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Talbot, Lorraine Emma orcid.org/0000-0003-2108-0225 (2016) Trying to save the world with company law? Some problems. Legal Studies. pp. 513-534. ISSN 0261-3875

https://doi.org/10.1111/lest.12123

Trying to Save the World with Company Law? Some Problems.[1]

Abstract

This paper aims to unravel two connected errors in the current critical position on companies. Since the financial crisis there have been a growing number of voices in the academic community raised against the shareholder value driven corporate sector. The often conservative and highly doctrinal voices of English company lawyers have become in parts more radicalised and have found common research ground with varied academic disciplines and with company lawyers in other jurisdictions more accustomed to critical approaches. New ideas have been forged, old ideas have been rediscovered and re-examined. In the emerging networks, the neoliberal domination of the study of companies is being substantially challenged. As exciting as this is, I am concerned that critical scholars have cohered around a core claim about company law which is erroneous. Furthermore, they have largely assumed that the current economy can sustain a social agenda as well as creating profit. This, I argue, hugely underestimates entrenched problems in the economy. In unravelling these issues my aim is to re-orientate challenges to shareholder primacy and to the claims of capital more generally.

My purpose in this article is to address two errors in current critical thinking. First, that company law in its current form offers some form of resistance to shareholder maximisation. It does not. Secondly, that the company can deliver for capital and for society as a whole in the current economic climate. It cannot. In the first section I start to develop my argument that the pro law

[1] This title takes its cue from Kent Greenfield's published debate (with D. Gordon Smith) 'Saving the World with Corporate Law?' (2008) 57.4 *Emory Law Journal* 948

position of many critical lawyers who interpret the common law duty of directors to promote the interest of the company as having some socially progressive potential is misguided. I argue that it is not just external factors that promote shareholder value but that it is also the law. I argue that most critical scholars' criticism of shareholder value is not a criticism of profit per se but of profit which is extracted in socially undesirable and destructive ways. I then argue that the premise of this position is that profit should and could be achieved through socially desirable mechanism. This underestimates the problems of modern global capitalism. In section two I argue that the company rose to prominence because of a crisis in capitalism and since then the company form has proven its adeptness in protecting capital in periods of crises by enabling value extraction for capital while protecting it from risk. I use a historical narrative to demonstrate this and in so doing account for the development of company law on directors' duties and the doctrine of separate corporate personality. I show that when a directors' fiduciary duty was owed to 'the company', the common law was reflecting a period when surplus was extracted from the production of things. The law was not describing a more social approach to fiduciary duties, rather it was describing the optimal approach to achieving shareholders' economic interest in that period. It is therefore a mistake to see company law (as it stands) as a solution to the anti-social company. In section three I trace the neoliberal dominance of the economic, political and legal sphere after the economy floundered in the early 1970s. I show how governments protected capital at the expense of labour and how the company form provided opportunities to extract value for shareholders notwithstanding a generalised fall in profit rates and growth. In respect of the arguments that there is a better way of making the same (or more) shareholder value, I argue that in this economic context shareholder value is best achieved in companies by doing anti-social things like engaging in asset transfers, financial engineering, investing in financial products and by returning capital to shareholders through share repurchase. This change of strategies to maximise shareholders value is reflected, I will argue, in modern company law. In section four I show how the company form continues to enable capital to deliver for shareholders – in spite of falling productivity – through share repurchases, high dividends and a merger boom, thus creating a more fragile economy and heralding a new crisis. In examining these issues, I intend to demonstrate that the entrenched profit falls to which neoliberal polices were responding were real and remain. This means that critical scholars will need to embrace truly radical reform.

Section 1

Overview of Current Problems

It is often argued by company lawyers that there is a disjuncture between what companies do or aim to do, and what the law says they should do. Or, to be more specific, (because companies are artificial entities run by natural persons, the directors), when company directors prioritise the pursuit of shareholder value it is not because the law says they should. They do so because of external constraints such as pressure from the equities market, or internal constraints such as shareholder activism, personal incentives such as performance related remuneration, or because of a powerful neoliberal ideology which promotes shareholder primacy and which provided the rationale behind the shareholder primacy enshrined in codes of conduct such as national and international corporate governance Codes. In all the midst of all these pressures to profit maximise the law is held up as the bastion of social conscience. It alone, many critical company lawyers maintain, requires directors to act in the interests of the *company*, a more socially inclusive concept than the shareholder-centric policies currently pursued by management.

This pro law position was famously articulated by Merrick Dodd who asserted that corporate law construed a directors' duty to act in the interests of the company as encompassing the interests of employees and consumers as well as shareholders.[2] The law, he claimed, was sufficiently socially orientated as to require no further controls on directors' decision making. Similarly, while critiquing the shareholder focus of modern corporate theory Blair and Stout maintain that the law

[2] E.M. Dodd 'For Who, are Managers Trustees' (1932) 45 Harvard Law Review 1145, 1162

conceptualises the corporation as a 'team production' unit.[3] They argue that team production is expressed in legal doctrine which acknowledges an independent board (independent so they can properly monitor team activity) and low shareholder rights over directors (so that shareholders cannot unduly influence directors' mediating role).[4] Corporate law, they maintain, requires directors to protect the '*enterprise specific investments'* of all the members of the 'corporate team'.[5] More recently Stout has claimed that shareholder primacy has simply 'got corporate law wrong'.[6] In promoting environmentalism and sustainability, critical scholars have also claimed that the law on directors' duties is sufficiently expansive to allow directors to incorporate sustainability in their decision-making.[7] Finally, critical scholars from Berle onwards have noted that corporate law does not hold that shareholders are owners of the company.[8] As this is a fallacy perpetuated by ideology,

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[3] M Blair & L Stout 'A Team Production Theory of Corporate law' (1998) 24 J. Corp. L. 751 Utilised in Alchian and Demsetz's earlier characterisation of the corporation.

[4] Ibid p754

[5] Ibid p757

[6] L Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations and the Public (Berrerr Koehler 2012) p24

[7] Sjåfjell, B & A Sørensen, L Cecilie (2013). Directors' Duties and Corporate Social Responsibility (CSR) in Hanne Birkmose; Mette Neville & Karsten Engsig Sørensen (ed.), *Boards of directors in European companies – reshaping and harmonising their organisation and duties*. Kluwer Law International. Chapter 7 – one among many of Professor Sjåfjell's prolific writing on this subject. A Johnston 'Reforming English Company Law to Promote Sustainable Companies' (2014) 11(2) European Company Law 63

[8] AA Berle The Modern Corporation and Private Property (Macmillan 1932), P Ireland 'Company Law and the Myth of Shareholder Ownership' (1999), 62 MLR: 32. In Critical Company Law (second edition Routledge 2015) I argue that while shareholder's interest are in the surplus created by the assets, in a capitalist economy dominated by surplus creation, that is a substantial, indeed, overriding claim.

not law, it is ideology and not law which promotes shareholders' primacy on the basis of ownership.[9] The law, in fact, assumes a more modest set of claims for shareholders.

In contrast to these various pro law positions, I argue that the law does not provide the social alternative to the market that many company lawyers hope that it might. Undoubtedly, the various market factors noted earlier are powerful constraints on managerial decision-making in that they insist on shareholder primacy. But so too does the law. Company law is not and has never been the champion of social activists. If it appeared for a period to be representing a more social position by maintaining that a directors' duty was owed to the 'company as a whole' and not the more narrowly drawn shareholders' interest, it was simply that the law can be slow to respond to change. It has since responded in the form of section 172 of the 2006 Act which asserts the bald shareholder primacy norm[10] and which applies to the vast swathe of global capital which falls under UK company law.[11] As I will argue, the old common law 'duty to the company' was an expression of the old relationship of capital to labour, the old productive relations that predated neoliberalism. It was not *necessarily* less shareholder primacy orientated, (though for a short period because of a shift in politics it was[12]) it was simply that shareholders' economic interests were met through different mechanisms than they are today.

This brings us to the second, but connected problem in the current debate. Company lawyers critical of corporate activities have identified the problem with companies as their pursuit of

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[9] Stout n 6 above p25

[10] L Talbot Critical Company Law (Routledge 2007 and 2014)

[11] The FTSE 100 has a net market capitalisation of £1,720,093 million calculated as on 31 March 2015. FTSE Factsheet. The London Stock Exchange lists 2,226 companies with a market value of £4, 260,061million most of whom are incorporated in the UK and are subject to the Companies Act 2006 (data from the LSE 31 March 2015)

[12] In the period following second world most western countries adopted a more egalitarian, social democratic approach in which the notion of a social company was encapsulated. I refer to this period as 'progressive' in previous publications but I do not examine it in this paper.

shareholder value as the primary or sole goal.[13] However, I believe shareholder value has a heterogeneous meaning. Furthermore, many of the understandings of shareholder value are based on an unrealistic appreciation of the choices available to company directors given the historic low profits accruing to non-financial companies or productive capitalism.

Shareholder value is intrinsically bound up with profit[14] whether it is subsequently used to increase the value of the company equity or distributed as dividends.[15] However, what many company scholars mean when they are critical of shareholder value is not the pursuit of profit *per se* but profit which is derived from particular practices. Undesirable practices may be investing in financial commodities, financial restructuring, creating negative externalities and/or generally adopting short-term strategies. Having made this distinction, the logical argument is then to argue that profit could be made from more social practices – the law having already been established as being in favour of this option. Directors should and could, for example, seek to profit from strategies which take account of all those involved in the company's operations or affected by its activities, they could and should consider its effect on the environment and the company's long term development.

[13] There remains, of course, a majority who see shareholder value as an unproblematic and desirable goal. I am not addressing this paper to these arguments in any respect.

[14] *Bligh v Brent* (1837) 2 Y & C 268

[15] That profit may not be enjoyed directly by shareholders in the form of dividend distributions but it underpins the value of the shares in various ways. Warren Buffet, as chairman of Berkshire Hathaway Inc, for example, famously does not use profits for dividends but to raise share value which he believes creates more shareholder value. From 1965 to 2012 he estimates that this has enabled Hathaway to massively outperform other S & P 500 companies. The overall gain in these years for Hathaway he estimates to be 586,817% while for the latter companies on average it was 7,433%.Chairman's letter to shareholders 2012 http://www.berkshirehathaway.com/letters/2012ltr.pdf

This inclusive perspective has a long historical trajectory,[16] but more recently it has cohered around the term 'stakeholding'.[17] Stakeholding is a popular positioning for scholars who reject the primacy of shareholders and instead argue that management should take a more inclusive approach in its decision-making to reflect the interests of all stakeholders because all stakeholders contribute to the operation and success of the company. Not all scholars who identify themselves with stakeholding take this normative and social perspective. It is a strand of stakeholding which Donaldson and Preston have described as 'intrinsic' stakeholding. This perspective claims that all stakeholders have legitimate claims, that is, interests of intrinsic value, which deserve to be taken into account in the governance of the company. This contrasts with what Donaldson and Preston call 'instrumental stakeholding' where the promotion of many interest in corporate decision-making is justifiable in so far as it enables profit making. The premise of the intrinsic stakeholder perspective (among other critical scholarship) is that the economy is strong enough to sustain social interests and be competitive and profitable, a premise which this paper rejects.

From this perspective, it is not the economy that is the barrier to making good managerial choices but undesirable social norms; a corporate culture that is too male and too greedy, or poor corporate governance indicators. The reform choices then become to have more women on the boards[18] so to redress the problematic gender bias of boards, reforms that have been addressed in part throughout many countries and in the UK Corporate Governance Codes[19] Alternatively, critical

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[16] Usually associated with Dodd in the HLR debate with Berle. Dodd n2 above.

[17] Usually attributed to the work from the Stanford Research institute in the early 1960s.

[18] C Villiers, 'Achieving Gender Balance in the Boardroom: Is it Time for Legislative Action in the UK?' (2010) 30(4) Legal Studies 533. Reform to redress the gender imbalance in boards this now, in part, implemented by the UK Corporate Governance Codes.

[19] Reports from the Department for Business, Innovation & Skills headed by Lord Davis Department for Business, Innovation & Skills, *Women on Boards* (2011) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31480/11-745-women-on-boards.pdf and

scholars argue that managerial decision-making could be more progressive if the performance criteria upon which directors' pay is based[20] was decoupled from short term shareholder value rewards and instead linked to long term performance.[21] Many different strategies have been proffered. Other scholars suggest raising the priority of the environment, stakeholders and long-term development as corporate goals in the corporate governance Codes.[22] Employees have also received attention. Margaret Blair has shown that as workers make firm specific inputs, which leaves them vulnerable and over-invested in their employer, they are entitled to have rights in corporate governance.[23]

These are all strategies that I fully support as worthy goals in themselves. Many of the exponents of such strategies are scholars that I know and respect. However, my concern here is that they are offered as superior mechanisms for producing the same profits as the inferior and destructive methods currently used. It is the assumption that it is a zero sum game that I am challenging. Worse, many critical scholars argue that when companies choose to make shareholder value in a

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Department for Business, Innovation & Skills, Department for Culture, Media & Sport and Government Equalities Office, *Women on Boards 2013: Two Years On* (April 2013) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/182602/bis-13-p135-women-on-boards-2013.pdf

[20] The UK's corporate governance Codes have traditionally linked pay with performance.

[21] A J. Wowak and D C Hambrick 'Current UK Corporate Governance Code A model of person-pay interaction: how executives vary in their responses to compensation arrangements' (2010) 31(8) Strategic Management Journal 803 . This paper suggests that the various and complicated performance related packages encourages risk taking and further encourages persons inclined to risk joining the profession.

[22] B Richardson and B Sjåfjell Company Law and Sustainability: Legal Barriers and Opportunities. (Cambridge University Press. 2015)

[23] M Blair Ownership and Control: Rethinking Corporate Governance for the Twenty First Century (Washington DC Brookings Institute Press 1995)

more socially responsible way they can actually make *more* shareholder value by pursuing this approach.[24] Stout argues that the decline of the corporate sector in the UK in all but the areas of finance and commodities extraction can be attributed to a failure to embrace a stakeholding approach.[25] Wallace's study[26] of stakeholding and company success in the United States at the end of the 1990s concluded that there is a direct correlation between treating stakeholders well and creating value for shareholders.[27] However, he also notes that it was only in the extremes of poor behavior to stakeholders that companies lost shareholder value. Once companies improved stakeholder relations to a degree and shareholder value increased, additional sums allocated to stakeholders did not improve shareholder value any further.

This chimes with the experience of multinational companies when their tarnished brand directly detracts from shareholder value and where funds allocated to improve stakeholder relations redresses this loss; a win-win effect. However, as many commentators have noted, this strategy works only in the most egregious cases of stakeholder abuse.[28] For example, the well publicised

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[24] M Porter and MK Kramer 'Strategy and Society; The Link Between Competitive Advantage and Corporate Social Responsibility' (2006) 84 (12) Harvard Business Law Review 78, on creating a framework to integrate social responsibility and stakeholders' interests into a profit maximising strategies. Lyn Stout n 6 above.

[25] Lyn Stout n 6 above p85

[26] J Wallace 'Value Maximisation and Stakeholder Theory: Compatible or not? (2003) 15(3) Journal of Applied Corporate Finance 120. The study compared the annual Fortune ranking of "America's Most Admired Companies" over the period 1996-2000 so admired for their evidenced stakeholder strategies ('innovativeness, quality of management, employee talent, financial soundness, use of corporate assets, long-term investment value, social responsibility, and quality of products/services') and their financial success measured by the Standard & Poor's Compustat database to compute Market Value Added (MVA).

[27]ibid p120

[28] D K Millon. "Enlightened Shareholder Value, Social Responsibility, and the Redefinition of Corporate Purpose without Law" in *Corporate Governance after the Financial Crisis*. Ed. P. Vasudev & S. Watson (Edward Elgar, 2012) with particular reference to cases like Nikes use of child labour.

tragedy in Rana Plaza forced brands like Primark to take responsibility for the safety of the workers of their 'invisible' suppliers[29] who had caused workers to work in obviously dangerous conditions. The ensuing agreement between suppliers and their corporate customers enshrined in The Bangladesh Accord 2013 may result in safer conditions in Bangladesh's factories, as well as repairing the connected brands' reputation.[30]

However, outside these extreme examples, the argument that shareholders will do better if companies take better care of stakeholders is misguided. We are well acquainted with the hoary old neoliberal justification for shareholder primacy that managements' focus on profit maximisation increases net wealth which benefits all stakeholders, the 'trickle down' theory. We were amused when Kent Greenfield quipped that this theory basically asserted that managers were better at looking after stakeholders' interests when completely ignoring them.[31] Yet, some critical scholars from the stakeholding position seem to think it is entirely feasible to apply the same perverse logic to stakeholding and assert that managers can best promote *shareholders'* interest by ignoring them. The simple and logical truth is that managers cannot take better care of shareholders (and therefore also their own performance related remuneration) by looking after stakeholders. If that worked, they would do it.

The fact is that directors engage in the profit making strategies that they do because they are the best, not the worst, way to deliver shareholder value. Investing in financial products, buying back shares, financial restructuring and so on are better ways of delivering shareholder value than ways that are good for stakeholders and long term development. If they weren't, they wouldn't be doing them. The real question is why are they better at delivering shareholder value? The short answer is

[29] Talbot n8 above chapter 4

[30] J Donaghey and J Reinecke (2015) 'After Rana Plaza: Building coalition power for labour rights between unions and (consumption-based) social movement organisations' (2015) 1 Organisation 22

[31] Greenfield n1 above

that productive capitalism now has very low returns. The economy is changed and this means that although critical scholars' normative claims are still defensible, their assumption that their application would not fundamentally change capitalist performance is not.

In order to deliver for shareholders, directors must look to other strategies than the productive capitalism where profits have been persistently low for some years. That strategy could be to invest in innovative and useful products. This would be good for society and good for employment. But this would involve more fixed capital investment and the risk that this may not give the desired returns. As Mazzucato's excellent book shows, private investors tend to profit from the state's prior and substantial investment in research and innovation, investing at late stages of product development.[32] In a period of low returns on capital investment they are all the more reticent to take on the risk of innovation. The managers of capital prefer to deliver shareholder value with solutions which retain liquidity and give quick returns. As the OECD recently observed productive companies are currently considered risky investments while paradoxically investing in financial commodities are considered safe. It reported that investors were selling shares in high capital expenditure companies and buying shares of companies with low capital expenditure. In 2009-14, by investing in this way they would have increased the value of their portfolios by 12% in Japan, 21% in emerging countries, 47% in Europe and 50% in the United States. In Angel Gurría's words, 'stock markets in advanced economies are punishing firms that invest.'[33] This risk aversion also accounts for the much remarked upon high levels of capital retention by top companies post crisis.

[32] M Mazzucato The Entrepreneurial State (Anthem Press 2013)

[33] http://www.oecd.org/about/secretary-general/launch-of-the-oecd-business-and-finance-outlook-and-opening-high-level-roundtable.htm 24th June 2015

A recent paper argued that this retention was to offset the risks of innovation and product development.[34]

Historically, the company has provided mechanisms to enable capital to transcend limits to profitability, to avoid risk, to seek out value and protect the interests of capital against labour. It is doing so now in this period of recession and austerity for the many, in which conversely, the elite (the holders of equity and other financial products) have experienced rising wealth. Increases in inequality, as many prominent commentators indictors like Oxfam[35] have noted is on the rise. As Pikketty and Harvey have noted, rising inequality is a general characteristic of recession.[36] The company form has been particularly useful in periods of economic crisis, so that it is crises that accounts for its dominance as a business form. So, while it is true, as we are told as undergraduates, that companies became popular vehicles to pool investment, it is equally if not more accurate to say they are numerous because capitalism fails, at least from the standpoint of capital. The many circuits of crises that capitalism has entered and exited have been accompanied by the company's protection of capital. This can be shown historically and it can be shown in the current period. In the next section I will show how and why the company form came to dominate business by the end of the nineteenth century and how this impacted on company law doctrine.

[34] T W Bates, K M Kahle and R M Stulz 'Why Do U.S. Firms Hold So Much More Cash than They Used To?' (2009) (114) The Journal of Finance 1985. This article was recently highlighted in Michael Robert's political economy blog.

[35] Oxfam, 'Having it All and wanting More' 2015 https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/ib-wealth-having-all-wanting-more-190115-en.pdf

[36] T Piketty Capital in the 21st Century (Belnap Harvard 2014)

Section 2

Industrial capitalism: Crisis, companies and the common law of companies

As a general tendency, the productive economy has experienced progressive falls in profit rates, (with some upward spikes after dramatic events like World War Two).[37] Historically, it is as a result of these falls in profit rates that the modern company rose as the dominant legal business form because it could protect capital in periods of crises. When the company first came to prominence it was its abilities to enable mergers and to reduce risk that accounted for its popularity with business.

In England, general incorporation Acts with limited liability were available to the public for many decades before those engaged in productive capitalism began to organise their business as limited liability companies. In the nineteenth century when the profits accruing to industrial production were extremely high, the limited liability company was not popular. Its early use was confined to new speculative business with high rates of attrition that sought the protection of limited liability in the expectation of failure.[38]There is also evidence that the limited liability company was used by established businesses as an alternative form of partnership not fundamentally relying on limited liability in that these companies had just a few shareholders holding partly paid shares which enabled the creditors to look to their personal solvency as if they were still partners.[39] So, despite a protracted battle for limited liability in the years leading up to the Limited Liability Act 1855,[40] high end profit making industrial production had no need of it. Industrial capitalism, the business

[37] M Roberts The Great Depression (Michael Roberts 2009)

[38] HA Shannon 'The First Five Thousand Limited Liability Companies and their Duration' (1932) 3 Economic History 421

[39] J B Jeffrey 'The Denomination and Character of Shares 1855-1885' (1946) 16 economic history review 45

[40] Marie Djelic 'When Limited Liability was (Still) an Issue: Mobilization and Politics of Signification in 19th-Century England' Organizational Studies 2013

of manufacturing, was largely undertaken by partnerships in which the relationship between capital and labour was direct and where capital was bound to the productive process. The partners contributed capital to the business, managed production, disciplined labour and had full entitlement to the surplus made from production. Equally, their fortunes were bound to the success of the business and they were fully liable for the debts of the business. In law, partners were full owners and controllers of the business.[41] In periods of high profitability this was an agreeable arrangement. Calculations from Maito show that the average real rate of return on fixed capital from 1855-1874 was 39.8%.[42] However, high profitability is not a constant in capitalism. Competition in individual sectors, among other factors, drives business to raise labour's productivity. In early Victorian capitalism they were free to lengthen the working day, or reduce wages or to introduce fines for spurious failures in performance. Victorian capitalists were fairly free to do with labour as they wished. There was little in the way of legal protection for labour, labour law was not yet conceived and trade unions were in their infancy. Indeed, this absence of protection led many working people to initiate their own institutions to support them through life's vicissitudes.[43] Another method of making labour more productive was to introduce more machinery into the production process. For those innovators this promised super-profits, though the costs of investment was high. But as competitors caught up with these levels of technology, profit levels evened out. Competition forced investment in machinery driving up the cost of production. Through this process of making labour more productive, commodities were made faster and cheaper, but the production process became much more mechanised and expensive. Inevitably, profit rates fell. This pattern, which Marx identifies as the tendency of the rate of profit

[41] The Partnership Act 1890

[42] Esteban Ezequiel Maito 'And yet it Moves (down) (2014) The Worker 5

[43] Such as Friendly Societies and Building Societies which emerged in the C18th and then rapidly grew in the C19th.

to fall,[44] affects all sectors, once they become established (new sectors achieving relatively well at the beginning). But as the economy as a whole is mainly composed of established sectors, there will be a generalised fall in profits rates.

After many decades of innovation and high profits Victorian capitalism fell into a protracted slump known as the Great Depression at the end of the nineteenth century. Growth halved, unemployment rose and prices fell. [45] The average real rate of return on fixed capital slumped.[46] It was in this crisis that the company form showed its utility because it provided a way to redress the entrenched falls in the return on capital investment. Through various mergers and incorporations, the many unincorporated businesses became much fewer incorporated companies.[47] Competition was reduced, prices stabilised and many smaller capitalists were put out of business. As Marx put it, 'The battle of competition is fought by cheapening of commodities. The cheapness of commodities depend on the productiveness of labour, and the scale of production. Therefore the larger capitals beat the smaller.'[48]

When returns on capital investment fell, the company form also enabled investors to avoid the risks inherent in the partnership (unlimited liability and partnership property bound to the business). Principally company law enables capital to become a form of money capital in that it

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[44] Karl Marx *Capital: A Critical Analysis of Capitalist Production Volume I*, (Foreign Languages Publishing House Moscow 1954) p623

[45] D J Coppock 'British Industrial Growth during the 'Great Depression' (1873—96): a Pessimist's View' 17(2)The Economic History Review 389

[46] A Kumar, K Bagchi and A Cahtterjee Marxism with and Beyond Marx (Roetledge 2015)

[47] MA Utton 'Some Features of the Early Merger Movement in British Manufacturing Industry' p626 (1972) 14(1) Business History 51. It was a similar trajectory in the United States, R Schneirov, G Fernandez, Democracy as a Way of Life in America: A History (Routledge 2014) p73-4

[48] Marx n44 above p626

retains much of the fluidity of money while holding all the entitlements of capital. Historically, in order to claim profit, money must become capital, that is it must be invested in production and thereby lose the flexibility it had as money. In this way money, as capital, is bound to production until the commodities made are sold. By investing in production there are risks and uncertainties which are not resolved until the sale and capital becomes money once again and regains its fluidity. However, without embracing these risks money cannot access surplus. The ideal was to access surplus while reducing risk by retaining the fluidity of money. Company law enabled this by degrees. First, it pared down the nature of ownership of a share to the ownership of surplus value only, severing a shareholders' interest from the company assets. Until the early part of the C19th a purchase of a company share was treated in law as a purchase of the company's equity and shareholder were co-owners in equity. [49] Investment was bound to the production process. However, in the 1837 case *Bligh v Brent* the share was held to be a claim to the surplus created by the chattels purchased by the money investment, not the chattels themselves. The company share, at least in larger companies, thereon ceased to be a beneficial interest in the whole production process and in the surplus value created and became a legal and beneficial interest in the surplus value alone. The share became a transferable property form. But legal transferability was not sufficient to render capital in its share form fluid like money. This required an active and fully fledged stock market.[50] This came later and once it did, entitlements to surplus value could be sold at any point in the productive cycle, in a market that was legally, culturally and geographically distinct from the markets in which the tangible products of the company were sold.

The introduction of limited liability in 1855 further protected the value of the share from the debts of the company so that its value would be based on the expected profitability of the company

[49] S. Williston, 'History of the Law of Business Corporations before 1800 – part II' (1888) 2 Harv L Rev, *Bligh v Brent* (1837) 2 Y & C 268

[50] P Ireland, I Grigg-Spall and D Kelly 'The Conceptual Foundation of Company law' (1987) 14 *Journal of Law and Society* 1149

unencumbered by any other person's debts. So once the share was conceived in law as a separate piece of property and the debts of the business were conceived in law as the debts of the company, not the shareholders', and, once the markets for shares developed and selling shares became easier, capital in the form of shares could claim a fluidity close to that of money itself. Through the company form, the risk associated with capital was significantly reduced. Rather than being bound to a particular company's failure, should that transpire, shares can be sold and capital can move to more lucrative companies. Management will continue to owe a duty to capital, regardless of the longevity of a shareholder's ownership of a share.

Legal developments coupled with an active market in shares gave capital its required fluidity.[51] However it was the fall in rates of profit in the Great Depression which super charged the stock market, unlocking the potential of shares to be quickly transferable. Businesses thereon gravitated to the company form. This protracted recession led to the abandonment of small unincorporated business (where capital was bound to production), and their merger into larger incorporated companies. Much like today's mergers boom, this was not about enhancing production but reducing it and thereby reducing competition. In the legal form of the company, capital could move to where profit was or appeared to be emerging. It was no longer attached in law or in practice to a particular business. The company, unlike the partnership, enabled shareholders to protect themselves from risk through limited liability and by selling their shares. Actual production could be run by a professional management (or remaining key shareholders, or a combination of the two) tasked with disciplining the labour force, developing the business and providing value for shareholders. It was at this time that key company law doctrines were established; the doctrine of separate corporate personality and a directors' fiduciary duty to act in the interests of the company.

(a) The Common law of Companies

[51] ibid

i. Separate Corporate Personality

By the end of the century the House of Lords held that once a business had been properly registered as a company it was to be treated in law as a separate legal person[52] with limited liability (if it was registered as a limited liability company).[53] That the business in this case was essentially a one man business in which the other subscribers held nominal shares and did not participate in the business were not relevant issues in establishing the validity of an incorporation. The only issue was whether the formalities under the act had been conformed with or whether the incorporation masked a fraud. The decision in *Salomon* reflected the economic reality in large companies which were dominating the economy by the end of the century. In these companies the productive entity existed and competed in markets that was separate from the market in which entitlements to the surplus which production created were exchanged. The productive entity encompassed the activities of labour, managed by directors or those authorised by them. The entitlements to surplus were owned by shareholders who could, if they wished, have a fairly transitory relationship with the company. Formally these two 'worlds' met at the annual general meeting. Following the 1897 decision all companies would be treated as if they had the practical partitions of large companies (when they patently did not) because there was no legal distinction between large and small (or even one man) companies. In order for the share to retain the fluidity of money, the protection from risk and the entitlement of capital, its legal separation from the company needed to be unassailable. This is the principle which has dominated jurisprudence on corporate personality.

[52] The entity nature of the company was also reflected in the doctrine of ultra vires which held that a company incorporated for a particular business purpose did not have the capacity to enter into a contract involving business activities which were not specifically noted in its constitution. If the company did so the contract could be declared void. *Ashbury Railway Carriage & Iron Co v Riche* (1875) LR 7 HL 653. In interpreting the company's business purpose in this strict manner the courts were reflecting the distinct nature of an organisation which operated separately from its members.

[53] *Salomon v Salomon* [1897] AC 52

Although some judges have attempted to loosen the rigidity of this doctrine, notably Lord Denning in cases like *DHN*,[54] the courts have responded decisively and swiftly to redress such moves. Not long after *DHN* Lord Keith stated that the veil may only be pierced 'in special circumstances when a limited company might well be a façade concealing the true facts'.[55] The interests of shareholders were to be fully severed from the company's liabilities.

ii. A Directors Duty to the Company

For many decades a director's duties have been understood by to be owed to the company. This point is generally made with reference to the case of *Percival v Wright*[56] where the court held that the duty was not owed to the individual shareholders. Directors were trustees of the company's property and agents of the company in its transactions. They were not agents of the shareholders. That being so they were entitled to make decisions which were not those desired by the shareholders (in *Percival* a high price for their shares). Does this mean that the law embraced a more holistic stakeholder approach to directors' duties in which shareholders' interest were just one of many interests a director would consider? I argue that it does not. British capitalism at that time was a capitalism of production and directors managed the company, the productive entity, in order to create value for the investors. Protecting the productive entity in periods of relatively high profits was the best way to create shareholder value. The courts understood that directors, not outsider shareholders, were best placed to makes these decisions.

There is little evidence in the commercial courts of a leaning towards non-commercial decisions. Indeed, even in the lengthy period of growth and profitability which characterised the post Second

[54] *DHN Food Distributors Ltd v Tower Hamlets London Borough Council* [1976] 1 WLR 852

[55] *Woolfson v Strathclyde RC* [1978] S.L.T. 159

[56] *Percival v Wright* [1902] 2 Ch 421

World War period, in which the company was viewed by many as a vehicle for social progress,[57] the courts did not embrace a similarly social approach to the company. This is summed up neatly in *Parke Daily News* [1962] a case which assessed the relative interests of shareholders as a whole against those of employees and concluded that the latter could only be considered if by doing so the interests of the former were met. The court held that even a majority of the shareholders were not entitled to ratify a proposal to pay compensation to the company's employees when the company faced insolvency because the best interests of the company were the best interests of shareholders as a whole.[58] Plowman J. took issue with the claim that when directors pursued the best interest of the company this might be construed as the interests of employees regardless of any proceeding benefit to the company. He rejected the claim that although the prime duty was to shareholders there was also a duty to take into consideration employees. He stated that he knew of no authority to support these claims and 'in my judgment such is not the law.'[59] Like Plowman J., I know of no authority to support these claims. What seems to be the consistent line from the case law is that as stated in *Greenhalgh v. Arderne Cinemas Ltd.* [60] and cited by Plowman J. in which Lord Evershed M.R. said that 'the benefit of the company meant the benefit of the shareholders as a general body.'[61]

Wider interests, particularly those of labour, were met through political reforms, politics which reformed the laws on industrial relations (*Parke* itself precipitated the passage of the Redundancy Payments Act 1965), and which redressed some of the imbalance of power between labour and

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[57] CAR Crosland The Future of Socialism (Jonathan Cape 1956), Berle n 4 above, K Galbraith, The Affluent Society (Houghton Mifflin 1958) , PF Drucker, The New Society The Anatomy of the Industrial Order (Windmill Press, Kingswood 1951) Carl Kaysen, 'The Social Significance of the Modern Corporation' [1957] 47 Am Econ Rev 311

[58] *Parke v Daily News* [1962] Ch 927

[59] Ibid p963

[60] [1951] Ch. 286

[61] *Parke* n58 above p963

capital.[62] In respect to the company, equality was also sought through fiscal policies and the wealth of individual capital holders in companies, the shareholders, was taxed at 'punitively high rates'.[63] The top rate of taxation applicable to dividends was 90% rising to 98% from 1974-79.[64] As Armour and Skeel show the contrasting tax policy for institutions like pension funds, which paid no tax on dividends, meant that private shareholders decreased in numbers while the holdings of institutions increased, an outcome they see as unintended. However, far from being unintended, this reflected a political commitment to the rule of institutions over individuals and a belief that institutions enhanced equality and bureaucratic efficiency for the good of society. It was in that same spirit that post war, finance had been put under state control with the nationalisation of the Bank of England and that utilities and other key industries were nationalised. These were some of the political shifts that led politicians like CAR Crosland to characterise the company as one which no longer pursued shareholder interests and was a creature of the community.

But company law stands out as making no contribution to this. Indeed, in cases such as *Rookes v Bernard*, the courts seemed keen to undermine organised labour even against a parliamentary consensus. The House of Lords held that in threatening to go on strike unless an employee (who refused to re-join the union in defiance of the closed shop agreement) was moved from his position, the union had committed the tort of intimidation, even though Rookes (who was suspended and then fired by his employer) had not been directly threatened or intimidated. The case provoked anger from trade unions who wanted the law changed to avoid another such outcome – the incumbent Conservative Party did not side with the courts but instead launched a Royal Commission into industrial relations.

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[62] LE Talbot *Progressive Corporate Governance for the 21st Century* (Routledge 2013& 2014) chapter 2

[63] J Armour and DA Skeel 'Who Writes the Rules for Hostile Takeovers and Why? The Peculiar Divergence of United States and United kingdom Takeover Regulation' (2007) 95 GeoLJ 1727, 1768

[64]Ibid p 1768

The courts also furthered the interests of shareholders in their approach to hostile takeovers. After Charles Clore made a dramatic and successful hostile takeover of Sears in 1953, many others saw that the discrepancy between share prices and company asset value were readily exploitable once they gained control as controlling shareholders. Many company directors sought to thwart these takeovers by, for example, using their power to issue shares to give blocking votes to insiders, or to enhance the votes attached to 'safe' shares – companies using these methods in a sample of companies examined by Franks etal increased from 3.7% in 1950 to 11.1% in 1965.[65] The courts responded by developing earlier authorities of cases like *Piercy v S.Mills & Co. Ltd*[66] and *Punt and Symonds Co Ltd*[67] into a way of striking down anti-takeover manoeuvres. Issuing shares for the purposes of thwarting the ambitions of a majority shareholder was found to be an abuse of authority and a breach of duty to the company. In contrast to *Percival v Wright*, in which directors were able to thwart a takeover if they thought it was in the interest of the company to keep the productive unit whole, in *Hogg v Cramphorn*[68] directors were held to be in breach of their duty to the company. As they had issued shares with the primary purpose of preventing a controlling shareholder from gaining control (and as they believed ousting the board of directors), the allotment was accordingly a breach of the directors' fiduciary duties notwithstanding that their intention were said to be honest and selfless. Similarly the Privy Council in *Howard Smith v Ampol*[69] held a share allotment designed to thwart an unpopular takeover was void and a breach of the directors' duty to the company.

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[65] J Franks, C Mayer and S Rossi 'Spending Less Time with the family: The Decline of Family Ownership in the UK' Finance Working Paper No 35/2004 European Corporate Governance Institute at 4

[66] [1920] 1 Ch 77

[67] [1903] 2 Ch. 506.

[68] [1967] Ch. 254

[69] *Howard Smith Ltd. Appellant v Ampol Petroleum Ltd* [1974] A.C. 821

In short, the law on companies has consistently enabled the expansion of capital's interest regardless of shifting political policies which frequently favoured an inclusive and labour friendly company. There is therefore little reason to suppose that in the current non-inclusive, capital friendly environment that the law would adopt new allegiances.

Section 2

Financialised capitalism: Crisis, labour, companies and modern company law

It is important to emphasise that when the law described directors' duties as being owed to the company it did so in the context of a predominantly productive capitalism which has since changed. Around forty years ago western economies entered an economic and political crisis which for most, and certainly for the UK and the US, saw the end of the post war social democratic consensus which conceptualised companies as productive institutions serving the public as a whole, rather than the private interests of shareholders.[70] The economic prompt for this political shift was the slowing of the high growth rates that had characterised the post war decades up until the 1960s.[71] By the 1970s, stagflation was entrenched in most western capitalist economies and this affected overall confidence in settled, corporatist arrangements. Pro-market liberal dissenters began to emerge as visionaries of a new form of liberalism[72] and in 1979 the UK elected a new style Conservative government, ideologically wedded to the market and opposed to labour and the

[70] Crosland etal n 57 above

[71] Roberts n 37 above. Though these low growth rates then would be envied in western economies today.

[72] D Harvey A Brief History of Neoliberalism (Oxford 2005)

welfare state. Now, the relationship between labour and capital brokered by the state, often in favour of labour, swung decisively in favour of capital.

The neoliberal conservative administration embarked on a series of anti-union laws to radically restrict collective action and reduce the powers of trade unions.[73] They did so in large part to counter the reaction of organised labour to their new monetary policies which focused on the single goal of controlling inflation through high interest rates. By 1980 interest rates had risen to 17% and by 1983 unemployment had risen to 10%. In the 1970s the unions might have defeated such attacks on labour but the restrictive legislation[74] was already in place and the failure of the miner's strike of 1984-85 left the unions in political disarray.

Similarly, the United States elected a neoliberal government under Ronald Reagan. Under this administration the Federal Reserve Bank raised interest rates from their long standing flat rate to nearly 20% by 1981.[75] Again the impact was high unemployment. To counteract the inevitable reaction from the (then) strong unions, the Reagan administration began a series of political attacks beginning, significantly, with PATCO the large, white collar and respected air traffic controllers union which had embarked on strike action in defiance of the government. Of the 13,000 striking workers represented by PATCO 11,345 were fired and banned from federal service for life.[76] PATCO was prohibited from representing workers from then on.[77]

In the neoliberal project of reasserting the power of capital over labour, both nationally and globally, the company became key. Organisationally it was able to transfer assets legally and effectively from a productive process in which policy had aimed for a broader public end, to

[73] Talbot n 62 above

[74] The Employment Act 1980 and 1982

[75] Harvey n 70 above p23

[76] Under the Taft-Hartley Act of 1947 striking government workers could lose their job, though the expectation was that this law would never actually be used to its full extent.

[77] By the Federal Labor Relations Authority on October 22, 1981.

financial interests which aimed to enhance private wealth.[78] Companies rich with retained capital and valuable assets were re-engineered by private equity firms to extract value or were subject to hostile takeovers that stripped out valuable parts of the business.[79] This delivered value for shareholders but reduced the value of the companies as working entities and encumbered the business with debts. Companies closed down and unemployment rose. In spite of the social impacts of these value destroying or transferring activities,[80] takeovers were defended by neoliberal ideologues. Through the lens of shareholder value, takeovers enabled 'good' corporate governance because they were said to focus management attention on profit maximisation; the so called market in corporate control.[81] Accordingly, neoliberals argued that regulation should facilitate and not inhibit takeovers because they provided a market answer to agency costs.[82] Takeovers benefitted shareholders who as 'residual property owners' in the company were entitled to have the company run (or liquidated) in their interests. Employees, in contrast, who lost their jobs in companies subject to takeovers, had no property interest in the company and therefore had no claims outside their employment contract. From industrial relations and to mergers and takeovers, the law helped capital profit at the expense of labour, as part of the neoliberal recovery programme.

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[78] In respect of the privatization of nationalised industries this took a more direct form of transfer of national assets from the public to private hands at very favourable prices for the latter. The justification for these transfers was deeply entrenched in neoliberal ideologies on the importance of private property, profitability to the economy and the upgrading of shareholders as owners of those profits.

[79] D Millon *'Theories of the Corporation'* (1990) 39 Duke. L. J. 201

[80] S. Deakin 'Hostile Takeovers, Corporate Law and the Theory of the Firm' (1997) 24(1) Journal of Law and Society

[81] A theory which originated with Henry Manne's piece in 1965. Henry Manne, 'Mergers and the Market for Corporate Control' (1965) 73 JPolEcon110.

[82] M Jensen and W Meckling 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305

The company form more recently has facilitated other techniques to side-step the problem of low profit rates. As the Kay Review of 2012[83] concluded, productive, non-financial companies in the UK have re-orientated their business to trading in financial commodities in order to meet shareholder value; a short-termist strategy that in many cases has meant companies have failed to remain competitive in their area of productive expertise. Kay laments this as wrong and short sighted. But however understandable this response may be, the reality is that were shareholder value to be found in their own business, they would not have strayed. As many other commentators have shown, non-financial companies have reoriented their business to that of being investors or dealers in financial commodities rather than being producers because that was where the profits lay.

Longstanding neoliberal policies have, of course, enabled this. Dumenil and Levy's statistics show how financial companies made low profits throughout Europe and in France they actually made losses, prior to neoliberal reforms. However, by the 1980s, their profits rose sharply, while non-financial companies were still low. Then, by the 1990s both financial and non-financial companies had higher profits as non-financial companies were buying stocks in financial companies, rather than investing in their own low profit making businesses.[84] Non-financial companies availed themselves of the profits accruing to financial companies because of the underlying weaknesses in the economy. So, as more recent work by Norfield shows, the huge growth in the derivative markets is the direct result of these low profit rates and while this may have accelerated the current crisis, derivatives themselves were not the underlying cause.[85] Investing in finance seemed like the

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[83] The Department for Business, Innovation and Skills, The Kay Review of UK Equity Markets and Long Term Decision-Making- Final Report 2012

[84] G Dumenil and D Levy 'Costs and benefits of neoliberalism: a class analysis' in Financialisation and the World Economy (Edward Elgar 2005) edited by Gerald A. Epsten p32-3

[85]

cure to low profit rates. This was, of course, illusory. Labour creates value, money cannot create money. If it looks like it is, it is a mirage, a bubble waiting to burst. So, as Andy Haldane, Chief Economist and the Executive Director of Monetary Analysis and Statistics at the Bank of England, showed, the 'gains' made by finance were later paid for by the public in their entirety when the finance bubble finally burst.

> 'For the largest 25 or so global banks, the average annual subsidy between 2007-2010 was hundreds of billions of dollars; on some estimates it was over $1 trillion (Haldane 2011). This compares with average annual profitability of the largest global banks of about $170 billion per annum in the five years ahead of the crisis.' [86]

The profits may have been illusory but shareholders and directors were not required to pay them back. Instead the public paid for the deficit between false and true profits in full. Haldane maintains that this amounted to a political policy of transferring wealth to capital from the public.

> Government subsidies – whether implicit or explicit – cannot be said to have added to economic well-being in aggregate. At best, they are a sectoral re-distribution of resources from the general taxpayer to the banks.[87]

However, there is no shift in policy and no reduction in companies seeking out profit in finance. And UK company law has responded. It no longer reflects the law of productive economy, it reflects the law appropriate to a general profit creating entity in which production is largely bypassed. Directors' fiduciary duty has reformulated in subtle but important ways. The law on

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[86] A G Haldane, V Madouros 'What is the contribution of the financial sector?' Vox 22 November 2011 http://www.voxeu.org/article/what-contribution-financial-sector

[87] ibid

corporate purpose which shapes what directors can do to create profit has all but disappeared. Only the doctrine of separate corporate personality remains unchanged.

Modern Company Law

i. A Director's Fiduciary duty

Neoliberal theory and corporate governance, infected with neoliberal theory, always insisted that a director's duty was to shareholders, in an agent/principal relationship.[88] However, it wasn't until the 2006 reforms that the relationship was set out in the law, in section 172 of the Companies Act. This section represented the long deliberations of the Company Law Reform Steering Group on whether to adopt a stakeholder/pluralist approach or an enlightened shareholder value approach, conceptualised by Jenson.[89] They decided on the latter, an approach which explicitly requires directors to act in the interests of shareholders but to consider other stakeholders when doing so. Thus section 172 states that 'a director must promote the success of the company for the benefit of its members as whole' but when doing this they must consider a number of different stakeholder and issues including employees, consumers and the likely consequence of nay decision in the long term. They must report on how they have made their decisions in the company annual report [90] but they must be guided in their decision making by the interests of the member.

In this construction, the presence of a 'non exhaustive' list of considerations does not mean that directors owe a duty to stakeholders, or to the long term consequences of their decision making,

[88] Jensen and Meckling n 82 above

[89] M. Jensen, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function," Journal of Applied Corporate Finance, Vol. 14, No. 3 (2001), pp. 8-21.

[90] The matters which directors may consider is set out in section 172(a)-(f) For listed companies, this must reported under requirements in Companies Act 2006 section 414A (previously section 417)

as commentators hope it means.[91] However, neither does the more focused shareholder position make section 172 *less* stakeholder orientated than the common law 'duty to the company'. The new construction of the director's duty merely reflects the change in economic context described above. Under the common law, the duty was to the company because historically the director protected and managed a productive entity. Today, in a period of low profits, the highly paid director will be investing in derivatives, in other companies' equities or bonds, restructuring company capital or be involved in mergers unrelated to production. Anything to create shareholder value. Connectedly, the law on corporate purpose[92] expanded by the end of the twentieth century to encompass most activities that made profit.[93] Company law reform went a step further and there is now no legal requirement to have an express business purpose.[94] All companies, have the same, singular purpose, to make profit, reducing one small obstacle to directors' decision making in the interests of members. So, when section 172 of the Companies Act says 'A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the *benefit of its members* as a whole…', (my italics) for the 'benefit of its members' is what it means.[95] Directors can have *regard* to stakeholders when acting for the benefit of its members, but no more.[96] Today, that is what representing capital means.

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[91] Virginia Harper Ho "'Enlightened Shareholder Value': Corporate Governance Beyond the Shareholder-Stakeholder Divide," 36 Journal of Corporation Law 59 (2010).

[92] Discussed in footnote 52 above.

[93] *Bell Houses Ltd v City Wall Properties Ltd* [1966] 2 QB 656. Corporate gift giving being an exception.

[94] Companies Act 2006 section 30

[95] Keay has argued that this section is problematic because it is incomplete as to its interpretation and application and 'produces a lack of clarity as to its boundaries.' Keay AR and Zhang H, 'An Analysis of Enlightened Shareholder Value in Light of Ex Post Opportunism and Incomplete Law', European Company and Financial Law Review 2011, 445-475, at 475

[96] A point I first made in *Critical Company law* (Routledge 2007) at pp 182-184 and in many subsequent papers.

ii. The Doctrine of Separate Corporate Personality

The doctrine of separate corporate personality remains intact. Though exceptions have developed in case law and in statute, they have aimed to make directors accountable and to make them avoid reckless or fraudulent behaviours, particularly in respect to creditors.[97] The law has endeavoured to ensure that the veil is not pierced so as to undermine the integrity of a shareholder's property. Lord Keith's statement in *Woolfson*[98] that the veil may only be pierced 'in special circumstances when a limited company might well be a façade concealing the true facts' still holds true.[99] Two recent Supreme Court cases also testify to the law's unwavering commitment to the *Salomon* doctrine. In *VTB Capital Plc v Nutritek International Corp & Ors*[100] Lord Neuberger, in overruling an earlier case[101] that had attempted to extend the scope of veil piercing, went as far as to say that veil piercing did not exist at all. In this he cited Lord Halsbury's judgement in *Salomon* and his assertion that if one established that a company had been legally incorporated then it was not possible to take an action which depended on its non-existence; there cannot simultaneously be a company and not a company. Only statute could set aside that presumption.

Though softening this position somewhat in *Prest v Petrodel*,[102] Lord Sumption still offered a narrow window of opportunity for veil piercing when a person was attempting to evade a previously

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[97] Insolvency Act 1986 sections 212-217

[98] *Woolfson v Strathclyde RC* [1978] S.L.T. 159

[99] It was cited favourably in the leading case of *Adams v Cape Industries* [1990] Ch.433 and was reflected in Lord Munby's statements that the veil could be lifted where there was control of the company by the wrongdoers and the misuse of the company by them was a façade to conceal their wrongdoings. *Ben Hashem's Case* [2009] 1FLR 115

[100] *VTB Capital Plc v Nutritek International Corp & Ors* [2013] 2 AC 337 (SC)

[101] *Antonio Gramsci Shipping Corp v Stepanovs* [2011] EWHC 333 (Comm) Burton J held that the veil could be pierced to allow the controllers (the 'puppeteers') of a company to be sued under the company's contracts as if they were themselves a contracting party.

[102] *Prest v Petrodel Resources Ltd* [2013] B.C.C. 571 Supreme Court

existing legal obligation through use of the core feature of a company, its separate corporate personality. He called this the evasion principle. The veil could be pierced if 'a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement.'[103]*Gilford v Horne* was classic example of evasion because the key issue was Horne's 'evasive motive for forming the company'.[104] This principle for veil piercing should, Lord Sumption stated, be distinguished from similar cases where a company is interposed 'so as to conceal the identity of the real actors', cases which fell under the 'concealment' principle. Here the courts could look behind the veil to see what facts the veil was concealing, without disregarding the veil or the integrity of the company itself.[105] However, even where the evasion principle can be applied, the veil piercing should be limited to depriving the wrongdoer of any advantages gained from use of the corporate veil; and then only if the wrong could not be otherwise remedied. Only in very extreme cases, invariably involving the use of small companies which allow the company's controllers to engage in wrongdoing, will the corporate veil be set aside.[106] In practice, the corporate veil remains near sacrosanct, to be set aside only *in extremis*.

Unlike many other doctrines in company law which have been changed and honed to enable profit maximisation, the doctrine of separate corporate personality remains intact. This is because this doctrine is so central to the preservation of share value. If the veil was pierced to set aside limited liability this would fundamentally undermine share values. Indeed, even a suspicion that the veil might be routinely dispensed with would cause massive instability in the stock market as it struggled to locate the value of shares once potential liabilities were factored in. With the

[103] Ibid p585

[104] Ibid

[105] For example, in *Jones v Lipman* the defendant sought to avoid selling property he was bound to sell by transferring it to a company. However, as he owned and controlled the company he was in a position to perform his obligation to the plaintiffs by exercising his powers over the company, veil piercing was not required.

[106] Talbot n8 above, chapter 3

proliferation of fictitious commodities whose real value is in any case inflated and likely to be adjusted downward in the near future, the modern economy is even more dependent upon the integrity of the corporate veil to protect values.

Section 4

Parasitism and Shareholder Value to Date

Critics of shareholder value orientated corporate governance are understandably concerned that shareholder value is being achieved through destructive mechanisms which are distorting the economy. The title of William Lazonick's recent article 'Profits without Prosperity',[107] neatly encapsulates where we are – corporate management no longer attempts to create real wealth. Instead they keep up shareholder value through financial tinkering, specifically (Lazonick's particular concern) by repurchasing shares with existing capital or through cheap debt. American capitalism is particular rife with the share repurchasing strategies. In 2014, S&P 500 corporations bought back just over $565 billion of their own shares, an amount equivalent to around three-quarters of their total capital expenditures.[108] Lazonick's statistics show that the 449 companies that were listed in the S&P500 index from 2003-2012 spent 91% of their earning on dividends and share repurchases, leaving very little for innovative development or improved wages for employees.[109] In the UK around £28.3bn was paid out in dividends during the second quarter of 2015 in ordinary dividends alone, higher than any pre-crisis payment. This was driven by finance

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[107] W Lazonick 'Profits without Prosperity' Harvard Business Review September 2014 https://hbr.org/resources/pdfs/comm/fmglobal/profits_without_prosperity.pdf

[108] OECD Economic Outlook, Volume 2015, Issue 1, p240 http://www.oecd.org/economy/outlook/Economic-Outlook-97-Lifting-investment-for-higher-sustainable-growth.pdf

[109] Lazonick n106 above p4

with the banks making the highest dividend payments.[110] It is getting so extreme now that from the OECD to the American campaign trail,[111] the wealthy are wondering how long they can keep making money in this way particularly given an increasingly impoverished (and massively indebted) consumer market.

The pursuit of shareholder value in the context of a weak global economy is also evidenced in the rise of mergers and of buyouts from private equity. Pfizer and Allergan are, at the time of writing, in merger talks which would result in the biggest merger this year, (in what is already a bumper year of mergers), and the biggest ever in healthcare,[112] with a joint value of $330 billion. Part of the attraction for Pfizer is, of course, the low corporate tax rates in Ireland.[113] However, the overriding impetus for all current mergers is low interest rates and low returns on capital investment in developing productive capacity. To continue to produce shareholder value companies buy a rival

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[110] Capita UK Dividend Monitor Issue 23, July 2015, p3 http://www.capitaregistrars.co.uk/assets/media/Dividend_Monitor_July.pdf The upper echelons of these blue chip companies represent vast quantities of capital. The FTSE 100 had a net market capitalisation of £1,720,093 million calculated as of the 31 March 2015, the FTSE 250 just under one tenth of that. FTSE Factsheet 2015 http://www.ftse.com/Analytics/FactSheets/temp/283a5945-b751-48be-974a-fbe45ba1ba3a.pdf

[111] A campaign speech by Hilary Clinton condemned share buy backs and 'quarterly capitalism' http://www.reuters.com/article/2015/07/24/us-usa-election-clinton-speech-idUSKCN0PY0AY20150724 25th July 2015

[112] Healthcare has seen a huge rise in mergers, increasing the cost of healthcare provision. http://www.healthcarefinancenews.com/slideshow/healthcare-mergers-and-acquisitions-2015-running-list

[113] J de la Merced and L Pickeroct 'Pfizer Bid for Allergan Has Its Eyes on Ireland' NY Times 30/10/2015 http://www.nytimes.com/2015/10/30/business/dealbook/allergan-pfizer-deal.html?_r=0 M

businesses to reduce costs, competition and to keep prices stable.[114] It also increases incumbent managements' empire and thus their own remunerations as well as providing high rewards for the finance providers. For ordinarily paid workers reducing costs means loss of jobs. In the UK, private equity groups engage in a multi-billion pound business in both equity buyouts and sales. According to a survey by the Centre for Management Buyout Research, in the first half of 2015 there were more than 100 UK buyouts worth £10.5bn overall. In the first half on 2015, buyouts were up 33% on the first half of 2014.[115] No institution is free from private equity. Over 18% of Oxford University's £1.7bn endowment fund is managed by private equity funds, up from 8% in 2012.[116] The artifice driven buoyancy of the share market is also prompting record sales of private equity investments. In the first half of 2015 private equity sold almost £22bn of past investments.[117] Cinven recently sold its last share in Spire, a group of UK private hospitals that it bought in 2007. In the US, after holding on to First Data Corp in a buyout which cost KKR $30bn the corporation is starting the first of an expected series of IPOs. The first IPO is valued at around $100 million.

[114] http://www.theguardian.com/business/2015/oct/11/mergers-and-acquisitions-madness-may-be-about-to-stop business leader

[115] Joseph Cotterill 'Buyout firms move deeper into UK public services' FT July 13, 2015

http://www.ft.com/cms/s/0/5eb941da-26dc-11e5-bd83-71cb60e8f08c.html#axzz3gZ4osEEl

[116] Madison Marriage 'University of Oxford doubles exposure to private equity' FT July 19, 2015

http://www.ft.com/cms/s/0/c47821e8-2bdd-11e5-acfb-cbd2e1c81cca.html#axzz3gZ4osEEl

[117] Joseph Cotterill 'Buyout firms move deeper into UK public services' FT July 13, 2015

http://www.ft.com/cms/s/0/5eb941da-26dc-11e5-bd83-71cb60e8f08c.html#axzz3gZ4osEEl

As the majority shareholder, KKR was able to require First Data to borrow to repay KKR's investment so by 2015 First Data had $20.5bn net debt.[118]

In contrast the prosperity enjoyed by those who wealth lies in shares and finance, labour has experienced sharp falls is wages, job security and state imposed austerity. However, in a somewhat perverse twist, the loss to labour has partly been masked by the company form as the newly unemployed have become self-employed in the absence of alternatives and organised as private companies. According to the BIS 'In recent years the majority of business population growth has been amongst non-employing businesses (of all types); 91% of total growth since 2000 and 80% of growth in the last year.'[119] 'Businesses with no employees' accounted for 76% of all private sector businesses (4 million in total), 17% of private sectors employment and 7% of private sector turnover.[120] The UK continues to have the highest levels of self-employment in the EU, indicative of a weak labour market.[121] Even for those employed, 697,000 people were on zero-hours contracts for their main job between October and December 2014. That represents 2.3% of the UK workforce.[122] For full-time employees, between 2009 and 2013 real earnings have fallen on average 7.5%.[123]

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[118] 'First Data: second chance' FT July 21, 2015 http://www.ft.com/cms/s/3/6f068118-2f62-11e5-8873-775ba7c2ea3d.html#axzz3gZ4osEEl

[119] BIS Business Population Estimates For the UK and Regions 26 November 2014 Statistical Release Reference: URN 14/92 p2

[120] ibid p5

[121] http://www.theguardian.com/business/2014/aug/12/uk-self-employment-capital-western-europe-ippr-recovery

[122] ONS 'Analysis of Employee Contracts that do not Guarantee a Minimum Number of Hours' 25 February 2015 http://www.ons.gov.uk/ons/dcp171776_396885.pdf

[123] ONS 'UK Wages Over the Past Four Decade's 3 July 2014 http://www.ons.gov.uk/ons/dcp171776_368928.pdf

All this might seem a relatively modest transfer of value from labour to capital in the recent period, given a global financial crisis, until one considers the amount the public has paid for this. Sovereign debt in the UK is stands at £1.26 trillion, just over double that in 2009. It is just under 80% of GNP.[124] And the underlying decline continues. In the United States corporate profits are down 0.8% in 2014 compared to 2013 the decline in the FTSE 100 has continued.[125] Still companies have only one solution, buy back more shares. Shareholders demand it and governments oblige with low interest rates. The precipice of economic decline is beckoning.

Conclusion

When critical scholars deplore myopic shareholder orientated corporate goals and formulate socially progressive reform it is vital to understand or to re-understand that these anti-social strategies were, and are, a reaction to pre-existing weaknesses in the economy. This package of strategies was a neoliberal reaction to the weaknesses, one that catastrophically chose the exact moment of low profit rates to make the achievement of shareholder value paramount. These parasitical strategies will undoubtedly precipitate another and much worse crisis soon – but it wasn't alright, then it went all wrong. Importantly for reformers today that means that we can't just do capitalism differently and expect it to succeed. The weakness was that the productive economy was not delivering the profits that it once had. So the neoliberal solution was to use the company in other ways than making profit through production.

I have argued that the law *as it stands* is not a source of resistance. Under English common law a directors' duty was owed to the company, but now under the Companies Act 2006 directors owe

[124] http://www.ukpublicspending.co.uk/uk_national_debt_chart.html 22 July 2015

[125] Latest decline as of writing this http://www.bbc.co.uk/news/business-33619756 22 July 2015 revised 30th October http://www.bbc.co.uk/news/live/business-34617910

a duty to act in the interests of the members as a whole. This is a direct requirement to represent the interest of shareholders. But even when the common law required directors to act in the interest of the company, this was not a duty to be more socially responsible or more inclusive. It was a recognition that shareholders' interests were represented through the productive entity. In the period of financialised capitalism this is of secondary importance.

Secondly, I have argued that most, critics of shareholder primacy, do not oppose profit making, just 'bad' shareholder-driven profit making. But this is a product of the amnesia imposed on us by neoliberalism. Critical scholars now believe there is a choice between good productive stakeholder capitalism and bad parasitical shareholder-value capitalism. That was not the choice forty years ago when growth was higher and inequality so much lower. It is even less the choice now. Neoliberals have responded to entrenched low profit rates (albeit unevenly experienced globally) by using the company mainly for purposes other than that of production so that there is a continuous disconnect between share value and production.[126] Their driving logic is shareholder value. Its outcome will be an ever more degraded productive economy, deeper and more frequent crises and intensified attacks on labour and social welfare. These are the necessary causalities of attempts to protect capital. But if the driving logic of reformers is that there is a more socially responsible way to do capitalism successfully, they too will fail. Creating value for shareholders is not compatible creating an economy that delivers for people. Today shareholder value is best created by squandering funds on financial restructuring at precisely the point when an economy-for-people needs to develop productive and innovative capacity. Capitalism is failing to deliver what it once could (for shareholders and society) because of the nature of capitalism. Radical solutions will be needed to preserve industries that provide useful things for people but which don't provide shareholder value. Radical initiatives must encourage the innovations that have traditionally been

[126] The FTSE 100 rose again at the very point that manufacturing slows down. http://www.bbc.co.uk/news/business-32545887

capitalism's saving grace, but in a degenerate finance capitalism have become expensive risks. Today, radicals must dig deeper when critiquing the modern company and ask whether capitalism itself has a future and if so, is it a future that we want?