘creditor’s claims on future production’) and argued that the rise of the JSC and of ‘finance capital’ was ‘establish[ing] social control of production’ and ‘socialize[d] production’. The problem was that they represented an ‘antagonistic’ or ‘fraudulent’ form of socialization in which the control of production ‘remain[ed] vested in an oligarchy’. Hilferding nevertheless saw this as progressive, for it had ‘facilitate[d] enormously the task of overcoming capitalism’: taking possession of ‘six large Berlin banks’ would now enable one to take control of the most important spheres of industry. The key was ‘the struggle to dispossess this oligarchy’.<sup>46</sup> Although often written in a very different idiom, similar themes ran through the work of the American political commentator, Walter Lippmann. He too placed great emphasis on the creditor-like nature of corporate shareholding. ‘In theory’, he wrote, the stockholder was one of the corporation’s ‘owners’, but the modern shareholder was a ‘very feeble representative of the institution of private property’, having no productive role to play and no responsibilities to discharge: the ‘one qualification’ was the ‘possession of some money and the desire for more’. ‘Deprived of their property rights’, shareholders had become ‘transient’ ‘absentee owners’, who flitted like ‘butterfl[ies] from industry to industry’ with their liquid, mobile capital. It was unrealistic to expect a ‘high sense of social responsibility’ from them. Lippmann went further, however, arguing that socialization was already becoming a reality. There had been a discernible ‘change in business motives’ and a ‘revolution in business incentives’. Business and management were becoming ‘professions’ akin to medicine, law and engineering in which ‘motives other than profit came into play’. It was true that ‘control ha[d] passed *for the time being* into the hands of investment experts, the banking interests’, but this was already being challenged—not by the ‘decadent stockholders’ but by ‘those most interested in the methods of industry: the consumer, the worker and the citizen at large’.<sup>47</sup>

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<sup>45</sup> Karl Marx, *Capital* Volume III, chapters 23, 25, 27.

<sup>46</sup> Rudolf Hilferding, *Finance Capital* (1909, Routledge ed., 2007), 110-11, 367-8.

<sup>47</sup> Walter Lippmann, *Drift and Mastery* (1914; Madison: University of Wisconsin Press, 1985, introduction by Walter Leuchtenburg.)

Not everyone, however, was as confident that financial domination was a temporary stop on the road to socialization. The American economist and sociologist Thorstein Veblen could see the progressive potential of the rise of the large corporation. It rendered, he argued, the idea of individual property rights in the means of production hopelessly outdated: modern technology not only made a more ‘socialized’ economy possible, it demanded it. But it had also seen ‘*industry*’, the technical processes concerned with the efficient production of useful goods, fall under the control of ‘*business*’ – by which Veblen meant ‘parasitic’ financial interests more concerned with making money than things. As a result industrial processes were being managed to secure pecuniary gains for the owners of financial property rather than to enhance productive efficiency.<sup>48</sup> The ‘financial community’, Veblen argued, had taken over ownership of the country’s largest corporations and thereby gained control of ‘the usufruct of [its] industrial system’<sup>49</sup> Crucially, the financial interests of ‘absentee’ shareholder-owners often obstructed productive activity and conspired against the full use of the ‘industrial arts’, for larger profits were often to be had from financial manipulation and obstructing production. Having little faith in class struggle as a way of realizing the possibilities inherent in modern industry and technology, Veblen struggled to see how these vested financial interests might be overcome.

### **Towards Socialised Corporations?**

Over the course of the following century the double-edged nature of the ‘corporate revolution’ repeatedly surfaced, finding expression in the continuing debates about the nature of the corporation and the changing trajectories of corporate governance. In simple terms, a period of intensely financialized governance at the end of the nineteenth and beginning of the twentieth centuries – ‘the first financial hegemony’<sup>50</sup> - was followed by a period of increasingly socialized governance. This has in turn been followed in recent decades by the return of financialized governance and a highly financialized, neoliberal capitalism.

Claims that corporations were being socialized began to surface early in the twentieth century. They were rooted in beliefs about the growing dispersal and disempowerment of shareholders and growing power of professionalized and increasingly beneficent managers. As we have seen, Walter Lippmann was making claims about the changing motivations of business managers as early as 1914. Keynes made similar claims a few years later. There was, he argued, an inevitable tendency for ‘joint stock institutions, when they [had] reached a certain age and size, to approximate to the status of public corporations rather than that of individualistic private enterprise’. Big business tended to ‘socialise itself’ when ‘the owners of the capital’, meaning shareholders, became ‘almost entirely disassociated from the management’. At this point managers became more concerned with stability and reputation than with profit maximization, and shareholders had to satisfy themselves with ‘conventionally adequate dividends’. It was on this basis that Keynes dismissed the need for nationalization. ‘The battle of socialism against unlimited private profit’, he argued, was ‘being won in detail, hour by hour’ from within these large enterprises.<sup>51</sup> Similar ideas

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<sup>48</sup> Thorstein Veblen, *Theory of Business Enterprise* (Scribner, 1904): see especially 77–8, 80.

<sup>49</sup> Thorstein Veblen, *Absentee Ownership* (Huebsch, 1923), 231-2.

<sup>50</sup> Gerard Dumenil & Dominique Levy, *Capital Resurgent* (Harvard UP, 2004).

<sup>51</sup> J M Keynes, *The End of Laissez-Faire* (Hogarth Press, 1926)).

surfaced again in the early 1930s in the celebrated debate between Merrick Dodd and Adolf Berle. Dodd argued that the great majority of corporate shareholders bore little resemblance to traditional owners and that corporations increasingly resembled social institutions. Directors not only *should* be required to take account of the interests of employees, consumers, creditors and society as a whole as well as of shareholders, they were doing so as a matter of *fact*. This, he suggested, was perfectly defensible if you took seriously the existence of the corporation as a separate legal person.<sup>52</sup>

By this time, the likening of shareholders to creditors and was becoming increasingly common, figuring prominently in the work of RH Tawney and Harold Laski in the UK<sup>53</sup>, and the work of Thorstein Veblen in the US.<sup>54</sup> It also appeared in Berle and Means' *The Modern Corporation and Private Property*. Berle and Means recognised that the character of the shareholder and the corporation had radically changed. The rise of the modern corporation, they argued, had 'dissolved the [private] property atom' in which possession and control were united. There were now two forms of property: one *active*, the tangible assets owned by the corporation and controlled by the managers; the other *passive*, the intangible revenue rights, 'liquid, impersonal, and involving no responsibility', owned by the shareholders. With shareholders now 'not dissimilar in kind from bondholders or lenders of money', it was no longer appropriate to view them as 'owners' of the corporation. This raised crucial 'legal, economic and social questions', the 'greatest' of which was 'in whose interests should the great quasi-public corporations ... be operated?' The answer they seemed to favour involved recognizing that shareholders 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 doctrine of strict property rights'. The community was now entitled 'to demand that the modern corporation serve ... all society' and that various groups be 'assign[ed] ... a portion of the income stream on the basis of public policy rather than private cupidity'; shareholders should get only 'a fair return' on their capital. It followed that the idea of the corporation as a private enterprise should be replaced by a 'new concept of the corporation' as a *social* institution.<sup>55</sup> It was only because we didn't yet have the institutional know-how to impose this broader 'scheme of responsibilities' on managers that Berle, *contra* Dodd, supported shareholder primacy as the only currently available way of making managers accountable.<sup>56</sup>

By the 1950s, however, Berle was conceding that history had proved Dodd right: modern directors were acting not as pure profit-maximisers but as 'administrators of a community system'.<sup>57</sup> This belief was a central tenet of the so-called 'managerialist' theories of the firm that emerged after the Second World War. Premised on the *de facto* disempowerment of corporate shareholders and growing autonomy of professional managers, managerialist ideas about the corporation underpinned the belief, prevalent during the halcyon years of

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<sup>52</sup> See E Merrick Dodd, "For whom are corporate managers trustees?" (1932) 45 *Harvard Law Review* 1147.

<sup>53</sup> R H Tawney, *The Acquisitive Society* (1920); H Laski, *A Grammar of Politics* (Allen & Unwin, 1925).

<sup>54</sup> Veblen, note 49, 231-2.

<sup>55</sup> A Berle and G Means, *The Modern Corporation and Private Property* (New York, Macmillan, 1932), especially Book IV.

<sup>56</sup> Berle, 'For Whom Corporate Managers are Trustees' (1932), 45 *Harvard Law Review*, 1365.

<sup>57</sup> Berle, *The Twentieth Century Capitalist Revolution* (1954, UK edition Macmillan, 1955), p137; Foreward to Edward Mason (ed), *The Corporation in Modern Society* (1959, UK edition, 1973), xii.

social democracy, that capitalism was gradually and inexorably being socialised, notwithstanding the continued possession by shareholders of residual control rights. During this period proposals to change corporate rights structures to reflect these perceived new realities were commonplace. Thus some argued for an attenuation of the rights of shareholders and their formal relegation to the status of creditors<sup>58</sup>; others argued for worker participation and industrial democracy. However, significant changes to corporate rights-obligations structures did not materialise, in part because many on the left did not think them necessary. With organized labour strong, shareholders dispersed and weakened, controls on capital movements in place, finance seemed to have been tamed. Managers were not only in charge but subject to social controls and influences. The ‘managerial revolution’, it was thought, had ushered in socially responsible corporations and a new ‘softer’, socialised capitalism.

### **Organised Money: Exploiting Shareholder Residual Proprietary Rights<sup>59</sup>**

This, it turned out, was mistaken. With the residual proprietary rights attached to shares still intact, the landscape began to change once more. The bundle of rights and power possessed by shareholders was gradually enhanced by the relaxation of the rules regulating the free movement of capital (the demise of Bretton Woods) and rise of global financial markets, by the modification of the rules on take-overs, by the emergence of new mechanisms of investor protection and by the waning power of organized labour. At the same time, the ownership of shares and other forms of financial property gradually re-concentrated in financial institutions – within which competition between portfolio managers subject to regular market-based performance evaluation has steadily grown. New types of financial institution, like hedge funds and private equity firms, also emerged. As a result shareholders, in their new institutional guises, have been increasingly able to use the residual proprietary rights attached to shares to (re)assert their power in and over corporations, shaping (and in some cases directing) the behaviour of executives. This power is exerted both *directly* in individual companies and *indirectly* on the corporate sector as a whole through financial markets. Indeed, the latter has rendered financial power ubiquitous. ‘Even the largest global firms’, writes Grahame Thompson, ‘can be stalked by activist investors – hunted by private equity or sovereign wealth funds seeking added shareholder value extraction ... Few companies, however large or internationalised, are immune from the threat of takeover’.<sup>60</sup> This has propelled us back to a finance-capital-dominated world.

The changes in managerial behaviour have not, however, been a matter only of externally imposed market imperatives. Modern forms of executive remuneration aligning the interests of managers and shareholders have made the ruthless pursuit of ‘shareholder value’ very lucrative for executives: since the 1990s their pay has sky-rocketed. Financialization has been further intensified by financial institutions seeking the rapid capital gains available from

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<sup>58</sup> See, for example, George Goyder, *The Responsible Company* (Basil Blackwell, 1961). K W Wedderburn, *Company Law Reform* (Fabian Society, 1965)

<sup>59</sup> ‘We know now that Government by organised money is just as dangerous as Government by organised mob’: Franklin Roosevelt when announcing the Second New Deal, cited in Bowman et al, *What a Waste* (Manchester UP, 2014)

<sup>60</sup> Grahame Thomson. *The Constitutionalization of the Corporate Sphere* (OUP, 2012). More generally, see Paddy Ireland, ‘The Corporation and the New Aristocracy of Finance’, in Robé, Lyon-Caen & Vernac (eds), *Constitutionalization of the World-Power System* (Routledge, 2016).



rising share values rather than steady revenue streams. The result has been the emergence of brutally short-termist, financialized forms of governance which show little concern for the long-term productive health of corporations, let alone for the interests of employees, communities or the environment. Indeed, on occasions governance has descended into blatant looting and asset-stripping. The corporate legal form as currently constituted has made these forms of governance possible. The residual proprietary rights and creditors' privileges attached to shares have enabled short-term financial gain to be ruthlessly pursued without regard to, and without any sense of responsibility for, the long-term health of firms, let alone the economic, social, and environmental costs. Responsibility for dealing with any deleterious consequences (whether financial crises, railway accidents, lost jobs, lower wages, damaged communities, growing inequality or environmental degradation) has fallen on the state – states whose ability to raise taxes to deal with these 'externalities' has been undermined by these very modes of governance.<sup>61</sup> The great financial crash, in which the costs were socialized but not the guilty corporations, provided a stark illustration of this.

In recent years the most extreme examples of financialized governance have been associated with Private Equity firms.<sup>62</sup> Eileen Applebaum and Rosemary Batt's comprehensive study of PE in the US makes it clear that the cases in which PE firms provide the investment and management expertise needed to help turn companies around or grow are exceptional. The norm is for PE firms, making extensive use of debt and leverage, to seek quick capital gains by engineering financial deteriorations in the balance sheets of companies to force through radical cost-cutting measures entailing job losses, greater precarity, cuts to pay and social benefits (like pensions), poorer working conditions, and so on.<sup>63</sup> Not only do their activities frequently have negative impacts on the workforce (which is seen as disposable or substitutable) and on communities, they often damage the long-term productive health of enterprises without always delivering the claimed returns to the limited (as opposed to the general) partners.<sup>64</sup> Crucially, although practices vary between countries and although these firms represent only a small proportion of the institutional market, the aggressive and highly financialized approach of Anglo-Saxon PE is not only spreading but has begun to influence the practices of corporations themselves. PE firms, argues Julie Froud, have acted as 'pioneers who have developed and tested out forms of financial and workforce engineering that have increasingly been normalized by public corporations' (such as the use of high levels of debt and tax arbitrage). There has, she says, been 'a kind of convergence of behaviour of organized money', through which the 'cynical financialized behaviour' of financial intermediaries has come to 'play an increasingly important role in shaping economic activity and social life'.<sup>65</sup>

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<sup>61</sup> See Wolfgang Streeck, *Buying Time* (2014).

<sup>62</sup> Marco Hauptmeier, Book Review, 13 *Socio-Economic Review* (2015), 816.

<sup>63</sup> Eileen Applebaum & Rosemary Batt, *Private Equity at Work* (Russell Sage, NY, 2014). The bankruptcy rate of PE companies is far higher than that of public corporations: see interview with Applebaum and Batt: <http://www.nakedcapitalism.com/2014/12/andrew-dittmer-eileen-appelbaum-rosemary-batt-private-equity-really-works.html>

<sup>64</sup> Though there is no doubt that the search by pension funds for higher yields has increased PE's popularity. In the US pension funds linked to unions have been significant investors in PE firms, as they seek higher returns that will secure the financial viability of pension and health-care funds. This is paradoxical given the impact of PE on workers (lower wages, fewer jobs, reduced welfare and pension benefits, union de-recognition, and so on).

<sup>65</sup> Julie Froud, Book Review, 13 *Socio-Economic Review* (2015), 813.

## Defending Shareholder Residual Proprietary Rights

The radical reassertion of the principle of shareholder primacy has, of course, been controversial, prompting in recent decades the development of new justifications which rely less on problematic assertions of shareholder corporate ownership and more on its alleged 'efficiency' benefits. Claims of this sort underpinned the nexus-of-contracts theories of the corporation which rose to prominence in the 1980s. These theories represent the academic apotheosis of corporate schizophrenia, in some contexts vigorously asserting the reality of the separate corporate person, in others conceptualizing the corporation out of existence. Thus Frank Easterbrook and Daniel Fischel begin their well-known exposition of contractual theory by curtly dismissing the idea of the corporation as a 'legal fiction', a matter of 'convenience rather than reality'. With the corporation out of the way, nothing stands between the shareholders and the corporate assets and the directors, enabling them to depict corporate governance as a simple 'agency problem': how do you get agent-directors to act in the interests of shareholder-principals? On the other hand, when defending limited liability - which they describe as 'perhaps *the* distinguishing feature of corporate law'- Easterbrook and Fischel are forced hastily to resurrect the (fictional) corporate entity. 'Corporations', they tell us, 'do *not* have limited liability; they must pay all of their debts, just as anyone else must'.<sup>66</sup> The separate existence of the corporation is thus very seriously in one context, but completely ignored in another.

The defenders of shareholder primacy are generally aware, however, that no matter how theoretically sophisticated, consequentialist defences of shareholder rights do not have quite the same persuasive power as defences based on notions of ownership. As a result, assertions of (or assumptions about) shareholder corporate 'ownership' persist not only in everyday consciousness, as the Railtrack cases show, but in the academic literature. Historically, the credibility of these assertions has been bolstered by the proliferation of private and subsidiary companies. As we have seen, the Companies Act 1844-62 and the corporate legal form were not designed for use by small firms not organized on a joint stock basis. However, the closing decades of the nineteenth century saw more and more such firms incorporate to get limited liability. Many doubted the legitimacy and legality of this practice but it was validated by the House of Lords in the celebrated case of *Salomon v. Salomon & Co Ltd*. Most significant business enterprises were soon incorporating, whatever their economic natures<sup>67</sup>, with the result that the radical conceptual separation of companies and shareholders, developed in the specific context of JSCs populated by large numbers of passive *rentier* shareholders, was extended to 'private' companies that were, in reality, nothing more than incorporated individual proprietorships and partnerships. Crucially, in these firms, there was usually a clear controlling individual or group operating much like an 'owner' in the traditional sense of the word, albeit, of course, with limited (or no-) liability.

Equally importantly, when corporate groups began to emerge the *Salomon* principle was formalistically extended to them. Today the economically most powerful firms are

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<sup>66</sup> Frank Easterbrook & Daniel Fischel, *The Economic Structure of Corporate Law* (Harvard UP, 1991)

<sup>67</sup> *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.

multinational *enterprises* composed of groups of companies connected through shareholding, each of which is regarded in law as a formally separate entity, although in most cases the organisation as a whole is co-ordinated by a single management team. The liability shields made possible by such groups has, of course facilitated irresponsible behaviour. These enterprises can, for example, choose where to locate their activities and profits, pushing investment-seeking states into competing to create favourable legal, regulatory and tax environments.<sup>68</sup> The existence of subsidiary companies of this sort has also fuelled the idea of shareholder ownership by creating companies where there is a controlling shareholder who looks and acts like an ‘owner’ in the traditional sense.

Indeed, ownership claims loom large in defences of shareholder primacy in other ways too. With the growth in private pensions, share ownership has ceased to be the preserve of the wealthy and trickled down (indirectly) to ordinary people. This underpins arguments that share ownership has been ‘democratised’ and that shareholder primacy not only *indirectly* benefits us all by ensuring productive efficiency but *directly* benefits a growing number of us in our capacity as share-owners. However, although ownership of shares and other forms of financial property has indeed spread, it has also become increasingly concentrated amongst the very wealthy.<sup>69</sup> In the US since 1970, for example, the proportion of ‘wealth’ or ‘capital’ owned by the top 10% has risen from just over 60% to over 70%, and the proportion owned by the top 1% has risen from under 30% to over 35%. The levels of concentration are not quite as high in Europe but the pattern is similar. Income inequality has also increased, driven in part by the growth in ‘supersalaries’, the enormously high incomes going to corporate executives and the ‘supermanagers’ of ‘other people’s money’.<sup>70</sup> The result has been the emergence of a politically powerful alliance between the very wealthy, the managers of their money, the executive managerial class, and what Jeffrey Winters has called the ‘agents of wealth defence’ - the army of skilled professionals (lawyers, accountants and the like) employed by the wealthy to protect their incomes.<sup>71</sup> This ‘new aristocracy of finance’ has been the real beneficiary of the vigorous reassertion of shareholder primacy and emergence of increasingly financialized corporate governance.

### **Realising the Potential of the Corporation**

In recent years, interest in alternative business forms – alternative to the traditional, profit- and shareholder-oriented corporation – has been growing. And quite rightly so. The standard for-profit public corporation, as currently constituted, is not merely not serving society well, it is heavily implicated in the increasing dysfunctionality of contemporary financialized capitalism. In this context, experimentation with alternative, more socially responsible and sensitive, more environmentally-friendly, and more participatory and

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<sup>68</sup> See Jean-Phillipe Robé, ‘Globalization and the Constitutionalization of the World-Power System’, in Robé et al, note 60.

<sup>69</sup> Paddy Ireland, ‘Shareholder primacy and the distribution of wealth’ (2005) 68 *MLR* 49.

<sup>70</sup> Thomas Piketty, *Capital in the twenty first century* (Belknap, Harvard UP, 2014), 315-335, 346-350. Piketty may have actually *understated* the levels of wealth and financial property concentration in the US: see Emmanuel Saez & Gabriel Zucman, *The Distribution of US Wealth, Capital Income and Returns since 1913* (March, 2013).

<sup>71</sup> See, for example, Winters ‘Wealth Defence Industry’ (2011) [http://www.alternet.org/story/154930/wealth\\_defense\\_industry%3A\\_the\\_real\\_reason\\_america's\\_oligarchs\\_c\\_an\\_squeeze\\_the\\_rest\\_of\\_us](http://www.alternet.org/story/154930/wealth_defense_industry%3A_the_real_reason_america's_oligarchs_c_an_squeeze_the_rest_of_us).

democratic organizational forms is urgently needed. At present, however, a significant proportion of society's productive resources remain either under the direct or indirect control of public corporations. Social transformation will, therefore, require not only experimentation with alternative, more 'socialised' organizational forms, but radical reform of the corporations whose activities dominate the economic landscape.

We should not be surprised by the growth of corporate social irresponsibility. As we have seen, the JSC was from its inception a vehicle not only for productive activity but for *rentier* investment, and the construction in the nineteenth century of the corporate legal form was shaped above all else by the needs and interests of *rentier* investors. One manifestation of this was the (re-)constitution of the share as a legal hybrid combining some of the residual 'insider' rights of owners with the 'outsider' privileges of creditors. This hybridity foreshadowed very different possible futures. Historically, in the US and the UK corporate governance has been shaped in significant part by the ability (or otherwise) of shareholders, in their many and changing guises, to utilise and exploit their residual proprietary rights to influence the behaviour of corporate executives. Put simply, when shareholders have been unable (or disinclined) to use their residual ownership rights in an effective manner, the ruthless logic of capital accumulation, with its lack of concern with social costs and consequences ('externalities'), has been tempered (though not eliminated), making possible less shareholder-oriented, financially-driven and socially damaging forms of governance. By contrast, when shareholders have been able and willing to assert their residual proprietary rights, the strict logic of capital has been re-imposed and governance become more 'financialized' and socially irresponsible. Given the nature of corporate shareholding, we should not be surprised that in the context of a corporate legal form which couples no-liability (and no moral responsibility) shareholding with control rights, the re-concentration of shareholding in institutions, rise of increasingly open and global financial markets, and reassertion by shareholders of their residual proprietary rights have seen the emergence of radically re-financialized and socially irresponsible forms of governance.

The financial crash of 2007-08 has seen the re-emergence of debates about the nature and purpose of the corporation and renewed questioning of the neoliberal corporate governance orthodoxies of the 1990s. Attacks on the idea of shareholder value, encapsulated academically by Lynn Stout's *The Shareholder Value Myth*<sup>72</sup>, extend to the business world, exemplified by Jack Welch's assertion that it was 'the dumbest idea in the world'.<sup>73</sup> The 'mess' we have made of corporate governance, the *Financial Times*' Martin Wolf recently argued, 'has a name: it is shareholder value maximisation'.<sup>74</sup> These critiques do not, however, generally entail a rejection of shareholder primacy. On the contrary, their goal is usually to get managers to pursue shareholder value in a more 'enlightened' manner and to focus on long- rather than short-term financial returns. Many of the reform proposals that have emerged thus seek to get shareholders to act more like 'proper', active, committed 'owners', (often by re-empowering them with enhanced proprietorial rights) and to persuade managers to adopt the role of 'stewards'. Thus Colin Mayer, implicitly recognising the

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<sup>72</sup> See Stout, note 13.

<sup>73</sup> Welch is the former CEO of GE and was previously seen as one of shareholder value's leading proponents.

<sup>74</sup> *Financial Times*, 20/8/14

problem of corporate schizophrenia, seeks to supplement the traditional emphasis on ‘incentives, ownership and control’ with an emphasis on ‘obligations, responsibilities and commitment’, proposing *inter alia* that voting rights be withheld from shareholders until they have demonstrated their ‘ownership’ credentials and held their shares for a minimum period.<sup>75</sup>

What is missing here is recognition that the great majority of corporate shareholding is inherently passive and financially motivated, and that the increasing mediation of share ownership by institutions acting as the ‘general managers’ of ‘all lenders of money’ has intensified this financial focus. Trying to get no-liability, no-responsibility, *rentier* shareholders and their representatives to act more like owners is rather like trying to get cats to bark. Portfolio investment discourages not only shareholder involvement and responsibility, but careful monitoring of risk. It positively encourages financialization. In this institutional context, reforms aimed at empowering and enhancing the proprietorial rights of *rentier* shareholders and at making them more active, whether in financial markets or in corporations, are, therefore, more likely to exacerbate the problem than to solve it.<sup>76</sup> Although proposals such as Mayer’s for time-dependent voting rights are, then, steps in the right direction and highlight the urgent need to reform corporate rights-obligation structures, it has to be questioned whether they go far enough. They don’t address the underlying problem: the Janus-faced, hybrid nature of corporate shareholding and the schizophrenic treatment of the corporation as ‘completely separate’ from its shareholders for some purposes and as an object of property ‘owned’ by them for others. As the Railtrack cases confirm, the ‘contractual right [of shareholders] to receive profit on a residual basis ... along with rights to elect and remove directors ... appears to suggest to some that shareholders remain the ‘real owners’ of the business and therefore ought to enjoy that status *whenever it suits their purposes*’. It also ‘constitutes a direct rejection of the entity status of the corporation’, upon which, of course, in other (liability) contexts, shareholders rely.<sup>77</sup>

With money capital is increasingly concentrated in the hands of a small elite and managed by powerful financial institutions, this is a toxic mix. By mixing ‘insider’ with ‘outsider’ rights and combining no-liability *rentier* shareholding with control rights, our rights-obligations structures have become a recipe not only for short-termist financialized governance, but for managerial excess, corporate rapacity and irresponsibility, for the increasing exploitation of labour by capital, and for growing inequality. The problem is not merely one of ‘commitment’ - the members of RPSAG were long-term, committed shareholders - but of responsibility. There is, then, an urgent need to reconsider the Janus-faced, hybrid nature of corporate shareholding and to take separate corporate personhood seriously. This might enable us to tap the ‘yet unrealized potential of the corporation’.<sup>78</sup> Radical reform of corporate rights-obligations structures will require us to dispel the myth of shareholder ownership and the ideological and intellectual barriers to this are considerable. When Lynn Stout discussed her

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<sup>75</sup> Colin Mayer, *Firm Commitment* (OUP, 2013), 6, 246-8. This underpins his proposed solution: ‘trust companies’.

<sup>76</sup> See Robe, note 68; See also Lorraine Talbot, ‘Why Shareholders Shouldn’t Vote’, 76 *MLR* (2013), 791.

<sup>77</sup> Flannigan, note 39, 10.

<sup>78</sup> Mayer, note 75, 241

book recently, she reported that “the interviewer simply couldn’t get his mind around [her] claim that shareholders aren’t really ‘owners’”.<sup>79</sup>

The political obstacles to reform are, of course, even greater. The enormous power and influence of the new financial oligarchy means that even modest reforms are likely to be vigorously resisted, as are the necessary shifts in understandings and consciousness. But there are some promising signs: the characterisation and treatment of shareholders as ‘owners’ is once again actively and widely being questioned, and worker participation is beginning to re-emerge as a live issue. In this more open intellectual environment, the historical development of the corporate legal form and some of the old debates are worth revisiting, for they not only force us to question the hybrid status of corporate shareholders – ‘owed’ or ‘owning’?<sup>80</sup> – but remind us just how contingent, complex and malleable are the institutions of property and ownership. The rights in the property bundle can be allocated and arranged in many different ways. Not everything has to be ‘owned’ in the full liberal sense; nor is it always better if they are. As Mayer says, ‘there is no natural order ... we can create concepts and institutions to assist rather than subjugate us’.<sup>81</sup> The choice is not simply between private property and collective property.<sup>82</sup> It is time we began to experiment with different rights-obligations structures and what Berle called new ‘schemes of responsibility’, and to address the problem of institutional know-how he identified all those years ago.

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<sup>79</sup> <http://www.thedeal.com/thedealeconomy/lynn-stouts-the-shareholder-value-myth.php>. Although Mayer emphasises that companies are entities with a separate legal existence of their own, he still refers to corporate shareholders as ‘owners’: Mayer note 75, 22, 242.

<sup>80</sup> <https://themoderncorporation.wordpress.com/company-law-memo/>  
<https://themoderncorporation.wordpress.com/economics-and-msv/>

<sup>81</sup> Mayer, note 75, 255

<sup>82</sup> See Roberto Unger, *The Left Alternative* (Verso, 2009).