A RECONFIGURATION OF COMPANY AND/OR CORPORATE LAW THEORY

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Reform of company and/or corporations law to take account of societal concerns is moribund. The problem is that theory, the source of policy, while in extraordinary volume from many perspectives, is narrowly confined by a heritage arising from the early seventeenth century, in particular The Case of Sutton's Hospital. This article proffers a reading of the case that leads to an understanding of the constraints it applies on theorising. It suggests a way of overcoming those constraints by locating theories against and in relation to each other. This involves considering theories in three dimensions: purpose/law/effect, systemic focus and calculable purpose. All theories are limited in scope in this schema, yet paradoxically theorising is freed from constraint. By way of conclusion, ways in which freer theorising might approach the issue of the social responsibility of companies are indicated.

A. INTRODUCTION

Reform of company and/or corporations law¹ is moribund. One need only think of the more pressing major concerns in the field to concede the point. The demand for the social responsibility of companies,² the control of human rights abuses particularly by multi-national firms,³ the long-tail problem,⁴ controlling

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¹ The area of law referred to by this remarkably clunky term, made necessary in the title by jurisdictional differences in terminology, is hereafter called simply, and hopefully more elegantly, "company law".

² Where jurisdictions have managed to do anything about controlling the exercise of accumulated financial power, their efforts are little more than the faint concession that directors are not betraying their shareholders if they consider societal interests: eg s 172 of the Companies Act 2006 (UK). This is extraordinary, given that the dimensions of the problem were mapped by Berle and Means in the 1930s—see AA Berle and G Means, *The Modern Corporation and Private Property* (New York, Macmillan, 1932)—and fully articulated shortly thereafter, not the least by JW Hurst in *The Legitimacy of the Business Corporation in the Law of the United States 1780–1970* (Charlottesville, University Press of Virginia, 1970). A marvellous source for considerations of these issues is to be found on the Australian government's Corporations and Markets Advisory Committee website, <http://www.camac.gov.au>, especially under "Submissions" for "Corporate social responsibility" (last accessed on 24 February 2010). Just how anodyne governmental responses are is exemplified by the UK government's corporate social responsibility site, www.csr.gov.uk.

³ See, eg the Ruggie Report: "Protect, Respect and Remedy: A Framework for Business and Human Rights", A/HRC/8/5 (7 April 2008), available at www.business-humanrights.org/SpecialRepPortal/Home/ReportstoUNHumanRightsCouncil/2008 (last accessed on 24

the use of phoenix companies,⁵ disproportionate payments to executives and directors,⁶ liability both corporate and personal for corporate fault,⁷ to name just a few issues, all elude solution.

Solutions to difficult problems arise from imaginative thinking. In company law itself, thinking is locked into a sterile debate between bowdlerised sociological theory and hyper-individualism—between stakeholder theory and law and economics, apart from when it is informed by straightforward political opportunism.⁸ Contiguous to company law is a little regulatory theory indicating how company law might incorporate democratically inspired corporate self-regulation, yet this is more an exercise in idealism rather than a practical agenda of change in the context of the existing structures and path dependency

February 2010). Little is suggested by way of action other than pious hope in the form of due diligence and disclosure. An interesting example of the difficulties of action in the area is the fate of the Corporate Code of Conduct Bill 2000 in the Australian Parliament, chronicled to some extent in the Report on the same by the Australian Parliamentary Joint Committee on Corporations and Financial Services, to be found at http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/1999-02/corp_code/index.htm (accessed on 27 August 2008).

⁴ This came to the fore in Australia in relation to the actions of the James Hardie group of companies, the board of which tried to cordon off liabilities for asbestos-related diseases by a series of transactions: see <http://www.dpc.nsw.gov.au/publications>, under the title “Special Commission of Inquiry into the Medical Research and Compensation Foundation” (accessed on 24 February 2010). One of the major issues in relation to asbestos-related diseases is that the symptoms of a disease may only become apparent decades after contact with asbestos. In the meantime, the company may have been wound up—hence the “long tail” of liability. No convincing solution is proffered.

⁵ Little more than disqualification of those involved is implemented. Problems of proof abound.

⁶ Disclosure is the solution most often proposed here. No detectable change in salary structures has resulted: see Productivity Commission, “Executive Remuneration in Australia”, Report No 49, Final Enquiry Report (Melbourne, Productivity Commission, 2009), 96–98, available at www.pc.gov.au/projects/inquiry/executive-remuneration/report (accessed on 24 February 2010). Four justifications are commonly deployed to justify rewards worth millions of dollars for corporate executives. These are: the reward is deserved; that shareholders have consented to it; it is compensation for risk-taking; and that the market sets the price. Not one is persuasive: importance is relative and no comparison justifies them; consent by shareholders is problematic, given the proxy systems, institutional shareholdings and collective action problems; quantitatively the risk borne by executives is personally small, even if not insured against; market price depends on there being a market; and there demonstrably is nothing remotely approaching free entry, fungible products, perfect information and so forth. For a discussion, see G Haigh, “Bad Company: The Cult of the CEO” (2003) 10 *Quarterly Essay* 1.

⁷ See H Anderson and R Krever (eds), *Directors’ Personal Liability for Corporate Fault: A Comparative Analysis* (Boston, MA, Kluwer Law International, 2008).

⁸ Perusal of the material cited in nn 2–7 demonstrates this. My examination of reform of company law goes some way to establishing political opportunism, at least for Australia: D Wishart, “Simplification and Motherhood” [1996/2] *Butterworths Corporations Law Bulletin* 16–19; D Wishart, “Theory, Politics and the Reform of Corporations Law (or Corporations Law as a Glob)” (2002) 6 *Law Text Culture* 87. For New Zealand, see D Wishart, “Reform of New Zealand Companies and Securities Law” (1992) 2 *Australian Journal of Corporate Law* 30. It is passing strange that there is so little examination of company law reform from a political point of view—perhaps it goes to reinforce my point that the contextual study of company law has been captured by the binary opposition of economics and legal realism.

of law.⁹ The purpose of this article is to cut through the consequent knot of meaningless dialectic with a little up-to-date thinking—late twentieth century, if not new millennium—rather than nineteenth century sociology and 1980s law and economics.

The article begins by identifying *The Case of Sutton's Hospital*, decided in 1612, as a key turning point in company law. In as much as the corporation was recognised in that case to be a fictional legal person, human beings were recognised to be the sole subjects of law. This, as any such decision must, lead to various issues in the accommodation of law to the position taken, issues which are generally solved by process and theory. This article describes the directions theorising took, following Lord Coke's vision of law and society, and ending in the present stand-off.

The argument is that the consequence of *The Case of Sutton's Hospital* has been a threefold error. First, the subject of law is assumed to necessarily be the human being. Secondly, law and its nature has thereafter been a singular given. Thirdly, theorising takes place in a simplistic epistemology. The way out of the resulting current cul de sac is to recast the metatheory: to locate law within a larger description of government that does not presume that its means are the regulation of human beings. This is done here. The way that doing so would reconfigure company law theory is set out. Finally, this reconfiguration is applied to the issue where the moribund status of reform in company law is presently most obvious: the issue, in pre-reconfiguration terms, of the social responsibility of corporate management.

B. THE CASE OF SUTTON'S HOSPITAL

*The Case of Sutton's Hospital*¹⁰ was a dispute over property. Sutton was Master of Ordnance for the North, a coal mine owner and moneylender—occupations which, no doubt, were not unconnected. Yet we should not be too cynical, for he founded a charitable institution, a school and hospital, and on his death bequeathed the larger part of his fortune to it. Good deeds, however, can be viewed from other perspectives. Sutton's disappointed heirs took every opportunity to challenge his charitable bequest. They challenged the validity of the transfer of property to the charity by arguing that the charity, as a corporation, was not properly founded and that therefore, and separately, the transfer of property to it was void. It was held that the incorporation preceded the founding of the charity, as it should, that the incorporation was good, that

⁹ The best articulated argument in relation to the application of regulation theory to company law is C Parker, *The Open Corporation. Effective Self-regulation and Democracy* (Melbourne, Cambridge University Press, 2002).

¹⁰ (1612) 10 Co Rep 23a, 77 ER 960.

the founding of the charity was good and could be subsequent to the incorporation, that the transfer of the property was good, and that the nomination of the master who received the donation was good. All being good, the bequest was valid and the heirs did not get what they wanted. The school and hospital have persisted to the present day. Good triumphed.

The case was argued “openly” before “all the Judges of England and Barons of the Exchequer”.¹¹ We are told that it was decided at this exalted level “more for the weight of the value, than for the difficulty of the law”. Lord Coke reports it thus:

“1. For the confirmation of incorporation founded on works of piety and charity in times past. 2. For the better instruction how they which shall be founded hereafter shall be so established that no exception may be taken to them. 3. For the resolving of certain opinions and questions which were moved at the Bar, and which might have disturbed the peace of the law.”

All in all, *The Case of Sutton’s Hospital* was thought by Lord Coke to be a Very Important Case—and so it has come to us down the centuries.

1. The Subject of Law

Nowadays we mainly cite *The Case of Sutton’s Hospital* because Lord Coke says at 32b “the corporation itself is only *in abstracto*, and rests only in the intendment and consideration of the law; for a corporation aggregate of many is invisible, immortal, and rests only in intendment and consideration of the law”. This is considered important because it is an explicit statement that there is such a thing as corporate personality apart from the human beings comprising it.¹² Moreover it appears to accept the idea that a corporation is fictional, so falling on one side of a debate that raged 300 years later.

Yet it is still odd that the matter was considered important or undecided. After all, the report cites numerous cases about corporations which had already decided all the matters before the Court. Any generalisation or adoption of theory could hardly be the result of considered judgment for the 300 years before the matter was to be teased apart had yet to elapse. Thus the case stands solidly at the core of the common law as to corporations, though what exactly it stands for is, like much of such historical material, ambiguous.

¹¹ Except the Chief Justice of the King’s Bench, who, we are told at 24b, was sick; we are told at 34b of which illness he died.

¹² Then, as now in the UK, the “company” is considered to be plural—together, the governors of Sutton’s Hospital *were* the corporation. This becomes quite a sticking point in the case in relation to the appointment of the Master. In other places the company is incorporated and it has incorporators (or governors or whatever). The varying terminology reflects the dual aspects of a corporation as both a thing and as a group deciding things. I am advised the same linguistic differences exist for sporting teams: in some places the team *is* and others the team *are*.

Lord Coke's educative purpose in reporting the case may be a clue as to what was going on. He clearly felt a need to set out the law clearly and comprehensively. Lord Coke seems to find some deep confusions in a field where case-by-case development could be most injurious to the poor and sick, and to charitable work generally. How were charities to be set up and run? It was not that there had been no such charitable work until 1612, but that the common law seemed suddenly to be not dealing with the matter very well at all. Why was this?

The turn of the seventeenth century lies at the tail end of feudalism. The liberal era was to come. Lord Coke's towering legal intellect dominated this cusp. He formulated, in a series of other cases,¹³ a new constitutional structure at the centre of which was the common law.¹⁴ This required him, in turn, to formulate how the common law governs. Lord Coke clearly saw law as governing the subjects of the Crown: this is enunciated in *Calvin's Case*,¹⁵ which leaves institutions as non-subjects. They are defined away. However, it was obvious that collective institutions were very important to the smooth running of the state. Hence the issue of the status of charitable corporations was seized upon. Lord Coke proceeded to allow corporations a place but only as a figment of legal imagination.

2. Law and its Nature

The Case of Sutton's Hospital,¹⁶ on this reading, is more about establishing human beings as the subject of law than about deciding anything about corporations. There was no necessity for human beings to be the sole subject of law. It may now be hard to conceive otherwise, but Gierke showed us how, at least in Maitland's translation:¹⁷ we could have looked for the capacity to will and recognised it elsewhere. Or we could have developed the path to which we are called by the contumacious cockerel or the Hindu idol;¹⁸ as Stoljar recognises, the separate pool of assets as the subject of law fits many situations comfortably.¹⁹

¹³ *Prohibitions Del Roy* (1607) 77 ER 1342, 12 Co Rep 64; *Calvin's Case* (1608) 7 Co Rep 1a; 77 ER 377; 2 St Trials 559; *Dr Bonham's Case* (1610) 8 Co Rep 107a, 77 ER 638; *Case of Proclamations* (1610) 12 Co Rep 74, 77 ER 1352.

¹⁴ This is, of course, not to say that Lord Coke's vision became the constitutional structure or that it was uncontested. After all, he was sacked from judicial offices precisely for advocating it. Yet his vision of the common law remains substantially intact and that is the relevant point here.

¹⁵ (1608) 7 Co Rep 1a, 77 ER 377, 2 St Trials 559.

¹⁶ (1612) 10 Co Rep 23a, 77 ER 960.

¹⁷ See SJ Stoljar, *Groups and Entities* (Canberra, ANU Press, 1973), 184–85.

¹⁸ GW Keeton, *The Elementary Principles of Jurisprudence* (London, Pitman & Sons 1949), 149 and see Exodus xxi 28. As to the latter, see *Pramatha Nath Mullick v Pradyumna Kumar Mullick* (1925) LR 52 Ind App 245. This is not to mention the beetles of St Julien-de-Maurienne tried and executed in 1545.

¹⁹ Stoljar, *supra* n 17, 10.

Yet, as Wolff was to show,²⁰ largely working from Hallis's comprehensive survey of conceptions of legal personality,²¹ both of these approaches would have been inconsistent with Coke's constitutional and jurisprudential framework. The common law, governing human beings, is prior to all else.

3. Theorising

The human being as the sole real legal person is generally now assumed; at the very least, it is considered inevitable. In 1612 this left the corporation as something that had to be explained. Lord Coke took the obvious step of saying that, although it does not exist, law will treat it as if it did. Since then, many have likewise attempted to theorise the corporation. Four hundred years after *The Case of Sutton's Hospital*, theories of the corporation come at us from all directions. Let us, in overflight as it were, map the terrain because it is important for what follows.

Theories come from inside²² the law in the form of theories of the person, contract and shareholder primacy, and perhaps stakeholder theory. From outside, economics has most recently staked a claim for explanatory power, with less apparent success in its recommendations. If we deem institutional economics to be sociological²³ and hence not really economics, the most recent incarnation of corporations law material from an economic perspective originates in 1976 in the *Journal of Financial Economics*²⁴ in the form of agency theory of the firm and proceeds to various finely drawn descriptions of phenomena in corporate law.²⁵ Given that agency theory originated in a school of management,²⁶ it is not surprising management studies have resulted in a series of ways of thinking about companies. Team production and asset partitioning²⁷ is the latest such effort, but there are many others.

²⁰ M Wolff, "On the Nature of Legal Persons" [1938] *Law Quarterly Review* 494.

²¹ F Hallis, *Corporate Personality: A Study in Jurisprudence* (London, Oxford University Press, 1930).

²² See M Davies, *Asking the Law Question* (Sydney, Law Book Company, 1994); Gunther Teubner's autopoiesis makes a virtue of hermeneutics by characterising the development of law as reflecting in on itself: G Teubner, *Law as an Autopoietic System* (trans A Bankowska and R Adler) (Oxford, Blackwell, 1993).

²³ A brief glance at Toennies work at the turn of the nineteenth century makes this fair. See, eg F Toennies, *Community and Society* (trans CP Loomis) (New York, Harper & Row, 1963).

²⁴ MC Jensen and HW Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 *Journal of Financial Economics* 305. Of course, this has its progenitors; in this case, most particularly RH Coase, "The Nature of the Firm" (1937) 4 *Economica* 386 (but also variously reprinted).

²⁵ For example and for examples, see MJ Whincop, *An Economic and Jurisprudential Genealogy of Corporations Law* (Sydney, Ashgate, 2001); see also BR Cheffins, *Company Law: Theory, Structure, and Operation* (Oxford, Clarendon Press, 1997).

²⁶ The William E Simon Graduate School of Business Management, University of Rochester.

²⁷ M Blair and LA Stout, "A Team Production Theory of Corporate Law" (1999) 85 *Virginia Law Review* 247.

Political theory helped in building the foundation of incorporation by registration and limited liability,²⁸ and Berle and Means famously later forced a rethinking of the site of power in firms.²⁹ James Willard Hurst pushed this into a framework of legitimacy,³⁰ the upshot being the presently influential corporate governance movement.³¹

Modern empirical sociology has taken Berle and Means's cue and investigated the corporation/firm and the actors involved in them with studies of interlocking directorships in almost every jurisdiction imaginable, of directors' attitudes and behaviours, and their independence, and studies in a multiplicity of other matters. Accounting firms and management consultancies have most recently taken up this activity.

Theoretical sociology draws heavily on Toennies³² and Weber to describe contracting and bureaucratic procedures respectively. The upshot of the former is the institutional economics of Macneil³³ and Williamson,³⁴ although this is more often viewed as a variant of economics—the institutional economics adverted to earlier. Whincop,³⁵ as we shall see later, attempts reconciliation, although ultimately his analysis leaves the question begging. Weber leads to Frug,³⁶ but by then postmodernity has set in. Postmodern sociology has had small say about companies as yet, although one can feel the impending cool

²⁸ See P Ireland, "The Rise of the Limited Liability Company" (1984) 12 *International Journal of Sociology of Law* 239; R Formoy, *The Historical Foundations of Modern Company Law* (London, Sweet & Maxwell, 1923); WR Cornish and G Clark, *Law and Society in England 1750–1950* (London, Sweet & Maxwell, 1989). Liberal theory was at the core of Robert Lowe's impulse to formulate incorporation by registration, and ideas of "little republics" founded conceptions of internal relations. The latter reached a high point in *Pender v Lushington* (1877) 6 Ch D 70. While such approaches might seem anachronistic, they are alive and well when representations of indigenous peoples are at issue: New Zealand, the Native Land Act 1894, ss 122–30 recognised Maori incorporation, later to be replaced by trusts; see D Wishart, *Company Law in Context* (Auckland, Oxford University Press, 1994), 41–42. In Australia there is renewed emphasis on Aboriginal Corporations, with reforms in 2006 in the form of the Corporations (Aboriginal and Torres Strait Islander) Act 2006. For discussion of earlier versions see C Mantziaris and D Martin, *Native Title Corporations: A Legal and Anthropological Analysis* (Annadale, Federation Press, 2000). For a critical analysis of the 2006 changes see K Clothier, "Corporations (Aboriginal and Torres Strait Islander) Bill 2005: Positive or Negative Discrimination?" (2006) 10(2) *Australian Indigenous Law Reporter* 1.

²⁹ Berle and Means, *supra* n 2. See also the Berle/Dodds debate (1931–32) 45 *Harvard Law Review* 1145, 1365.

³⁰ Hurst, *supra* n 2.

³¹ To trace these connections see M Stokes, "Company Law and Legal Theory" in W Twining (ed), *Legal Theory and Common Law* (Oxford, Basil Blackwell, 1986), 155.

³² Toennies, *supra* n 23.

³³ See IR Macneil, "Contracts: Adjustment of Long-term Economic Relations under Classical, Neoclassical and Relational Contract Law" (1977–78) 72 *Northwestern University Law Review* 854, reprinted in P Burrows and CG Veljanovski (eds), *The Economic Approach to Law* (London, Butterworths, 1981), 61.

³⁴ OE Williamson, "Transaction Cost Economics: The Governance of Contractual Relations" (1979) 22 *Journal of Law and Economics* 233, also reprinted in Burrows and Veljanovski, *ibid*, 39.

³⁵ Whincop, *supra* n 25.

³⁶ GE Frug, "The Ideology of Bureaucracy in American Law" [1984] *Harvard Law Review* 1276.

change of Foucauldian governmentality³⁷ in conferences. Sociology still has a few Marxists out and about looking at corporations—Paddy Ireland springs to mind.³⁸ Mind you, anthropology has resisted the call to apply its tools to the corporate world, despite the desperate need for ethnographic studies of meetings of both shareholders and directors³⁹ along the lines of Sally Wheeler’s incisive study of creditors’ meetings.⁴⁰ Descriptions of business activity remain depressingly “thin”.⁴¹

Meanwhile, regulatory theory grew from criminological origins in the late 1980s to be very influential, at least in compliance-seeking circles. Relying on democratic ideals, it posited mechanisms of self-regulation as replacing command-and-control for the best achievement of policy goals.⁴² Avoiding the taint of Foucauldian “government of the self”, a considerable literature developed that empirically verified the efficacy of compliance mechanisms.⁴³ Christine Parker applied regulatory theory to the issue of corporate responsibility in *The Open Corporation*,⁴⁴ ultimately recommending forms of meta-regulation for the new regulatory state⁴⁵—rather wistfully, it would seem, given company law itself is still stuck in the cul de sac of the pragmatics of the precise form of legal change.

4. The Cul de Sac

It is easy in all this theorising, outlined in the preceding five paragraphs, to lose sight of the fundamental question for the common law system as formulated by

³⁷ See *infra* Section D.

³⁸ See, inter alia, P Ireland, “Capitalism Without the Capitalist: the Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality” (1996) 17 *Legal History* 41; I Grigg-Spall, P Ireland and D Kelly, “Company Law” in I Grigg-Spall and P Ireland (eds), *The Critical Lawyer’s Handbook* (London, Pluto Press, 1992), 98.

³⁹ Exemplified by Clifford Geertz, in his famous and engaging study of the Balinese Cockfight: “Deep Play: Notes on the Balinese Cockfight” in C Geertz, *The Interpretation of Cultures* (New York, Basic Books, 1973), 412–53. One might also turn to Sally Falk Moore’s “semi autonomous social field”: SF Moore, “Introduction” in *Law as Process* (London, Routledge & Kegan Paul, 1978). This is entirely apposite as it is founded in an understanding of corporations as separate fields of social activity. Or even see Alan Hunt’s governance approach, as set out in A Hunt, *Explorations in Law and Society: Towards a Constitutive Theory of Law* (New York, Routledge, 1993), ch 13.

⁴⁰ S Wheeler, “Capital Fractionalized: The Role of Insolvency Practitioners in Asset Distribution” in M Cain and CB Harrington (eds), *Lawyers in a Postmodern World* (Buckingham, Open University Press, 1994); see also S Wheeler, “The Business Enterprise: A Socio-legal Introduction” in S Wheeler (ed), *A Reader on The Law of the Business Enterprise* (Oxford University Press, 1994).

⁴¹ An interesting exception, in addition to Sally Wheeler’s work, is that of Neil Andrews: see, eg N Andrews, “Information in Late Capitalism Illustrated: the MBO of Elders IXL” (1999) 6 *Canberra Law Review* 77.

⁴² See, generally I Ayers and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (New York, Oxford University Press, 1992).

⁴³ Tests in the Popperian sense are sadly lacking.

⁴⁴ (Melbourne, Cambridge University Press, 2002).

⁴⁵ *Ibid*, 246.

Lord Coke—which is, despite HLA Hart,⁴⁶ just what is a corporation? Given that corporations exist within law, as recognised in *The Case of Sutton's Hospital*, how is the rest of law to be accommodated to them and how are their interior structures to be explained in terms of human beings? After all, the human being is accepted to be a unity, his or her interior structure does not have to be explained, and hence the human being can be a citizen or subject, a party to a transaction, a victim or perpetrator, and so forth. Decisions by humans are accepted to have been made by observable evidence, and there is no need to enquire or explain further. Within the structure of thinking after *The Case of Sutton's Hospital*, this is not true of corporations. That thinking's assumptions and epistemology necessitate the reduction of corporations to component human beings. And this is exactly what the theories do, thereby staying squarely within Lord Coke's paradigm.

The human being is central to most approaches—the corporation as a real person being the exception but Wolff's mocking tone⁴⁷ brought that back to a liberal reality. While much of the economics and management literature is more about the firm as an economic actor, rather than the corporation or company, thus harking back to “black box” theory, agency theory's triumph is the rendering of the black box into terms amenable to analysis as contracting by evaluating, maximizing, rational human beings.⁴⁸ Even the institutionalists deploy a softening of the rational actor, human beings' propensity to limited rationality and opportunism, to explain the transaction costs associated with the choice of institution, let alone legal form.⁴⁹ Weberian methodological individualism underlies much of the rest. Lowe's “little republics” did not survive the exigencies of limited liability, although the constitutionalism of *Automatic Self Cleansing Filter Syndicate v Cunningham*⁵⁰ is a pointer to an inarticulate sense of the political. It is this sense which is picked up by the regulatory theorists, albeit of necessity eschewing the form, concepts and metaphors of the law itself.

There are many summaries of these approaches and theories, none of which capture all of them and, while there is considerable description of each approach, there is little debate. Most discussions are conducted in a space cordoned off somewhere from general legal theory, and there is a corresponding ignorance of origin and context. This is perhaps less true of economic theories—the origins of which, for all their limitations, are paraded⁵¹—but is

⁴⁶ HLA Hart, “Definition and Theory in Jurisprudence” (1954) 70 *Law Quarterly Review* 37.

⁴⁷ Wolff, *supra* n 20.

⁴⁸ Jensen and Meckling were very sensible of the self-styled paradigm shift their work was supposed to engender: see *supra* n 24.

⁴⁹ See particularly Williamson, *supra* n 34.

⁵⁰ [1906] 2 Ch 34.

⁵¹ But compare T Lawson, *Economics and Reality* (London, Routledge, 1997).

certainly true of stakeholder theory, where Pound's sociological jurisprudence is bowdlerised in the extreme.⁵²

No theory is wrong in its explanations of corporations; at the very least, the demonstrably falsifiable ones do not survive long. Most theories simply describe matters a little, or even a lot, differently from the next one. This would not matter in the slightest except that theorists are not content to be "positive", in economists' language: they feel that they should recommend. And different explanations lead to differing and perhaps conflicting recommendations. For example, should directors' duties be owed just to the company or to the association as such, or beyond, to stakeholders? How should employees be dealt with? Should there be a third organ within the corporation? How should oppression be formulated and who should be able to sue in respect of it?

C. WHAT TO DO ABOUT IT?

We can deal with differences and inconsistencies in theories in a number of ways. We can treat the theories as glittering things, to collect them as a magpie does and parade them as a sign of some sort of prowess. This is the way textbooks generally approach the matter, although some adopt one or other approach as a structuring, even explanatory device.⁵³ Most simply ignore the whole thing. Alternatively we can track the theories, as Cheffins does,⁵⁴ and relate them in a more or less complete genealogy of knowledge now existing. This is usually a model of progress, although Cheffins is a little more sophisticated and also considers the Kuhnian paradigm and simple fads and fashions as the core of the genealogy.

Another way of dealing with theoretical differences and inconsistencies is to try for a reconciliation. Mostly this is done by reading all the other theories through the framework of the primary one. Alternatively an attempt to align the theories can be made. Whincop attempts both.⁵⁵ Neoclassical economics,

⁵² Lloyd is particularly scathing: D Lloyd, *The Idea of Law* (Harmondsworth, Penguin, 1970), 201–17. Stakeholder theory is problematic because it presumes what it is designed to solve: the identity of the stakeholders, the homogeneity and solidarity of their interests, and the processes, beyond begging its own question by nominating them as "balancing", by which competing interests are to be resolved. The stakeholder approach also often fails to perceive the limitations of legal discourse, sometimes even to the point of conflating the organisational or economic idea of the firm with the legal concept of corporation; see R Tomasic, J Jackson and R Woellner, *Corporations Law: Principles, Policy and Process* (Sydney, Butterworths, 4th edn, 2002), 118–25.

⁵³ Cheffins, *supra* n 25, deploys economics in his text; Bottomley *et al* deploy politics in R Tomasic, S Bottomley and R McQueen (eds), *Corporations Law in Australia* (Sydney, Federation, 2002); and Berns and Baron deploy post-structuralism: S Berns and P Baron, *Company Law and Governance* (Melbourne, Oxford University Press, 1998).

⁵⁴ BR Cheffins, "Corporations" in P Cane and M Tushnet (eds), *The Oxford Handbook of Legal Studies* (Oxford University Press, 2003).

⁵⁵ Whincop, *supra* n 25.

according to him, can incorporate institutional insights in his analysis of legal personality. Mind you, ultimately Whincop admits defeat by concluding that contractarian and communitarian analyses are simply “incommensurable”.⁵⁶

Yet another way of dealing with theoretical differences and inconsistencies is to attempt a metanarrative. This is what is attempted here—it is an investigation of the way in which we can understand the multiplicity of theories so that their recommendations can be assessed against each other as more than incommensurable alternatives. In other words, the purpose of this essay is to provide a background against which the theories of and dealing with corporations can be read.

As will be obvious later, this essay is heavily influenced by the postmodern destruction of metanarratives. The irony identified by Eagleton⁵⁷ is that doing that itself involves a metanarrative. This essay happily embraces the latter point, being quite comfortable in its perception of the intellectual world as multilayered, with no discernible centre—an onion, as it were.⁵⁸

Before proceeding to set out this background, it behoves me to qualify my intentions. What follows is not meant to be a universal theory of the meaning of everything, or even everything legal. This, in turn, is not meant to say that it cannot throw light on many matters—it is simply that it seems to be useful in the context of company law theory. Moreover, it is not intended to displace the theories adverted to before. It clearly does not have the substance. It is proposed as a means to facilitate discussions between adherents to theories, and to compare and contrast theories. It may also legitimate much that is discarded or suppressed because it does not fall within the parameters set by Lord Coke in *Sutton's Hospital*. Perhaps it may allow for imagination to again take root and some solutions to core societal concerns to be achieved.

In the section which follows the exposition of the metatheory, the theories themselves are compared and contrasted in ways it makes possible. If this all seems to you inexcusably theoretical, following that is a section which maps out practical “dimensions” of theory, enabling them and others to be contrasted and compared. These dimensions are: purpose/law/effect, systemic focus and calculable purpose. This rather obscure nomenclature hides an essentially pragmatic exercise. Thereafter, briefly and by way of illustration, a couple of

⁵⁶ For a critique, see D Wishart, “Critiquing Law and Economics” (2002) 14 *Australian Journal of Corporate Law* 74.

⁵⁷ T Eagleton, *Literary Theory* (Oxford, Blackwell, 1983); T Eagleton, *The Illusions of Postmodernism* (Cambridge, MA, Blackwell, 1996).

⁵⁸ Which reminds me, by way of mixed metaphors, of the fable of the nature of the universe, that the world rests on an elephant and the elephant on a turtle. But on what does the turtle rest? After that, as the fable goes, it is “turtles all the way down”. This is quoted by Stephen Hawking in *A Brief History of Time* (New York, Bantam, 1988) as an example of ridiculous cosmology, but by Clifford Geertz in “Thick Description: Towards an Interpretive Theory of Culture” in *The Interpretation of Culture* (New York, Basic Books, 1973) as a metaphor as to how we can never penetrate to the truth. It is the latter understanding to which I refer.

ways through which freer theorising might approach the issue of the social responsibility of companies are indicated.

D. A METATHEORY

Encapsulating all the theories mentioned above requires a scheme, into which law fits, that does not assume the existence in any particular substance or form of either the legal person⁵⁹ or the law: the former, the legal person, because it is the assumed centrality of the human being as the subject of law in *Sutton's Hospital* that set theorising off on its course to present confusion; the latter, law, is too contingent of definition to be a useful idea; as we shall see, it varies in meaning within the theories, its limits have been subject the subject of jurisprudence for hundreds of years, and it is in many ways an artefact of the particular culture in which it happens to be located.

Abandoning, as William of Ockham advises generally, law and the legal subject as intellectual constructs, is possible if a notion of “technique of governance” is adopted. Governing, in this perspective, is simply the exercise of power within society; moreover, no institution as vague as “the state” is implied. Exercises of power are made possible by ways of knowing, the language and patterns of thought within the community. These make ways and techniques of governing possible, particularly, but not exclusively, those when we govern ourselves. Thus, if there is expertise in probability we accept ideas of risk and govern ourselves to reduce it.⁶⁰ If we conceive of property and money value, we may accept prices as determined by markets as the means by which resources are allocated to us and rationing by price as governing us. In similar ways, rule-making is accepted—not only are rules internalised in the community, but so are acceptance of rules and institutions of rule-making.⁶¹ In this way, individuals and groups are both empowered and constrained. Power is constrained and limited by the forms of acceptable rule-making. Those forms are the “techniques of governance”. Making law is just one such technology.

Law as a technology of governance removes the human being (and even property) from the central position in law and refocuses on power. While this might render some important issues invisible, for present purposes it does not appear to do so. Law itself becomes what the previous discussion implied—a constraint useful for some purposes but not a necessary entity in the argument.

⁵⁹ This is not to say that human beings are not at the centre of reason. We are well down the chain of philosophy from those Cartesian and Kantian questions. The challenge here is to a particular relationship between law and human beings, and the argument is that we can examine this fruitfully from a Foucauldian perspective.

⁶⁰ Pat O'Malley, *Risk, Uncertainty and Government* (London, Glass House, 2004), ch 1.

⁶¹ This is, of course, the point of positivists' “rule of recognition”: HLA Hart, *The Concept of Law* (Oxford, Clarendon Press), chs 5 and 6.

The things which are done, the actions that are taken, are the object of our attention. Thus Parliament makes laws through a series of actions summarized as “legislation”. Courts resolve disputes, leaving judgments to be systematised by subsequent judges, academics and practitioners, so constructing case law. Law, in this perspective, is not something that can be directly studied or known, it is only the evidence of its making or the trace of its passing that can be seen. This is, of course, and ironically, HLA Hart’s point that we should not ask “What is?” questions.⁶²

E. PURPOSE AND EFFECT

Theories about company law, as those about most fields of law, deal with more than just the law. They cover the best law to do certain things, the effects of laws, how law can fit within other disciplines, and even what a theory from elsewhere says about law or its ideas. Law as a technology of governance is about the latter two, as we shall see, but the first two demand an expansion of its coverage.

The governmentality literature⁶³ expressly repudiates purpose and effect, the first because it is unknowable and the latter because it is unascertainable.⁶⁴ To ask “Why?” is to be irrelevant; to ask “What happened as a result?” is to unduly limit causality to pre-existing and current discourses. Cause and effect are so interrelated with each other and with the technology of governance that they can only be observed as a unity—yet to confine ourselves in that way is to deny the observability of many aspects of that which this essay purports to document: theories of company law.⁶⁵ It renders too much invisible. Hence the concepts of “purpose” and “effect” fall to be explored and incorporated.

1. “Purpose”

“Purpose” is the reason for doing something. It can be personal or public, of a group or institution, attributed or inherent. It can be of the action comprising the deployed technique of governance or of a theory describing it, or of the process framing a discourse which the techniques inhabit. This might seem so wide as to deprive “purpose” of meaning but is implied by the idea that doing is

⁶² Hart, *supra* n 46.

⁶³ See especially M Dean, *Governmentality: Power and Rule in Modern Society* (Thousand Oaks, CA, Sage, 1999); P Miller and N Rose, “Governing Economic Life” (1990) 19 *Economy and Society* 1. Its origins lie in M Foucault, “Governmentality” in G Burchell, C Gordon and P Miller (eds), *The Foucault Effect. Studies in Governmentality* (London, Harvester/Wheatsheaf, 1991), 87.

⁶⁴ A Hunt and G Wickham, *Foucault and Law: Towards a Sociology of Law as Governance* (London, Pluto, 1994), 6–7.

⁶⁵ Gary Wickham himself recants support for Foucault’s marginalisation of law, perhaps for reasons to do with cause and effect, in G Wickham, “Foucault, Law, and Power” (2006) 33 *Journal of Law and Society* 596.

an expression of power and therefore has reasons. Those reasons themselves inhabit a world of intellect which define and constrain what is done and indeed construct us as individuals. Thus purposes motivate or are seen to motivate the exercise of power but are also, in either case, the result of exercises of power.

A judge deciding a case, in the process of which he or she makes a statement as to what the law is, has a variety of purposes as a subjective matter. These may be personal or private and never to be confessed (the plaintiff is attractive, the judge wants to go home), self-aggrandising (the judge thinks he or she is a very clever fellow) or more professionally acceptable (this area of law needs clarification or repair). It may be that there is an agenda of moving the law to a stance more in tune with theory—competition law is prone to this—or with authority. These and a variety of other purposes can be attributed to the judge—indeed, that is all we can do—and the judge may declare some of them,⁶⁶ as Lord Coke did. Constraining the judge is their own perception of their role as adjudicator, their ideas of precedent and what it means they can do, their appreciation of the law, ideas of justice and so forth. These constraints are not necessarily imposed (whether they are or not is beside the point); rather, they operate as self-government by the judge. They are self-imposed because physical restraint is only very rarely exercised.⁶⁷ The knowledge of possible consequences and feelings of rightness operate to constrain in almost all circumstances.

In this vein, statutes are both Acts of Parliament and acts of Parliament. The evidence of the actions involved in the deployment of the governmental technique is the formal statute: the Act. The purpose, however, is more speculative. We can see the interplay between various descriptions. Of course, a true purpose is a mere construct, given that purpose is a matter of the intellect of individual human beings and Parliament is a group of human beings acting in a certain way in a certain environment (all of which helps to define the acts that have taken place as a governmental technique known as an Act of Parliament). Parliament's purpose can be nominated by Parliament or it can be later attributed by institutions or actors. No doubt each Member of Parliament has a different set of purposes for participating in the decision, though some may be common to all Parliamentarians.

2. “Effect”

Determination of effects of action inevitably provokes an incommensurability issue. In Kuhnian terms, results are dependent on the paradigm under which the

⁶⁶ Although this is itself a communication with an unknowable referent; in other words of fewer syllables, how well do we know ourselves?

⁶⁷ Compare RH Hickling and DA Wishart, “Malaysia: Dr Mahathir’s Thinking on Constitutional Issues” [1988–89] *Lawasia* 47, which article is a description of the events surrounding the impeachment of Tun Salleh Abbas.

measurement takes place. Evidence is theory contingent.⁶⁸ In terms of techniques of government, the theory upon which evidence is contingent includes the conceptualisation of that on which power is exercised, including society, individuals and institutions. The statement of an effect depends on our way of knowing all these things. Nevertheless, that there are effects of action is implied by acceptance of time and consequence, and these can hardly be ignored as they are part of many of the theories examined here. Moreover, that hypothesis testing is theory contingent does not mean that effects do not result; it merely means that that contingency is open to analysis.

More to the point, if theorising is to have a justification, it is that it is to lead to action in some endeavour, that it is to have effects. This is important in two ways. First, it implies the complex relation between effect and purpose. Purpose frequently decides what measurement of effect is to take place. Unintended effects are acknowledged and identified. In this, legitimacy is often found: the legitimate action is one where the effects are the ones intended. The reverse is also often the case: the purpose is confined by the measurability of the effects. The expertise which identifies effects allows the imagination of the purpose. For example, the development of probability allowed the imagination of risk mitigation.⁶⁹

The second implication is that theorising, even metatheorising, has purposes and effects. Avoiding plunging into the waters of the critique of representation by confining myself to the expression of theorising, the theorist acts by publishing words. This act has purposes and effects which permeate the evidence of its existence. This applies to this essay and also to others. Again, we cannot say with certitude what any purpose is, nor the effects of any particular action, but this does not mean that those purposes and effects do not exist. Moreover, if we talk of what it is right to do, the critique of effects is vitally important.

To sum up: the version of governmentality set out here for the purpose of reimagining company law places the evidence of the exercise of a technique of government—judgements, acts of Parliament—as the raw material of theory. They are not law, merely that from which we construct a vision of law. Around this process is a rich language and set of concepts which can locate theory and law (as a technology of government) against and in relation to each other.

⁶⁸ Any half-decent history and philosophy of science text will discuss this point, eg AF Chalmers, *What is this Thing Called Science?* (St Lucia, University of Queensland Press, 3rd edn, 1999). See also M Shipman, *The Limitations of Social Research* (London, Longman, 3rd edn, 1988).

⁶⁹ O'Malley, *supra* n 60, ch 1.

F. DEPLOYING THE METATHEORY

Company law is a particular, if arbitrarily chosen, complex of cases and legislation, the legislation mostly riding on the cases rather than establishing the core language of the field of law.⁷⁰ There are three main interrelated areas of cases and legislation involved: how the company is to exist and act as a legal person within the legal system; how decisions are to be made within the company as an institution; and the construction of markets for property made possible by the corporate form.⁷¹ In each area there are prevailing and less influential ways of thinking, metaphors and techniques, with more or less effect on legislators, judges, practitioners and, of course, academics, in their work.

An example of this is the section, to be found in most companies legislation deriving from the UK original, that the constitution of the company is to be enforceable as if it were a contract.⁷² “Contract” operates here in ambiguous ways. If the constitution of a company were a contract it would be a strange one indeed, as most of the most strongly held tenets in contract law do not apply: not all the terms are enforceable, and not by parties in capacities other than shareholder or director; indeed, directors in many jurisdictions can enforce it when they are not party to it.⁷³ Termination is mandated when unwritten expectations are belied by the contract itself⁷⁴—a rare example of the unwritten superseding the written. Oddly, the section itself is taken to establish the contractual nature of the relationship between the parties to the constitution of the company and to extend those who can rely upon it, but that relationship pre-existed the section and the purpose of the section has only been established by subsequent judicial fiat. By contrast, a concept of the relationship between stockholders and directors is lacking in US corporations law; rather, participants

⁷⁰ There are interesting relationships between statute and case law in corporations law, not at all those one is taught in first year of a law course. For example, the office of director is rarely established in companies statutes, but merely regulated. The same is true of member and almost every core conceptual foundation of the field. On the other hand, some core concepts, like the constitution of a company as a contract but nevertheless not being fully enforceable, withstand the most vigorous legislative countermands. Overall, the legislation seems mostly to ride on the cases rather than establish the core language of the field of law.

⁷¹ This is, of course, to theorise and can be disputed. For a description of Australian corporations law structured accordingly, see D Wishart, *Corporations Law Guidebook* (Melbourne, Oxford University Press, 2009) and its predecessor D Wishart, *Company Law in Context* (Auckland, Oxford University Press, 1994).

⁷² In the Companies Act 2006, it takes this form:

“[Section] 33 Effect of company’s constitution

(1) The provisions of a company’s constitution bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions.”

This echoes *Hickman v Kent and Romney Marsh Sheep-Breeders’ Association* [1915] 1 Ch 881.

⁷³ See, eg s 140 of the Australian Corporations Act 2001.

⁷⁴ *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360.

in corporations have statute-given statuses with rights, the mediating concept being the business judgement rule.⁷⁵ There is, then, in US law a poverty of exploration of decision-making relations. Perhaps for that reason there was a ready acceptance of the formulation proffered by economics: the agency contract. In yet another oddity, or perhaps idiocy, this ready acceptance has led to its proselytisation in the UK and UK-derived jurisdictions where the prevailing thinking was that the company is founded on contract anyway.

The agency contract theory of corporations resonates with the constitution of a company as a contract in operating both as a simile and as a metaphor in the determination of disputes arising between member and company, director and company, and between the members. The two are frequently confused yet, although they are related, they are quite different things. The first is a theory or abstraction of relations in firms,⁷⁶ which are themselves a descriptive abstraction of commercial institutions, while the second is a device employed by judges, and taken up by legislators, in resolving disputes. The first provides evaluative criteria and recommendations for governance, the second is a concept used to decide matters in litigation.⁷⁷ There could be different concepts for this latter function and, arguably, there are. For example, it is quite conceivable that the underlying idea for the conceptualisation of relations within companies is that of association; hence there are members and decision-making apparatuses.⁷⁸ “Contract” is but a term which can usefully found a base of bindingness, the exceptions⁷⁹ being founded on the way groups of people associated together

⁷⁵ B Welling, *Corporate Law in Canada* (Toronto, Butterworths, 2nd edn, 1991), 52–73, provides a most insightful comparison between three forms of company: the not-quite-contract, the deed of settlement and the status forms. The US Revised Model Business Corporation Act §8.01 simply allocates powers to the board of directors: “the business and affairs of the corporation [will be] managed under the direction of the board of directors”; §10.03 allows for limitation of board power in the articles provided there is both shareholder approval by vote and board authorisation. In §11.03 there may be shareholder agreements to that effect in closely held corporations. The latterly developed US Limited Liability Company, a hybrid of partnership and corporation and the Limited Liability Partnership, being the same except more so, both hinge on a contractual approach, although they are not totally there yet.

⁷⁶ *Pace Tomasic et al*, *supra* n 52, 9–10.

⁷⁷ Although it is interesting that the statutory formulation of the relationship is inevitably a simile: the provisions of the constitution are enforceable “to the same extent as if there were”; see *supra* n 72 above.

⁷⁸ See DA Wishart, “A Conceptual Analysis of the Control of Companies” (1984) 14 *Melbourne University Law Review* 601.

⁷⁹ If the constitution is a contract, it is a strange one indeed, because not all the terms of a company’s constitution are enforceable in any particular situation. Enforceability is limited to (i) the capacity in which the plaintiff is bound. Thus, before statute extended enforceability to directors, in *Eley v Positive Government Security Life Assurance Co Ltd* (1875) 1 Ex D 20 a director could not enforce a provision that they were to be a director; see also *Beatty v E & F Beatty* [1938] Ch D 708; *Andy Kala Pty Ltd v E J Doherty Pty Ltd* (1995) 13 ACLC 1630; and (ii) personal and direct rights, ie not for mere irregularities: *Quin & Axtens Ltd v Salmon* [1909] 1 Ch 714. This begs the question of what is a personal and direct right. Compare *Pender v Lushington* (1877) 6 Ch D 70 with *MacDougall v Gardiner* [1875] 1 Ch D 13, in which even the right to demand a poll was not enforceable as being direct and personal. A middle way is indicated by *Kraus v J G Lloyd Pty Ltd*

behave. Alternatively, political notions can underlie the concepts upon which dispute resolution can take place. Admittedly, this was tried by Arthur Lowe, and then dropped after a time, yet it still might have some life.⁸⁰

There are many other examples of ways of thinking, metaphors and concepts inhabiting the governmental techniques represented by company law. The “directing mind and will” of a company is one that is perhaps a little out of control,⁸¹ and “stakeholder” is in the process of being received.⁸² Regulatory theory operates to a certain extent in its administration, although there is very little evidence of its adoption within the law itself.⁸³

The impact of retreating, as is recommended here, away from law to governmental technique as metatheory is that these ways of thinking, metaphors and techniques cease to be interrogated for their place as authority within a legal system; rather, they are acknowledged to be deployed at times within it. They are both disenfranchised as law yet also recognised as participating within that mental structure. To put it another way, whether or not they count as law is relevant only to the operation of the system, to its effects, and not to the things themselves. They work within governing, as referents for terms in legislation or for ideas used to reason in judgments, and are developed and changed in the social processes of these and other activities. This means that there is no substantial difference for our purposes between a set of ideas arising within legal discourse, such as the contractual base to company law, and one from an outside discipline, such as the agency theory of the firm, except in terms of how they

[1965] VR 232, that a shareholder can insist on the company being managed according to the structure set out in the constitution. These exceptions are more appropriate to an association governing itself than any form of contract where the idea is that it is fully enforceable because the courts should have no idea as to what is important and what not: if the parties put it in writing, the court should presume it is important; see Welling, *supra* n 75. Ideas of the association make the internal management rule comprehensible whereas in a contract system it is simply odd.

⁸⁰ See generally S Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance* (Aldershot, Ashgate, 2007).

⁸¹ The impatience of the Privy Council with the NZ Court of Appeal’s rampant anthropomorphism in *Trevor Ivory Ltd and Trevor Ivory v Anderson* [1992] 2 NZLR 517 (the Court of Appeal has since recanted) is obvious in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500.

⁸² This is obvious in the immediate legislative reversal of *Parke v Daily News Ltd* [1962] Ch 927 and in the numerous provisions in various jurisdictions as to insolvent trading. We can go back as far as the nineteenth century for provisions deferring floating charges to employees’ entitlements in a winding up. Discussion of the reception of stakeholder interests usually takes place in the context of the directors’ duty to act for the benefit of the company as a whole: the reform of Companies Act 2006, s 172 was the British response to calls for greater corporate social responsibility.

⁸³ Graduated means of enforcement in relation to breaches seems the only evidence, apart, perhaps, from enhanced disclosure and triple bottom line accounting requirements in Listing Rules. It would be hard to argue that any of even this is a result of adoption of regulatory theory—time lines do not support it—rather, regulatory theory appears to be drawn from the observation of such approaches. Even corporate liability based on concepts of corporate culture is more a metaphorical response to outrageous anthropomorphism than the reconfiguration of the concept of legal entityhood.

arise within the legal discourse, what they do and are meant to do, and how they are thought.

As indicated at the outset of this essay, within company law two theoretical postures are locked in sterile debate. Of course, outside its realm there are many and apparently fecund ways of thinking, yet they are precluded from motivating reform by the exigencies of doctrine resulting from *The Case of Sutton's Hospital*. The metatheory outlined above enables the two positions to be viewed from a fresh angle, their partial nature to be exposed, their embrace to be disentangled, and spaces formed in which new and imaginative thinking may arise.

1. Economics and Agency Theory of the Firm⁸⁴

Agency theory, often called contract theory, is highly influential in company law as providing a justification for shareholder primacy and as a firm set of recommendations based on efficiency. Agency theory is founded in economics.

Economics has a history of explaining and recommending for law in a variety of ways associated with its epistemology and consequent presumptions about human behaviour, and assumptions as to the proper purposes of change. Its epistemology is founded on firm structuralist grounds, mostly Popperian, although with Kuhnian overtones. Science is the model because the world is unbearably complex and scientific epistemology provides a method through which the world may be observed. As a description, economics provides a way of understanding the world which may be and is deployed within law within academia, in judgments and government reports, and perhaps even by the general populace. Its great strength is that it encapsulates many relationships and enables their extrapolation in ways not otherwise observable. Yet, unlike science, which makes no claim to recommend for the physical universe, economics also claims there is a state called “efficiency” and that that is one worth seeking. The recommendations of economics are built upon this notion of efficiency. As a matter of practice, description often elides to recommendation in quite unqualified ways, especially when efficiency is not interrogated as an ethic. To some extent one gets the impression that the world is reconstructed to make the theory work—Posner’s undergraduate texts are particularly guilty of confusing “is” with “ought”, and vice versa.

The simplifications economics makes, to a more or less extent, for its model-building project include those as to the nature of human interactions, human choices, property, time, the state and law. For present purposes, it is important to note the key assumption that society comprises human beings and that law as a system of commands governs them. While there is interrogation of the production of rules and the enforcement of criminal law, there is little about

⁸⁴ For a more complete version of the below, see DA Wishart, “Arguing against the Economics of (Say) Corporations Law” (2003) 26 *The University of New South Wales Law Journal* 540.

what Hart would call “secondary rules”.⁸⁵ Where it is done, it is a matter of institutional economics and not deployed in the economics of the firm. Arguably, institutional economics is that against which agency theory is directed.

Given that economics in many ways is defined by its epistemology, it is particularly susceptible to the problems of theory contingent evidence in the testing of its hypotheses. For example, the issue of the Delaware preference in the US was repeatedly tested by measuring the stock price, discounted for other price movements, of corporations before and after moves to Delaware.⁸⁶ The idea was that stockholders value corporations and if the stock price went up the corporation would be worth more merely because Delaware’s legal structure is more amenable to corporate managements. Initial analyses concluded that the stock price did indeed go up. Much was made of this as confirming the hypothesis that freedom for management is good for the economy. Later analyses concluded that there was no significant change. However, the whole exercise was flawed due, mainly, to the error of thinking that statistics can “confirm” a hypothesis. Perhaps the stock price only went up because stock purchasers thought that such a move meant that the corporate management was better. They may have been right in a way, because prevailing orthodoxy had it that the move was good, so to do it indicated that the management was doing something (rather than is more usually the case, ie nothing much). Both of these arguments indicate that cause and effect are not as closely related as the epistemology of the economics assumed.

In terms of the tripartite generalisation of the law dealing with companies, economics is usefully deployed to understand and recommend for securities markets. After all, these are markets roughly approximating the sorts of things economics employs as the description of an analytical framework. For the second part of the three, internal relations, agency theory is less directly deployable because its key relationship between human beings, the classical laissez-faire contract emptied of substantive content, fails to encapsulate much of the subject matter of both legislation and cases. Agency theory thus becomes a source of critique and recommendation, claiming to originate these in abstracted models. It has little to say with respect to the rules establishing the personality of the corporation and how it is to exist and act within the legal system; there is little it can say. It has too thin a concept of law and deals with the consequences of *Sutton’s Hospital* with assumption, just as the old joke would suggest.⁸⁷ Society

⁸⁵ Hart, *supra* n 61, 77–96.

⁸⁶ For an excellent bibliographical study of the work in this area, see G Bittlingmayer, “The Market for Corporate Control (Including Takeovers)” in B Bouckaert and G De Geest (eds), *Encyclopedia of Law & Economics* (Edward Elgar and the University of Ghent, 1996–2000), available at <http://encyclo.findlaw.com/>, [5640], 738–46.

⁸⁷ An economist, an engineer and a physicist are marooned on a deserted island. One day they find a can of food washed up on the beach and contrive to open it. The engineer said: “Let’s hammer the can open between these rocks”. The physicist said: “That’s pretty crude. We can just use the force of gravity by dropping a rock on the can from that tall tree over there”. The economist is

must by definition be reduced to its component human beings, thus corporations can only act as human beings or be the product of the accumulated interactions of human beings. The social is represented by a notion of “imperfect market”, as an exception to the analysis, the consequences of which alone fall to be explained and addressed.⁸⁸

2. Stakeholder Theory

Stakeholder theory pervades recent discussions of corporate governance and corporate social responsibility—debates over decision-making and the control of decisions. It provides a counterpoint to agency theory’s insistence on property rights, and hence the pre-eminence of the capital provider, by justifying reference to the interests of others in decision-making. The justification lies in the “stake” the other has. If someone, or some group, has a “stake” in a decision, their interest ought to be considered by the decision-maker. This applies to company law through the realisation that directors and other officers make decisions which affect many people other than the capital providers.⁸⁹ These include creditors, employees, consumers, the environment and society generally. A little regard for its genealogy reveals that the theory in this form begs the questions with which it pretends to deal.

Stakeholder theory as applicable to law reform was developed from the work of the American Realists in the first part of the twentieth century.⁹⁰ The Realists located law within society and believed that law should reflect society. Judges should do what is right by reference to the persons affected by their decisions. The theory, then, was about judging. It enabled the effecting of purposes defined by a judge’s oath by providing a definition of justice when formulaic ideas of precedent were breaking down.

A good example of how it works for company law is the judgment of Richardson J in *Thomas v HW Thomas Ltd* in the New Zealand Court of Appeal,

somewhat disgusted at these deliberations, and says: “I’ve got a much more elegant solution. All we have to do is assume a can-opener.”

⁸⁸ Eg this is the way the “public interest” is deployed in competition law.

⁸⁹ Comp. agency theory’s insistence that the only effect of decisions is on cash flow and hence the members as “stochastic residual cash flow claimants” should make those decisions either personally or through agency contracts; see MC Jensen and W Meckling, “Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure” (1976) 3 *Journal of Financial Economics* 305.

⁹⁰ EE Freeman, “A Stakeholder Theory of the Corporation” in T Beauchamp and N Bowie, *Ethical Theory and Business* (Englewood Cliffs, NJ, Prentice Hall, 6th edn, 1997) is frequently cited as the seminal article establishing stakeholder theory in management literature. It appears merely to drift into legal discussion, more resonating with the work of the Realists than having them explicitly cited, yet that resonance is clear in the judgment of Richardson J in *Thomas v H W Thomas Ltd* (1984) 1 NZLR 686. See also the excellent discussion in Davies, *supra* n 22, 120–28; KN Llewellyn, “Some Realism about Realism—Responding to Dean Pound” (1931) 44 *Harvard Law Review* 1222; and W Twining, *Karl Llewellyn and the Realist Movement* (London, Weidenfeld & Nicholson, 1973).

a case widely cited to illustrate how unfairness in management is to be determined. The following is the text most frequently quoted:

“That conduct of the company which is unjustly detrimental to any member whatever form it takes and whether it adversely affects all members alike or discriminates against some only . . . fairness cannot be assessed in a vacuum or simply from one member’s point of view. It will often depend on weighing conflicting interests of different groups within the company. It is a matter of balancing all the interests involved in terms of the policies underlying the companies legislation and sec 209 in particular. . .”⁹¹

The clear injunction is to “balance interests”. But how do we know what the interests are? Interestingly, excluded from most extracts of the case is the passage immediately following the above. In this, “interests” are defined by the pre-existing principles of New Zealand company law, of which the contractual foundations to the company are but one:

“Thus to have regard to the principles governing the duties of a director in the conduct of the affairs of a company and the rights and duties of a majority shareholder in relation to the minority; but to recognise that sec 209 is a remedial provision deigned to allow the court to intervene where there is a visible departure from the standards of fair dealing; and in the light of the history and structure of the particular company and the reasonable expectations of the members to determine whether the detriment occasioned to the complaining member’s interest arising from the conduct of the company in that way is justifiable.”

Three points are illustrated here. One is that stakeholder theory does not tell what the relationships between the interests are beyond nominating them as things which have to be “balanced”. Secondly, it does not in itself tell us what the interests are. Thirdly, there is very little appreciation of its limits—limits which were thoroughly explored in the 1930s and which ultimately led to its rejection as a viable normative postulate. These were identified at the time as: the identity of the stakeholders; the homogeneity and solidarity of their interests; and the processes, beyond begging its own question by nominating them as “balancing”, by which competing interests are to be resolved. In terms of company law, these translate to a lack of indication of which sets of interests are to be taken into account, how conflicts of interest within stakeholder groups are to be reconciled and how the discretionary power conferred on decision-makers to deal with these issues is to be controlled.

There is, however, utility to stakeholder theory. By focusing on law-creation, it displaces law into society generally and interrogates social structures to determine the effects of changes in the law. This process relies on disciplines of knowledge outside the law to determine those effects and hence is less afflicted with theory contingent evidence, yet, as it is formulated in company law, it has

⁹¹ (1984) 1 NZLR 686.

taken a liberal materialist turn. This is partly as a result of the absence of guidance as to the process of “balancing” and hence the failure to specify the moral considerations involved in “justice”. The person is not necessary to the theory, although in the simplistic sociology attached to it within company law, effects are seldom otherwise indicated.

G. THE DIMENSIONS OF THEORY

The two theoretical postures, the analysis, critique and reformulation of which are the primary focus of this essay, are each directed at describing certain aspects of the substance of law and the legal system taken together, and at recommending for choices as to what the law should be where it is unknown or mutable in particular ways. They thus can be said to have “provinces”, to use the Austinian terminology, although the location and extent of these provinces are vague and arguable.

A metatheoretical approach allows for the dimensions of the provinces of the various theories to be mapped. Remembering that “law” has a very narrow meaning here (and “theory” has a correspondingly broad one), theories have three dimensions: purpose/law/effect, systemic focus and calculable purpose. They are not fixed in these dimensions; being mere ideas, their communication is an exercise for which, in Stanley Fish’s terms, there is, at best, one or more interpretive communities.⁹² The ideas thus change and mutate as interpretations are placed in them, and they may extend beyond or even shrink within the boundaries of their heretofore provinces. Their extensions are subject to analysis and critique, always from other theoretical standpoints.

1. Purpose/Law/Effect

The contractual theory of the company describes certain concepts deployed by judges and referred to in legislation. These concepts provide means to resolving disputes. In this guise they have a life of their own, being applied and disapplied in later disputes and rules, yet they are not seen as having an effect outside the law. They do, of course, as the resolutions to disputes ripple out financially and personally into society, but these effects are not reflected back to considerations of the effectiveness or justice of law. Indeed, the concepts are taken to define justice in the particular context. Similarly, in the always-already-there world of doctrinal conceptual thinking, they are not taken to determine purpose for law. They are simply the way certain relations are to be thought.

⁹² See, generally, S Fish, *Doing What Comes Naturally: Change, Rhetoric, and the Practice of Theory in Literary and Legal Studies* (Durham, NC, Duke University Press, 1989).

Contrast this with the agency theory of the firm. In its narrowest sense, agency theory of the firm provides a way of thinking about firm structure, founded on rational actor theory of human conduct. Within its various versions the position and substance of the legal discourse about companies remain ambiguous; it is abstracted, frequently into a set of property rights and at other times into a set of conditions, default or mandatory, arrived at in transacting. The found purposes of various laws are matched against the ideal of efficiency, which also provides the touchstone of the measurement of effect. Purpose/law/effect is elided into sets of recommendations for law, although this sits uneasily with claims about the legal process itself.

Stakeholder theory sits differently yet again, dealing primarily with the effect of law on groups within society. With an inarticulate sense of justice, at best a cost–benefit calculation bringing the approach perilously close to economics and Kaldor–Hicks efficiency, it recommends that the law be changed to mediate these effects.

2. Systemic Focus

Whereas “purpose/law/effect” holds judgements and Acts of Parliament steady in its exploration of the various ways theories represent law acting in society, “systemic focus” holds steady the elements of the process of law: process rather than substance. Law is produced within society by various processes occurring within and between institutions and humans. The various theories being discussed here concentrate to varying extents on parts of that process, and this can be mapped as another of their dimensions.

The contractual theory of the corporation/company is about the thinking of judges as illustrated by their judgments. It is referred to in legislation and provides a framework for change. This should be contrasted with the economic theory of the firm, which, being a description in abstracted terms, provides a framework for thinking about policy—what should be done in the field, whether it be by legislatures or courts. In the process of formulation of law, it indicates goals and provides evidence of effects within the terms of and for the purpose of formulation of those goals. Stakeholder theory is also about policy in this sense, but is focused more narrowly on decisions and on effects rendered invisible by the economics of the firm. It also sets out certain concepts, the definitions of the interest groups, for use within judgments and legislation.

3. Calculable Purpose

While postmodernity sternly advises that there is no firm connection between a communication and its referents,⁹³ one of Fish’s principles of interpretation

⁹³ Perhaps the core of the rule which structuralists accuse postmodernists of hypocritically foisting on readers.

could well be that readers calculate what the purpose of the communication is and that readings are mediated by this purpose. These calculations are for the most part agreed upon, although few would deny that they are only provisional. The factors involved in the calculations are what the writer or speaker says their purpose is and the way in which the theory configures and reconfigures subject matter. This is not to deny that writers and speakers have many other purposes in mind, or that for readers knowledge of any purpose is impossible; it merely asserts that we do formulate and attribute to communications intended purposes. This purpose, calculated and provisional though it might be, varies between theories, but tends to be common between readers of any particular theory at a given time. This does not mean that the theory cannot be deployed otherwise, merely that readers are mostly constrained in their appreciation of the theory by their perception of its purpose.

For contract theory, this purpose is that it explains the relationship between stock or shareholders and the board of directors. It is also deployed to assert the primacy of residual cash flow claimants. Economic theory of the firm in its positive modality is there to enable analysis of the interior “black box” of the firm and to explain behaviour within the discourse of economics. In its normative guise, economics of the firm recommends change against the touchstone of efficiency. Stakeholder theory is deployed quite specifically to argue against the primacy of residual cash flow claimants and more generally to be a measure of effect of decision-making. It also has variants, little referred to now, which explain the structure of the relationships comprising the company as being arrangements between a narrow range of stakeholders—sometimes called the “enterprise” theory of companies.

H. MOVING TO CONSTRUCTIVE THINKING

Many countries and jurisdictions in the world are struggling with demands for the social responsibility of corporations and companies. Indeed, it is the debate surrounding these struggles that has prompted this essay. When these debates focus on the question of what law reform is to take place, corporate social responsibility and shareholder primacy are conceived of as theoretical opposites, with little to reconcile them. All that is recommended are various positions between them, such as enlightened shareholder value, schemes of disclosure and specific mandatory rights, with little other than established principle as justification.

My contention in this essay is that this situation has arisen because in both of the pole positions the primacy of the human being is assumed and other ways of conceiving the dynamics of corporate life within legal doctrine are thereby rendered invisible. *Sutton's Hospital* excludes from law any conception

of corporate life other than that which can be constructed out of the activities of individual human beings. Theory is deployed simply to explain the interior of the corporation. In this task the doctrinal theory of the contract has become confused with the quite separate agency theory of the firm despite differences in what I have here called the dimensions of their provinces. Their intersection is at the point of their utility, the calculable purpose—both seek to maintain stochastic residual cash flow claimant primacy, although one is out of conservatism and the other out of a belief in the overriding importance of efficiency. In their other dimensions, however, they differ and are inconsistent. Stakeholder theory is deployed to highlight the effect of shareholder primacy on other constituencies but does not have the breadth in terms of purpose/law/effect to reconfigure shareholder primacy's justifications within a context of human beings as the sole subject of law. Stakeholder theory becomes simply a justification for external constraints, to the extent that the matter is not shifted to being within the discretion of the decision-makers.

If we move away from the sole focus of law being human beings, a company can be conceived of quite differently. For example, it can be seen as a community of members.⁹⁴ Alternatively, it could be viewed as a political institution with the capacity of self-regulating democracy.⁹⁵ In both of these views, the problem of corporate social responsibility is seen as the same as for human beings—how to instil a moral sense in the community represented by the common enterprise (in the first, it is of members; in the latter, of the organisation) and how that moral sense is to be maintained in the face of the pressure of self-interest. The difference between the human being and the company is that society does not have twenty-odd years of pre-adulthood and dependency in order to school companies, although that is to anthropomorphise. Nevertheless, we can understand that community moral restraints are a matter of common understandings and restraints: Foucault's self-governance, if you like.

What, then, are the restraints that ought to be imposed? This is a moral question, but is none the worse for it. After all, it is the thin morality of economics and the inarticulate morality of legal realism that the question seeks to depose.⁹⁶ Yet the answer cannot be direct as the determination of which moral standards are relevant is context dependent, even if morality is not relative. However, given that the company is a community, we can attribute to it the capacity to determine for itself moral questions. The answer, then, is to allow the community to be a moral community and to be able to express for itself the restraints on decision-making.

⁹⁴ See Wishart, *supra* n 78, 601 as an explanation of judicial reasoning; reconfigured in D Wishart, *Company Law in Context* (Auckland, Oxford University Press, 1994) as a model of the company.

⁹⁵ Parker, *supra* n 9.

⁹⁶ Regulatory theory likewise seeks to defer the moral question to definition of state policy. That might, however, be to carp.

The company as a moral community is quite consistent with existing law, once the stultifying influence of Lord Coke's constitutionalism is lifted. After all, the contractual theory of the company is only a way of deploying an existing concept about people associating together—contract—to try and explain the association represented by the company. It does not do that job very well, as we have seen. An explicit acknowledgement of an associative impulse might work far better as it explains internal management, membership, and a number of doctrines and statutory provisions. It also does not leave moral questions to boards of directors, which is surely a sensible result as they are hardly the sort of people to whom the resolution of such issues comes easily.⁹⁷ Alternatively, the organisation can be taken to be the key organising device, subordinating law's legal person and demanding a meta-regulatory overlay directed at enhancing the moral self-consciousness of systems-based decision-making.⁹⁸

I. CONCLUSION

When, some four hundred years ago, English law settled on the human being as the sole subject of law, theorising was deprived at the very least of the rich vein of metaphor in and about law. While mostly unexceptionable for legal doctrine, this has had a deadening effect on corporate law. Many constructive ideas are unnecessarily lost or discarded. The organic theory of corporate liability is the simplest example, acceptable only because it makes a human of the company,

⁹⁷ A programme along these lines might involve: (i) providing for the criminal liability of corporations on the basis of mental elements constructed by corporate culture; (ii) ensuring that the absence of a code of moral conduct in a corporate constitution would imply a willingness on the part of a company to act in inappropriate ways and would make the mental element of crimes and torts extremely difficult to deny, ie the mental element would be presumed in the absence of such a code; (iii) extending the capacity of members and directors to enforce a company's constitution to the code of conduct; and (iv) incorporating compliance with a code of conduct in director's contracts, perhaps compulsorily, and extending "proper" for the purposes of directors' duties to compliance with the code of conduct, fitting nicely with and providing rationale for s 172 of the Companies Act 2006 (UK).

⁹⁸ A programme implementing meta-regulatory ideals for the "corporate institutionalization of responsibility" is set out in Parker, *supra* n 9, 248. Were this essay to be an analysis of regulatory theory as applied to company law, it might note: (i) the inconsistency of the proposals with the existing concepts of company law, especially in terms of the organs of control, constitution and power structures—this is not to say that law is necessarily consistent or coherent (although it helps), simply that novel concepts and definitions lead to unintended consequences, misapplication and fears, loathing and destructive uninformed argument; (ii) the fudging of the distinction between company, organisation and business: the lack of appreciation of the structuration afforded by the notion of legal entity, the artificiality of distinctions involved in applying the principles only to "large" organisations", and the invisibility of small to medium enterprise; (iii) the refusal to consider the impact of competitive pressures even when immense effort is being placed on competition as the key constraint on corporate behaviour; and (iv) the alignment of responsible behaviour with compliance with government policy, rendering the interrogation of policy invisible: "moral" is much more fraught than that.

yet even so is destined for perversion. But there are many others, amongst which are the associative idea of the company and regulatory theory. These theories ought to be analysed as such, and not as being of law or not of law. This is only possible if the idea of the sole subject of law being the human being is discarded. In this essay a way in which the place of law can be preserved but the human being as the subject of law discarded is set out. This makes possible an analytical methodology for theory in terms of dimensions of purpose/law/effect, systematic focus and calculable purpose. The limited ambit and deficiencies of current theories in company law, especially contractual theories of the firm and stakeholder theories, are exposed when the analytical framework is applied to them. These considerations render other ideas, especially those not at core about human beings, more acceptable than hitherto and no more flawed than those presently held. Hence many more strategies are made available to deal with the problems of irresponsible action empowered by accumulated capital.