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THE DOCTRINAL BASIS OF THE RIGHTS OF COMPANY SHAREHOLDERS

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I. INTRODUCTION

THE concept of ownership is a complex, powerful and controversial idea.[1] In law it explains, justifies and gives moral force to a host of rights and duties as well as serving to legitimate the allocation of wealth and privilege. The influence of this idea is, furthermore, everywhere embodied in the law.[2] In company law, legal and economic conceptions have both rested on and have been shaped by the normative implications of ownership. Historically, ownership was the principal explanation and justification for the central role of shareholders in corporate affairs.[3] As owners, shareholders were entitled to control the management of the company and to the exclusive benefit of the company's activities. Ownership also served to legitimate the corporate form itself. So long as it was owned by individuals the economic and political power of the company was both benign and a bulwark against the intrusion of the state.[4]

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1 Generally see, Harris, *Property and Justice* (Clarendon, Oxford, 1996) p. 3; Penner, *The Idea of Property in Law* (Clarendon, Oxford, 1997) p. 1; Honore, "Ownership" in Guest (ed.), *Oxford Essays in Jurisprudence* (O.U.P., Oxford, 1961) p. 107; Reich, "The New Property" (1974) 73 Yale L.J. 733, 771; Vandevelde, "The New Property of the Nineteenth Century: The Development of the Modern Concept of Property" (1980) 29 Buffalo L.R. 325; MacPherson, "Liberal-Democracy and Property" in MacPherson (ed.), *Property: Mainstream and Critical Positions* (Uni. Toronto Press, Toronto, 1978) p. 199; Locke, *Two Treatises of Civil Government* (Dent, London, 1949); Lucy and Mitchell, "Replacing Private Property: The Case for Stewardship" [1996] C.L.J. 566; Gray, "Property in Thin Air" [1991] C.L.J. 252.

2 Harris, *op. cit.*; Vandevelde, *ibid.* "Property" has been invoked to justify all manner of things, from the right to use a shopping mall *(Robins* v. *Prune Yard Shopping Center* 592 P.2d 341 (1979) S.C., Calif., affd 447 U.S. 74 (1980)) to the right to prevent development of the wilderness *(Sierra Club* v. *Morton* 405 U.S. 727 (1972) to rights to personal autonomy (Radin, "Property and Personhood" (1982) 43 Stanford L.R. 957) and the right to employment (Collins, *Justice in Dismissal: The Law of Termination of Employment* (Clarendon, Oxford, 1992) p. 88.

3 Dallas, "Working Toward a New Paradigm" in Mitchell (ed.), *Progressive Corporate Law* (WestView, Colorado, 1995) p. 37; Hill, "Changes in the Role of the Shareholder" in Grantham and Rickett (eds.), *Corporate Personality in the 20th Century* (Hart, Oxford, 1998) Chapter 10; Radin, "The Endless Problem of Corporate Personality" (1932) 32 Columbia L.R. 643; Sappideen, "Ownership of the Large Corporation: Why Clothe the Emperor?" (1996–1997) 7 King's College L.J. 27; Herman, *Corporate Control, Corporate Power* (Cambridge U.P., Cambridge, 1981); Werner, "Corporation Law in Search of its Future" (1981) 81 Columbia L.R. 1611.

4 Stokes, "Company Law and Legal Theory" in Twining (ed.), *Legal Theory and Common Law* (Blackwell, Oxford, 1986) pp. 156–157; Parkinson, *Corporate Power and Responsibility: Issues in*

Despite the recognition of the company's status as a distinct entity and the consequential displacement of shareholders as legal owners of the company's assets, shareholder ownership has remained the central doctrinal explanation of the position of shareholders this century.[5] Typical of this is Parkinson's description of the prevailing "legal model" of the company: "The underlying theory views shareholders as having an entitlement that the company be operated for their benefit . . . by virtue of their position as members or owners. The law respects the right of shareholders to determine the objectives of their association . . . and that by virtue of their capital contributions they should be regarded as the owners of the company".[6] A similar view is echoed in the leading Australian company law text: "The directors must consider the interests of existing members because they are the proprietors of the company . . .",[7] while in a leading Canadian text shareholders are described as an "absentee proprietor".[8] Indeed, the persisting notion that the company is both owned, and is owned by its shareholders,[9] has been the underlying assumption of much of corporate law scholarship this century. From Berle and Means' identification of the separation of ownership and control in the 1930s,[10] the concern of corporate law has been to try to mitigate the effects of this separation.[11]

This century, however, has seen a steady weakening of the position

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the Theory of Company Law (Clarendon, Oxford, 1993) pp. 33–40; Reich, "The New Property" (1974) 73 Yale L.J. 733.

5 The assumption is even more prevalent amongst business commentators. For a random, but indicative selection of recent comments which rely upon or discuss this assumption see: "Reforming the Firm", *The Economist*, 9 August 1997, p. 14; "Kid's Stuff", *The Economist*, 21 June 1997, pp. 74–75; Bughin and Copeland, "The Virtuous Cycle of Shareholder Value Creation" (1997) McKinsey Quarterly 156; Geddes, "Ownership, Regulation, and Managerial Monitoring in the Electric Utility Industry" (1997) 40 J. of Law and Economics 261; Freidheim, "New World Order in the Board Room" (1996) 20 Directors and Boards 6; Useem and Gager, "Employee Shareholders or Institutional Investor?" (1996) 33 J. of Management Studies 613; Samuels, Greenfield and Piper, "The Role of Non-Executive Directors Post-Cadbury" (1996) 21 J. of General Management 1; Boatright, "Fiduciary Duties and the Shareholder–Management Relation: Or, What's So Special About Shareholders?" (1994) 4 Business Ethics Quarterly 393; "Shareholders of the Nations, Unite!" (1994) 108 Investors Chronicle 12.

6 Parkinson, *op. cit.* n.4, pp. 75–76. See also, Morse (ed.), *Palmer's Company Law* (25th ed., Sweet & Maxwell, London, 1992) Vol. 1, para. 6.001: "the shareholder is the proportionate owner of the company . . ."

7 Ford, Austin and Ramsay, *Ford's Principles of Corporations Law* (8th ed., Butterworths, Sydney, 1997) para. 8.095. See also, Gilles, *The New Corporations Law* (2nd ed., Federation Press, Sydney, 1992) p. 22. As for New Zealand, see Beck *et al.* (eds.), *Morison's Company and Securities Law* (Butterworths, Wellington, 1997) Vol. 2, para.13.1.

8 Welling, *Corporate Law in Canada: The Governing Principles* (2nd ed., Butterworths, Toronto, 1991) p. 456. See also, Buckley, *Corporations: Principles and Policies* (3rd ed., Edmond Montgomery, Toronto, 1995) p. 185; *Canada Corporations Law Reporter* (CCH Canadian Ltd., Ontario, 1997) para. 7000: "the shareholders of a corporation are the owners of the corporations . . ."

9 Sappideen, "Ownership of the Large Corporation: Why Clothe the Emperor?" (1996–1997) 7 King's College L.J. 27.

10 Berle and Means, *The Modern Corporation and Private Property* (rev'd ed., Harcourt, Brace and World, New York, 1967)

11 Werner, "Corporation Law in Search of its Future" (1981) 81 Columbia L.R. 1161.

and influence of shareholders. Although they still possess important rights, the law has progressively limited or denied completely many of those rights which were most obviously an emanation of the shareholders' proprietorship of the company. Thus, shareholders have been denied any proprietary rights in the assets of the business, they are no longer able directly to control the management of the company, and there is an increasing recognition that the business is not run exclusively for their benefit. While for some shareholder ownership is both the natural and desirable state of affairs, these developments suggest that the concept of ownership is no longer the key doctrinal construct in explaining the position and rights of shareholders. In particular, these developments suggest either that the idea of shareholder ownership is now so weak and without content that on its own it is incapable of explaining what rights shareholders should have or, more radically, that the prevailing paradigm, which once conceived of the company as little more than a partnership, owned and controlled collectively by the members, has changed. Either way, it is clear that ownership no longer provides an adequate doctrinal explanation of why shareholders are vested with certain rights.[12]

The aim of this article is twofold. First, it seeks to describe the law's progressive attenuation of shareholder rights. The purpose in doing so is to demonstrate that, whatever the popular perception, the law no longer conceives of shareholder rights as a consequence of a status as owners. Secondly, the paper seeks to identify new doctrinal bases upon which the rights of shareholders might now rest and the consequences of this new doctrinal framework. In doing so the aim is neither to present a normative account nor to suggest that the law is capable of entirely consistent explanation. Such is the nature of the common law that even major changes in the underlying theory will be reflected only in those rules which are most obviously inconsistent. Rather, the aim is to offer a doctrinal basis upon which, with respect to the position and rights of shareholders, the law as it presently stands may be explained.

Before passing on to the substance of the paper it is important to say something about the unitary nature of company law. Companies come in all shapes and sizes, from the publicly listed multi-national to the "quasi-partnership". The law, however, has steadfastly refused to recognise the differences between closely held and other companies. Although there are some concessions to reality[13] and while attempts

[12] Generally, see Dan-Cohen, *Rights, Persons, and Organizations: A Legal Theory for Bureaucratic Society* (University of California Press, 1986) pp. 21–22.

[13] Closely held companies are excused many of the formalities and reporting requirements of larger companies (see, for example, section 381A of the Companies Act 1985) and, through section 459

have been made over the years to develop a distinct small-business entity,[14] the law has developed,[15] and largely continues to develop, on the basis that there is an archetypical company and that that is a medium to large company where the involvement of shareholders is limited to their investment.[16] Thus, while there may be advantages to separate regimes for different types of companies, and while the developments outlined in this paper are perhaps more apposite to a large company, the law currently draws no such distinction.

II. The Shareholder as Proprietor

When Queen Victoria ascended the throne in 1837 there were two principal vehicles for the conduct of large scale business ventures—the corporation and the joint stock company.[17] The corporation owed its existence to Royal Charter or an Act of Parliament and, like its predecessors dating back at least two centuries, it had a separate legal existence.[18] By far the most important vehicle, however, was the joint stock company. In law the joint stock company was nothing more than a large partnership.[19] While it had shares that were freely transferable,[20] a board of directors and a constitution still recognisable as such today,[21] the joint stock company did not enjoy a separate

of the Companies Act, the law will give effect to the actual agreement or expectations of the "quasi-partners".

[14] Freedman, "Small Businesses and the Corporate Form: Burden or Privilege?" (1994) 57 M.L.R. 555, chronicles these attempts both in the United Kingdom and elsewhere. See also, Hicks, "Corporate Form: Questioning the Unsung Hero" [1997] J.B.L. 306.

[15] It is arguable that incorporation was not intended for, and should not be made available to, small business ventures. While it is clear that Robert Lowe, the architect of the early companies statutes, wanted limited liability extended to small traders, a wish frustrated for a short time by the Lords, it seems that he did not feel it appropriate to allow small traders to be incorporated. As discussed below, one of the central features of the 1844 Companies Act was to restrict incorporation to large enterprises. See also Hicks, *ibid.*, pp. 311–316.

[16] Sealy, "Perception and Policy in Company Law Reform" in Feldman and Meisel (eds.), *Corporate and Commercial Law: Modern Developments* (Lloyd's of London Press, London, 1996) p. 26; Freedman, n.14 above.

[17] See generally, Grantham and Rickett, "The Bootmaker's Legacy to Company Law Doctrine" in Grantham and Rickett (eds.), *Corporate Personality in the 20th Century* (Hart, Oxford, 1998) Chapter 1.

[18] *Halsbury's Laws of England*, (4th ed.), Vol. 9, para. 1209.

[19] Sealy, "Perception and Policy in Company Law Reform" in Feldman and Meisel (eds.), *Corporate and Commercial Law: Modern Developments* (Lloyd's of London Press, London, 1996) pp. 11–13; Davies, *Gower's Principles of Modern Company Law* (6th ed., Sweet & Maxwell, London, 1997) p. 31; Lobban, "Corporate Identity and Limited Liability in France and England 1825–67" (1996) 25 Anglo-American L.R. 397, 401. It is of course true that there were differences between ordinary partnerships and the large joint stock form (see Ireland, "The Triumph of the Company Legal Form 1856–1914" in Adams (ed.), *Essays for Clive Schmitthoff* (Professional Books, Abingdon, 1985) p. 32. The difficulty for the courts was to find a legal structure between an incorporated entity and a partnership without the assistance of Parliament.

[20] Although the creation of freely transferrable shares was prohibited by the Bubble Act 1720, this did not prevent the creation of "companies" with shares that were, at least in substance if not formally, freely transferrable.

[21] See Du Bois, *The English Business Company after the Bubble Act 1720–1800* (New York Commonwealth Fund, New York, 1938) p. 291 and Davies, *op. cit.* n.19, p. 29.

identity from its "members". In regulating this hybrid form, the courts quite naturally employed the principles of partnership law.[22] The members, as partners, owned the assets, were jointly and severally liable for the debts incurred by the business and had all the rights and powers which ownership implied. Their entitlement to the control and benefit of the company was, therefore, an incident of their legal ownership of the business.

The application of partnership concepts, however, had a number of acute problems. The principles informing partnership law were predicated upon a genuine relationship between the partners.[23] The typical joint stock company, however, had hundreds if not thousands of members. The assumption of a personal working relationship between partners was simply stretched beyond breaking point when it was sought to be applied to a venture where there were so many "interested" people.[24] The application of partnership principles to the joint stock company also posed real difficulties in integrating this form into the general private law. For example, if a partnership was to be sued it was necessary to make all the partners party to the suit. While in a partnership of five or six this presented no difficulty, discovering the identity of all the members of a joint stock company, where the shares were freely transferable, posed an insuperable obstacle.[25] Indeed, it was said that a joint stock company could not, practically, be made to pay any debt it chose not to pay.[26]

The Companies Act of 1844 was enacted to deal with these problems.[27] The reform pursued a twofold strategy. First, the position of the joint stock company was regularised. This was achieved by granting separate legal existence to any venture which complied with the statutory machinery in the Companies Act.[28] The second aspect to the reforms was to restore the validity of the basic premise of partnership law: the personal relationship between the partners. This

[22] Ireland, "The Triumph of the Company Legal Form, 1856–1914" in Adams (ed.), *Essays for Clive Schmitthoff* (Professional Books, Abingdon, 1983) p. 31; Lobban, "Corporate Identity and Limited Liability in France and England 1825–67" (1996) 25 Anglo-American L.R. 397, 401.

[23] Thus, the assumption reflected in the Partnership Act of 1890 was of a venture undertaken by the partners together.

[24] Gower, "Some Contrasts Between British and American Corporation Law" (1956) 69 Harv. L.R. 1369, 1372.

[25] Davies, *op. cit.* n.19, p. 31.

[26] Lobban, "Corporate Identity and Limited Liability in France and England 1825–67" (1996) 25 Anglo-American L.R. 397, 404.

[27] Sealy, "Perception and Policy in Company Law Reform" in Feldman and Meisel (eds.), *Corporate and Commercial Law: Modern Developments* (Lloyd's of London Press, London, 1996) p. 23; Lobban, *ibid.*; Davies, *op. cit.* n.19, p. 38; Ireland, "The Triumph of the Company Legal Form 1856–1914" in Adams (ed.), *Essays for Clive Schmitthoff* (Professional Books, Abingdon, 1985) p. 32.

[28] It is worth noting in this respect that although we now tend to assume that the Companies Act of 1844 and subsequent companies acts created a separate legal entity the Act itself says that the "subscribers of the memorandum . . . shall be a body corporate . . .": Companies Act 1985 s. 13(3).

was achieved by limiting the size of partnerships and companies.[29] Partnerships were limited to a few partners, thus forcing the large joint stock ventures to take on corporate form. Companies, on the other hand, could not be established with too few members.[30]

Apart, however, from regularising the position of the joint stock company, the reforms which began in 1844 seemed to have relatively little impact. As Sealy has commented, for the mid-nineteenth century lawyer the reforms did not affect the underlying nature of the company: "The members of a company did not simply associate; in law, they associated as partners."[31] Thus, the leading academic work on company law in this period was tellingly entitled, *Treatise on the Law of Partnership, including its Application to Companies*[32] and even as late as 1916 the courts were still invoking partnership principles to resolve company law problems.[33] Although a company created under the Act of 1844 was formally, like the old chartered corporation, a separate right and duty bearing entity which owned the undertaking of the business, the prevailing paradigm had not changed. The company remained in the law's eye a peculiar kind of partnership and the shareholders its collective owners. The shareholders' rights to control the business and to have it run for their exclusive benefit were thus still necessary consequences of that status.

III. Attenuation of Shareholder Proprietorship

As long as the company was viewed through a partnership lens, the position and rights of shareholders were fully explicable and justified as a natural consequence of the shareholders' status as the ultimate proprietor of the undertaking. Ownership confers upon the holder the rights, *inter alia*, to determine how the property should be used, to the exclusive benefit of the property, and to freedom from expropriation.[34] It was thus entirely proper that, as owners,

[29] Davies, *op. cit.* n.19, pp. 38–39; Lobban, n.26 above, p. 428; Ireland, "The Triumph of the Company Legal Form 1856–1914" in Adams (ed.), *Essays for Clive Schmitthoff* (Professional Books, Abingdon, 1985) p. 32.

[30] The number has been steadily reduced, virtually from the moment a minimum number was introduced. (See Sealy, "Perception and Policy in Company Law Reform" in Feldman and Meisel (eds.), *Corporate and Commercial Law: Modern Developments* (Lloyd's of London Press, London, 1996) p. 13), though the Companies Act still restrains large partnerships (Companies Act 1985 s. 716). The permission for a single person to incorporate, while bowing to practical realities, nevertheless has its own problems. For example, the difficulty of reconciling the protection afforded by the corporate veil to one-man companies with the aims of tort law: *Williams* v. *Natural Life Health Foods Ltd.* [1997] 1 B.C.L.C. 131, noted by Grantham, "Company Directors and Tortious Liability" [1997] C.L.J. 259, reversed on appeal: [1998] 1 W.L.R. 830.

[31] Sealy, *ibid.* p. 23.

[32] Lindley, *Treatise on the Law of Partnership, including its Application to Companies* (Sweet & Maxwell, London, 1860).

[33] *Re Yenidje Tabacco Ltd.* [1916] 2 Ch. 426 (C.A.).

[34] Honore, "Ownership" in Guest (ed.), *Oxford Essays in Jurisprudence* (O.U.P., Oxford, 1961) Chapter V.

shareholders should have the right to manage the company, to have the company run for their exclusive benefit and to be able to regularise transactions that did not conform to the constitution or did not serve their interests.[35]

The last decade of the 19th century, however, saw the beginnings of a fundamental change in the law's perception of the company. This manifested itself in the progressive attenuation of those rights which most clearly and unequivocally flowed from, and were necessary to give content to, the shareholders' claim to proprietorship. While, true to the methodology of the common law, the direction and pace of change have not been constant, the courts successively rejected the associative underpinnings of incorporation, any claim which the shareholders had to the ownership of the company's assets, the right of shareholders to override management decisions and, most recently, that the company was conducted for their exclusive benefit.

A. The Company as an Association

It is perhaps not surprising, given the seminal nature of the decision, that the first definite signs of this change should appear in *Salomon* v. *A. Salomon & Co. Ltd.*[36] As mentioned, despite the general availability of incorporation the courts persisted with the idea that the company was in essence little more than a large partnership. The conclusion that the members were the proprietors was thus quite logical, while the separate legal personality of the company was neither obvious nor particularly significant. In relation to the creation of the company this meant, first, that it was the members who were incorporated, rather than a new "person" being created[37] and, secondly, that if there was no genuine association of the members as partners the incorporation was improper.[38] As Sir Frederick Pollock commented in a contemporary note of *Salomon's* case, "[w]hen the founders of company legislation spoke of seven or more persons being 'associated', they meant such an association as, without the help of the statute, would have made those persons members of an ordinary partnership".[39]

[35] An owner's right to determine the use of the property implies not only that shareholders may control the day-to-day management of the company but also that their will as to what should be done with their property should prevail over the constitution. See Honore, *ibid.*

[36] [1897] A.C. 22. It is interesting to note that despite the quite different histories of English and American company law, the seminal decisions in both jurisdictions establishing the company's identity as a person occurred at about the same time. In England it was *Salomon's case* in 1896, while in America is was *Santa Clara County* v. *Southern Pacific Railroad* 118 U.S. 394 (1886).

[37] Section 13(3) of the Companies Act 1985 still provides that the "subscribers to the memorandum . . . shall be a body corporate . . ."

[38] Sealy, "Perception and Policy in Company Law Reform" in Feldman and Meisel (eds.), *Corporate and Commercial Law: Modern Developments* (Lloyd's of London Press, London, 1996) pp. 12–13.

[39] (1897) 13 L.Q.R. 6, 6–7.

It was against this background, then, that *Salomon* fell to be decided. The facts of the case are well known, but in essence the case concerned an attempt by the liquidator of the company to recover from Mr. Aron Salomon in respect of losses incurred by the company. The basis of this claim was that the company was a fraud designed to shield Aron Salomon from his creditors. Thus, it was said, that although there were seven subscribers as required by the Act, six of them were "dummies" under Aron Salomon's control. In the Court of Appeal,[40] this argument was upheld. The Lords Justices were in no doubt that when Parliament had stipulated for seven subscribers, it had intended there to be seven genuine participants in the business. In the House of Lords, however, their Lordships were equally clear that the claim could not succeed.

Although hidden beneath an ingenuous reliance on the literal wording of the relevant Companies Act,[41] the judgments in the House of Lords represent a fundamental paradigm shift. In holding that the company was properly incorporated, even though Mr. Aron Salomon was the only active member of the business, their Lordships departed from the assumption that had formerly underpinned the law's view of the company.[42] As indicated above, the Companies Act of 1844 was not seen as creating a new form of trading institution. Rather, it took the partnership that was the joint stock form and conferred a separate existence upon it. The existence of a genuine partnership was, therefore, a prerequisite to incorporation, both legally and historically. In holding that the company was properly incorporated the House of Lords thus radically reformulated the corporate concept. It moved the law's paradigm from that of an association of individuals, governed by partnership principles, to something that more closely resembled the old chartered corporation. Incorporation was now to be viewed as the creation of an entity distinct from its members rather than as merely a means for the members to trade as a collective.[43]

[40] Reported as *Broderip* v. *Salomon* [1895] 2 Ch. 323.

[41] In this respect, Michael Whincop's recent criticism of what he describes as the formalistic conception of the company in *Salomon* misses the point ("Overcoming Corporate Law: Instrumentalism, Pragmatism and the Separate Legal Entity Concept" (1997) 15 Co. & Sec. L.J. 411). In asserting the superiority of the modern law and economics approach to company law, Whincop treats *Salomon* as an exemplar of an arch-formalism which is unable to resolve complex legal issues. While such a formalistic approach may well be guilty of such a charge, quite simply it is not an accurate description of approach in *Salomon*. In any event, the Privy Council's decision in *Meridian Global Funds Management Asia Ltd.* v. *Securities Commission* [1995] 2 A.C. 500, takes much of the wind out of Whincop's sails.

[42] See Pollock's comments referred to above at note 39.

[43] The significance of this shift can also be illustrated in etymological terms. The origins of the word company lie in an association or collection of individuals. Indeed in the *Oxford Dictionary of English Etymology* (O.U.P., Oxford, 1996) "company" appears under the entry for "companion". "Corporation", on the other hand, derives from the Latin *corporare*, to fashion into a body.

B. The Nature of Company Shares

Originally, a share in a company[44] was the member's share in the common property of the business. The "shareholders" in a deed of settlement company, like ordinary partners, held an equitable interest in the assets of the company[45] and, despite their incorporated status, a similar analysis was initially applied to chartered and statutory corporations.[46] The shareholders were treated as the beneficial owners of the assets, with the company holding the assets on trust for shareholders.[47] From the early 19th century, however, the courts began to treat shareholders as having no direct, severable interest in the company's assets. This change, however, the beginnings of which may be seen in *Bligh* v. *Brent*,[48] did not initially indicate a departure from the idea of shareholders as proprietors. In many of the cases the denial of the shareholders' interest was intended to indicate only that the shares were not realty and that like ordinary partners shareholders had no *severable* interest in the company's assets.[49]

By the beginning of the 20th century the idea that shareholders had no direct interest in the company's assets had become well established. In what is still the leading formulation, Farwell J. in *Borland's Trustees* v. *Steel Brothers & Co. Ltd.* said: "A share is the interest of a shareholder in the company measured by a sum of money, for the purposes of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se. . . ."[50] As well as its contractual emphasis, Farwell J.'s definition is notable for one other feature. In describing the share as an interest in the company Farwell J. seemed to suggest that although they held no interest in the assets the shareholders nevertheless owned a share of the company itself. The theory, as noted in *Gower's Principles of Modern Company Law*, is that the "company itself is treated not merely as a person, the subject of rights and duties, but also as a *res*, the object of rights and duties".[51]

[44] Generally see, Davies, *op. cit.* n.19, p. 299; Rice, "The Legal Nature of a Share" (1957) 21 Conv. (N.S.) 433; Pennington, "Can Shares in Companies Be Defined?" (1989) 10 Co. Lawyer 140

[45] *Buckeridge* v. *Ingram* (1795) 2 Ves. Jun. 652; *Howse* v. *Chapman* (1799) 4 Ves. Jun. 542. See also Rice, *ibid.* pp. 433–434 and Pennington, *ibid.* p. 140.

[46] *Sutton's Hospital Case* (1612) 10 Co. Rep. 1; *Salmon* v. *Hamborough Co.* (1671) 1 Ch. Cas. 204; *Naylor* v. *Cornish* (1648) 1 Vern. 311. See also Pennington, *ibid.*; Davies, *op.cit*. n.19, p. 299.

[47] *Child* v. *Hudson's Bay Co.* (1723) 2 P. Wms. 207; *Harrison* v. *Pryse* (1740) Barn. Ch. 324.

[48] (1836) 2 Y. & C. 268. See also *Myers* v *Perigal* (1852) 2 De G.M. & G. 599; *Watson* v. *Spratley* (1854) 10 Ex. 222; *Edwards* v. *Hall* (1855) 6 De G.M. & G. 74; *Linley* v. *Taylor* (1859) 1 Giff. 67; *Entwistle* v. *Davis* (1867) 4 Eq. 272.

[49] Rice, "The Legal Nature of a Share" (1957) 21 Conv. (N.S.) 433, 434–435.

[50] [1901] 1 Ch. 279, 288.

[51] Davies, *op. cit.* n.19, p. 301. See also Beck *et al.* (eds.), *Morison's Company and Securities Law* (Butterworths, Wellington, 1997) para.13.1. Thus, although it is often cited for the proposition that shareholders do not own the *company* (see, for example, Welling, *Corporate Law in Canada: The Governing Principles* (2nd ed., Butterworths, Toronto, 1991) p. 602; Wishart, *Company Law*

In the years following, however, the emphasis placed on Farwell J.'s definition in *Borland's Trustees* shifted from an "interest in the company", measured by the particular rights which made up the share, to the rights themselves. In describing the share the courts increasingly omitted reference to the share as an interest in the company and defined the share exclusively in terms of the rights to a dividend, to a return of capital on winding up and to vote. Thus, in *Peters' American Delicacy Co. Ltd.* v. *Heath*[52] Dixon J. said "[p] rimarily a share in a company is a piece of property conferring rights in relation to distributions of income and capital", while in the New Zealand case of *Coleman* v. *Myers*[53] Mahon J. held that the share "only vests in the holder that collection of rights provided by the memorandum and articles of association".[54] Although outwardly this was merely a shift in emphasis, this focus on the specific rights reflected a significant conceptual change. Rather than identifying the company itself as the *res* (the "thing" that is at the heart of the share and which justifies its categorisation as property), the courts began to identify the rights comprising the share.[55] This analysis reached its high point in *Short* v. *Treasury Commissioners.*[56] The entire share capital of the company was being compulsorily acquired by the Crown. In assessing the compensation payable it was contended that as all the shares were being acquired the shareholders were entitled to the entire value of the company, which was greater than the aggregate value of the shares. The Court of Appeal rejected this contention. The shareholders were not entitled to compensation for the value of the company, but only for what was being expropriated; that being their shares.[57]

While it remains true that the share gives the holder rights not

in Context (O.U.P., Auckland, 1994) p. 110), it is not clear that *Borland's Trustees* stands for this proposition.

[52] (1939) 61 C.L.R. 457, 503–504. See also the comments of Lord Wrenbury in *Bradbury* v. *English Sewing Cotton Co. Ltd.* [1923] A.C. 744, 767: "A share . . . forms, however, a separate right of property. The capital is the property of the corporation. The share . . . is the property of the corporator."

[53] [1977] 2 N.Z.L.R. 225, 295 (H.C.).

[54] See also *I.R.C.* v. *Crossman* [1937] A.C. 26, 66, where Lord Russell described the share as an "interest being composed of rights and obligations which are defined by the Companies Act and by the memorandum and articles of association of the company."

[55] This focus also manifested itself in the largely instrumentalist conferral of proprietary status on the share. The share was treated as property not because it was an interest in the company, but simply in order to secure the shareholders' rights and to emphasise that shareholders might pursue their own self-interest in the exercise of these rights. See, *Peters' American Delicacy* v. *Heath* (1939) 61 C.L.R. 457, 504; *Carruth* v. *Imperial Chemical Industries Ltd.* [1937] A.C. 707, 765; Pennington, *Company Law* (7th ed., Butterworths, London, 1995) p. 70.

[56] [1948] 1 K.B. 122. In *Mellon* v. *Alliance Textiles Ltd.* (1987) 3 N.Z.C.L.C. 100,086, 100,092, Hardie Boys J. said "when the subject matter is a holding in a large public company, the share can only be regarded as an investment . . ."

[57] This conclusion also seem to be reflected in the principles which govern the valuation of shares. The shares will only be valued on an asset-backing basis where the company is unlikely to continue as a going concern.

only against the company but also *in* the company itself, the rights in the company are no longer seen as a consequence of the shareholders' status as proprietor. The rights in the company arise as a consequence of ownership of the share and are limited to those rights. Thus, once these rights are satisfied, there is no residual claim to the company itself because, as *Short* illustrates, the shareholders' entitlement is then exhausted. Shareholders have thus been transformed from owners of the assets and undertaking to owners merely of certain rights in and against the company. The important implication of this change is that while rights specifically embodied in the share, and those reasonably implied as necessary to protect the shareholder's investment, can be explained as an incident of ownership,[58] as a result of the identification of the *res* at the heart of the share as comprising only the specific rights, it is no longer possible to explain all shareholder powers in that way.

C. Control of the Company

By the beginning of this century legal opinion had begun to embrace the long-standing commercial belief that it was no longer appropriate for shareholders to have direct control over the day-to-day management of the company.[59] It had long been the practice in deed of settlement companies for management to be vested in the board,[60] but this practice was now enshrined in the law. In a series of decisions, the Court of Appeal established the exclusivity of the rights held by each "organ" of the company.[61] This was achieved initially through the adoption of a contractual model of the company.[62] In *Automatic Self-Cleansing Filter Syndicate Co. Ltd.* v. *Cuninghame*[63] and *Salmon* v. *Quin & Axtens Ltd.*[64] the Court conceived of the company as merely an agreement between its members, that agreement being embodied in the memorandum and articles. As part of this agreement, the right to manage the company was entrusted to the board. For a shareholder or even a majority of shareholders to assert control over the management of the company was to act

[58] For example, the right to vote on matters such as the alteration of the constitution and ratification of irregular transactions. See section V(A) below.

[59] Ford, Austin and Ramsay, *op. cit*. n.7, pp. 224–225. See also Davies, *op. cit*. n.19, p. 182.

[60] Du Bois, *The English Business Company After the Bubble Act 1720–1800* (New York Commonwealth Fund, New York, 1938) p. 291.

[61] Davies, *op. cit.* n.19, pp. 14–15; Ford, Austin and Ramsay, *op. cit.* n.7, p. 220.

[62] Stokes, "Company Law and Legal Theory" in Twining (ed.), *Legal Theory and Common Law* (Blackwell, Oxford, 1986) p. 163.

[63] [1906] 2 Ch. 42 (C.A.). In this line of authorities see also: *Thomas Logan Ltd.* v. *Davis* (1911) 104 L.T. 14; *Scott* v. *Scott* [1943] 1 All E.R. 582; *Breckland Group Holdings Ltd.* v. *London & Suffolk Properties Ltd.* (1988) 4 B.C.C. 542; *Black White and Grey Cabs Ltd.* v. *Fox* [1969] N.Z.L.R. 824; *Clifton* v. *Mount Morgan Ltd.* (1940) 40 S.R.(N.S.W.) 31; *Winthrop Investments Ltd.* v. *Winns Ltd.* [1975] 2 N.S.W.L.R. 666.

[64] [1909] 1 Ch. 311 (C.A.), affirmed [1909] A.C. 442 (H.L.).

contrary to their own agreement. A court would be justified in restraining this action, as it would be in restraining the threatened breach of any other contract. In this way, the Court of Appeal established that the right of management, which had for some time been conferred upon the board, was exclusive and that the board was not subject to the direction of the general meeting.

Although the effect was to secure day-to-day autonomy for the board, the contractual analysis was still consistent with a shareholder-centred view of the company. The directors' authority still derived from the members' agreement and in principle the unanimous consent of shareholders was still effective to bind the board.[65] The contractual analysis, however, had a number of difficulties.[66] Most significantly, if the company was merely a contractual association of individuals it was unclear how its separate existence, as explained in *Salomon*, was to be established or why the shareholders should not be fully liable for the debts of the association.

These difficulties soon led to a fundamental change in the way the law conceived of the source and allocation of control within the company. This new model took as its starting point the separateness of the corporate entity from those persons who constituted the organs through which the company must necessarily act. Thus, rather than the right to bind the company arising, as it does with a partnership, from a delegation by the members, the rights (of both the board and shareholders) were conceived of as flowing from the company itself. The legal personality of the company was thus the ultimate source of rights and the articles, transformed from mere agreement to something akin to the constitution of the State,[67] was the mechanism by which the company delegated its authority.[68]

An important corollary of the new analysis was that those to whom the articles had granted rights held them free from encroachment by other agencies.[69] Despite the ambiguity of the

[65] The comments of the Court of Appeal in *Gramophone and Typewriter Ltd.* v. *Stanley* [1908] 2 K.B. 89, which are often taken to contrary effect, must be seen in their special context. The case involved an attempt by the Revenue to lift the veil and assess the shareholders for the profits of the company. To succeed it was necessary for the Revenue to establish that it was the shareholders in their personal capacity that controlled the company, not merely that the general meeting had authority to direct the board. As it is to this that the comments of the Court were addressed the case says little about the internal division of power.

[66] Stokes, "Company Law and Legal Theory" in Twining (ed.), *Legal Theory and Common Law* (Blackwell, Oxford, 1986) pp. 163–164.

[67] Davies, *op. cit.* n.19, pp. 14–16.

[68] See, for example, Brennan J.'s description in *Northside Developments Ltd.* v. *Registrar-General* (1990) 170 C.L.R. 146, 172, of the source and delegation of power within the company. As Ford Austin and Ramsay (*op. cit.* n.7, p. 221) note, on this approach "company law vests in certain groups of people an original authority to commit the company or delegate to others. . . . The relationship between the board and general meeting is not hierarchical. According to the organic approach, whatever may have been the case in the past, the power to bind the modern company is divided between the board and the general meeting . . .".

[69] *Clifton* v. *Mount Morgan Ltd.* (1940) 40 S.R. (N.S.W.) 31.

standard article conferring the right to manage on the board,[70] the courts were nevertheless clear that it was unconstitutional for shareholders to interfere with the right of the board.[71] Thus, although shareholders might still subjugate the board by altering the articles and assuming overriding control, until the articles were altered their wishes, even if unanimous,[72] were not binding on the board.[73] As Greer L.J. said in *John Shaw & Sons Ltd.* v. *Shaw* the shareholders, "cannot usurp the powers which by the articles are vested in the directors . . .".[74]

The significance of these developments lies in the fact that the exclusion of shareholders from the day-to-day management of the company was not a mere qualification of the rights of shareholders as proprietors of the company. In the deed of settlement company, shareholders were also excluded from management but they remained the legal owners of the company. Rather, the establishment of the autonomy of the board reflected a reconceptualisation of the company. The collective will of shareholders was no longer the original source of authority. The right to control the company now flowed from the company itself and shareholders like directors held only those rights which the company conferred upon them. The shareholders' lack of control over management thus did not arise because they had delegated that right to the directors but because the law no longer recognised them as having that right to delegate.

D. The Right to the Benefit of the Company

Along with the right to control, the right to the exclusive benefit of an asset is a key incident of the ownership of that asset. The shareholders' exclusive right to the benefit of the company's activities in the deed of settlement companies was thus in law a consequence of their ownership of the business. In the early years of this century, however, shareholder claims to ownership of the company's assets

[70] Until changed in 1985 (Art. 70, Table A, Companies (Tables A to F) Regulations 1985 (S.I. No. 805, 1985)), the articles conferring power on the board (Art. 80 of Table A of the First Schedule to Companies Act 1948) qualified the conferral by providing that it was "subject nevertheless to any regulation of these articles, to provisions of the Act and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting". As other commentators have pointed out (Goldberg, "Article 80 of Table A of the Companies Act 1948" (1970) 33 M.L.R. 177; Sullivan, "The Relationship Between the Board of Directors and the General Meeting in Limited Companies" (1977) 93 L.Q.R. 569) the article seemed to provide for shareholder control of management. However, the case law this century deprived the words quoted above of any meaning. The difficulties with the wording of the empowering article, however, indicates how strong was the courts' resolve to exclude shareholders from any involvement in the management of the company.

[71] *Howard Smith Ltd.* v. *Ampol Petroleum Ltd.* [1974] A.C. 821, 837.

[72] Grantham, "The Unanimous Consent Rule in Company Law" [1993] C.L.J. 245.

[73] *Tunstall* v. *Steigmann* [1962] 2 Q.B. 583; *Timaru Herald Co. Ltd.* v *Commissioner of Taxes* [1938] N.Z.L.R. 978 (C.A.).

[74] [1935] 2 K.B. 113, 134. For a recent example of how entrenched this view is see the decision of the Supreme Court of New South Wales in *N.R.M.A.* v. *Parker* (1986) N.S.W.L.R. 517.

were rejected and it was established, perhaps as a corollary of the company's separate existence, that the duties of the directors were owed to the company. These developments made it increasingly difficult to treat the shareholders as owners of the business and consequently to explain why the company's interests should be exclusively equated with the interests of shareholders. It was, nevertheless, assumed by most commentators that in managing the business the exclusive concern of the board was the interests of the present shareholders.[75] As Parkinson notes, "[b]y reason of their ownership rights, and given the 'traditional logic of ownership', it is taken that the shareholders are entitled to have the company run in their interests: it is *their* company".[76]

Although this assumption undoubtedly informed the theoretical conception of the law in the first half of this century and continues to be reflected in the leading company law texts,[77] there is surprisingly little evidence to suggest that the courts in fact adopted this approach.[78] The principal authority cited in the commentaries is *Greenhalgh* v. *Arderne Cinemas Ltd.*[79] where Evershed M.R. said "the phrase, 'the company as a whole', does not (at any rate in such a case as the present) mean the company as a commercial entity distinct from the corporators. It means the corporators as a general body". Most of the other authorities cited for this proposition, of which there are only a modest number, merely adopt and repeat Evershed M.R.'s formulation without further analysis.[80]

This already slim body of authority is further weakened by the fact that it is far from clear that Evershed M.R. intended to lay down a principle of general application. His Lordship expressly limited his comments to "such a case as the present",[81] and in

[75] Davies, *op. cit.* n.19, p. 602; Ford, Austin and Ramsay, *op. cit.* n.7, p. 303; Pennington, *Company Law* (7th ed., Butterworths, London, 1995) p. 584; Parkinson, *op. cit.* n.4, pp. 76–79. See also Heydon, "Directors' Duties and the Company's Interests" in Finn (ed.), *Equity in Commercial Transactions* (Law Book Co., Sydney, 1987) p. 123. This assumption also underlies American company law. It underpinned Berle and Means' analysis (*The Modern Corporation and Private Property* (rev'd ed., Harcourt, Brace and World, New York, 1967) and continued to be the orthodox position for much of this century.

[76] *Ibid.*, pp. 75– 76, emphasis as in the original. See also, Austin, "Commentary on Hill" in Grantham and Rickett (eds.), *Corporate Personality in the 20th Century* (Hart, Oxford, 1998) Chapter 11.

[77] See the texts referred to in note 74 above.

[78] In contrast to America where this was explicitly adopted: *Dodge* v. *Ford Motor Co.* 170 N.W. 668 (1919).

[79] [1951] Ch. 286, 291. Evershed M.R.'s dictum is relied on as the principal authority by Davies, *op. cit.* n.19 p. 602, Parkinson, *op. cit.* n.4, p. 76 and Ford, Austin and Ramsay, *op. cit.* n.7, p. 303.

[80] For example, in *Parke* v. *Daily News* [1962] Ch. 927, this dictum was relied upon to hold that the directors' consideration of the interests of employees was a breach of duty to the company.

[81] [1951] Ch. 286, 291. As Rixon, "Competing Interests and Conflicting Principles: An Examination of the Power of Alteration of Articles of Association" (1986) 49 M.L.R. 446, 448–454, notes, it is difficult to work out precisely what Evershed M.R. intended. Certainly, in *Allen* v. *Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656 (C.A.) and the cases immediately following it, "company" meant the corporate entity. It may be, therefore, that Evershed M.R. adopted a stipulative

Greenhalgh the dispute was between shareholders. Mr. Greenhalgh objected to a proposed alteration of the articles which he felt sacrificed the interests of the minority to those of the majority. In such a context, it is hardly surprising that the interests of shareholders should be to the fore and, arguably, the interests of other corporate constituencies and the company as a commercial entity were simply not at stake.[82] It is, therefore, more likely that Evershed M.R.'s formulation was only ever intended to apply in the context of inter-shareholder disputes. This conclusion is reinforced by two further considerations. First, even in those cases that pit shareholders against each other, if the commercial interests of the company as an entity are relevant it seems that the corporate interest will not be defined exclusively in terms of shareholder interests. Thus, in cases such as *Re Smith & Fawcett Ltd.*,[83]*Sidebottom* v. *Kershaw, Lesse & Co. Ltd.*,[84] *Gaiman* v. *National Association for Medical Health,*[85] *Mills* v. *Mills*[86] and *Mutual Life* v. *Rank Organisation*,[87] discrimination between shareholders was justified on the basis of "paramount considerations which affect the company itself as a commercial or corporate entity".[88] Secondly, the context-specific nature of the Evershed M.R.'s comments has been recognised by other courts. In *Re Halt Garage Ltd.*[89] and *Kinsela* v. *Russell Kinsela Pty. Ltd.*,[90] *Geeenhalgh* was expressly limited to the inter-shareholder context, while in *Peters' American Delicacy Co. Ltd.* v. *Heath*[91] the contextual limitation led Dixon J. to reject reference to the company altogether.[92]

It may also be that any equation of the corporate interest with the interests of shareholders simply reflected the fact that it was too difficult to give effect to other interests. Since the 1930s there had been widespread acknowledgement that in managing the company a

definition of the term to avoid the illogical insistence that shareholders act in the interests of the entity when the dispute is essentially about the personal rights of shareholders.

82 Rixon, *ibid.*, p. 467.

83 [1942] Ch. 304 (C.A.).

84 [1920] 1 Ch. 154 (C.A.).

85 [1971] Ch. 317.

86 (1938) 60 C.L.R. 150.

87 [1985] B.C.L.C. 11.

88 Rixon, *op. cit* n.81., p. 473. See also Sealy, "Company Law—When Discrimination is Legitimate" [1985] C.L.J. 365, 367. In *Gambotto* v. *WCP Ltd.* (1995) 182 C.L.R. 432, 446, the High Court held that a benefit to the entity was not sufficient to justify expropriation of minority shares. This aspect of the decision was based more on what the Court held were the proper purposes of the power to expropriate than a position indicating that the interests of the company should be equated with the interests of shareholders. Thus, the Court accepted that potential harm to the entity would justify expropriation.

89 [1982] 3 All E.R. 1016 (Ch.D.).

90 (1986) 4 N.S.W.L.R. 22 (S.C., N.S.W.).

91 (1939) 61 C.L.R. 457.

92 It was precisely because the dispute to which the test related was between shareholders that Dixon J. felt it inappropriate. In such a dispute the interests of the company are not at stake. Dixon J.'s approach has recently been affirmed by the High Court of Australia in *Gambotto* v. *WCP Ltd.* (1995) 182 C.L.R. 432.

range of interests besides those of shareholders were at stake.[93] Yet it was felt there was no way to give effect to these other interests without losing control of directors.[94] The point for present purposes is that the continued centrality of shareholder interests may not in any event have arisen from a persisting view of shareholders as owners, but rather from a concern with the accountability of management.

E. The Corporate Interest and Other Constituencies

Whether or not the law ever embraced shareholder primacy as firmly as has been believed, in recent years there has been a clear rejection of the notion that the company's interests are defined necessarily, exclusively and exhaustively by the interests of shareholders. This manifests itself most obviously in the consideration which directors may give to the interests of employees and creditors. In respect of employees, section 309(1) of the Companies Act 1985 provides that the "matters to which the directors are to have regard in the performance of their functions include the interests of the company's employees . . .". While there are doubts about the proper interpretation of the section,[95] the Court of Appeal's comments in *Fulham Football Club Ltd.* v. *Cabra Estates plc*[96] suggest that the section has profoundly changed the conception of the company. Neill L.J., speaking for the Court, said: "The duties owed by the directors are to the company and the company is more than just the sum of its total members. Creditors, both present and potential, are interested, while section 309 of the Companies Act 1985 imposes a specific duty on directors to have regard to the interests of the company's employees in general."[97] Although many commentators doubt whether the section will have any real effect on management

[93] See the famous debate between Professors Adolf Berle and Merrick Dodd: Berle, "Corporate Powers as Powers in Trust" (1931) 44 Harv. L.R. 1049 and "For Whom Corporate Managers Are Trustees: A Note" (1932) 45 Harv. L.R. 1365; Dodd, "For Whom are Corporate Managers Trustees? (1932) 45 Harv. L.R. 1145. See also, Davies, *op. cit.* n.19, p. 602.

[94] Professor Berle's point in the aforementioned debate was not whether management should consider the interests of other stakeholders, but whether the price of doing so was too high. Berle later conceded the argument to Dodd (Berle, "Corporate Decision Making and Social Control (1968) 24 Bus. Lawyer 149, 150), though his concession was somewhat premature. See also Prentice, "Directors, Creditors, and Shareholders" in McKendrick, (ed.), *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon, Oxford, 1992) pp. 76–77, and Dickerson, Howard and Getz, *Proposals for a New Business Corporations Law for Canada* (Information Canada, Ottawa, 1971) Vol. 1, para. 32.

[95] Sealy, "Directors 'Wider' Responsibilities—Problems Conceptual, Practical and Procedural" (1987) 13 Monash U.L.R. 164, 184; Boyle, *Gore-Browne on Companies* (44th ed., Jordans, Bristol, 1986) para. 27.4 and 27.4.1; Parkinson, *op. cit.* n.4, p. 82; Xuereb, "The Juridification of Industrial Relations Through Company Law Reform" (1988) 51 M.L.R. 156.

[96] [1992] B.C.C. 863.

[97] *Ibid.*, p. 876. See also, *Re Saul D. Harrison plc* [1994] B.C.C. 475 (Ch.D. and C.A.) where a petition under section 459 of the Companies Act 1985 was dismissed on the basis that the directors were entitled to act in the interests of employees.

behaviour, principally because employees are unable to enforce the duty,[98] for present purposes the significance of the section lies in the legislative, and judicial,[99] acceptance that the interests of the company are not exclusively those of shareholders. In recent years the courts have also accepted that in fulfilling their duty to act in the interests of the company the directors must have regard to the interests of the company's creditors.[100] This duty is reflected in an expansion of the concept of the "interests of the company" to embrace creditors as well as shareholders and employees.[101]

Although the interests of employees and creditors are the most obvious and widely discussed examples, the rejection of the exclusive equation between the corporate and shareholder interest is not limited to these instances. It also manifests itself, in particular, in the context of hostile takeovers. That a takeover should provide such a clear example should not be surprising.[102] It is now clear, almost beyond dispute, that it is in the interests of the shareholders of the target company, first, to have the opportunity to accept the offer and, secondly, to be presented with an offer at the best possible price.[103] Yet despite the unequivocal dictates of the shareholder interest, it is clear that directors are allowed considerable scope to deny shareholders the benefit of the takeover offer and seemingly have no duty to secure a bid at the best price.

In the United States, this is now explicit in both statute and the common law. Following the rash of hostile takeovers in the 1980s many states enacted provisions[104] which allowed, and in some cases

[98] Section 309(2) of the Companies Act 1985 provides that the duty is "owed to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors".

[99] See note 97.

[100] Generally see, Prentice, "Creditor's Interests and Director's Duties" (1990) 10 O.J.L.S. 265; Prentice, "Directors, Creditors, and Shareholders" in McKendrick (ed.), *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon, Oxford, 1992) p. 73; Sappideen, "Fiduciary Obligations to Corporate Creditors" [1991] J.B.L. 365; Wishart, "Models and Theories of Directors' Duties to Creditors" (1991) 14 N.Z.U.L.R. 323. Grantham, "The Judicial Extension of Directors' Duties to Creditors" [1991] J.B.L. 1.

[101] Prentice, "Creditor's Interests and Director's Duties" (1990) 10 O.J.L.S. 265; Grantham, *ibid.*

[102] Parkinson, *op. cit.* n.4, p. 77.

[103] The shareholders of the target company do in fact benefit from the bid. As Gordon, "Corporations, Markets, and Courts" (1991) 91 Columbia L.R. 1931, 1949, notes "empirical evidence available to the court overwhelmingly shows that shareholders make out exceedingly well in takeovers, that shareholders of firms that successfully rebuff a hostile bid lose out on average, and that shareholders suffer significant losses when states adopt more protective anti-takeover regimes". See also, Black, "Bidder Overpayment in Takeovers" (1989) 41 Stanford L.R. 597, and Jarell *et al.*, "The Market for Corporate Control: The Empirical Evidence Since 1980" (1988) 2 J. Econ. Persp. 49.

[104] For an overview of the history and general thrust of these provisions see, Millon, "Redefining Corporate Law" (1991) 24 Indiana L.R. 223; Gordon, "Corporations, Markets, and Courts" (1991) 91 Columbia L.R. 1931; Henning, "Corporate Law After the Eighties: Reflections on the Relationship Between Management, Shareholders, and Stakeholders" (1992) 36 St. Louis University L.J. 519; Tyson, "The Proper Relationship between Federal and State Law in the Regulation of Tender Offers" (1990) 66 Notre Dame L.R. 241; Chandy, Foster, Braswell and

required, directors to take account of constituencies other than shareholders when assessing how to respond to the bid.[105] The displacement of shareholders as the exclusive concern of management is also in evidence in the courts' approach to the rights and duties of target directors.[106] In *Unocal Corp.* v. *Mesa Petroleum Co.*,[107] the Supreme Court of Delaware held that the directors might be justified in blocking a takeover bid by the "impact [of the bid] on 'constituencies' other than shareholders (*i.e.,* creditors, customers, employees, and perhaps even the community generally) . . ."[108] This approach reached its high point in *Paramount Communications Inc.* v. *Time Incorp.*[109] where the directors were permitted to deny the shareholders the opportunity to accept the offer in order to protect the distinctive editorial culture of *Time Magazine.*[110]

Commonwealth courts take a similar approach, although less transparently so. In cases dealing with control contests[111] the courts have in effect allowed directors to act other than in the interests of shareholders.[112] *In Re a Company No. 008699 of 1985*[113] Hoffmann J. (as he then was) held that the directors were not under a positive duty to recommend or facilitate the highest bid, a proposition adopted by the Court of Session in *Dawson* v. *Coats Patons plc.*[114] Although in *Heron International Ltd.* v. *Lord Grade*[115] Lawton L.J. held that the directors did owe such a duty the facts of the case were

Poe, "The Shareholder Wealth Effects of the Pennsylvania Fourth Generation Anti-Takeover Law" (1995) 32 American Bus. L.J. 399.

105 While often formulated in permissive terms and ostensibly limited in application to the takeover context, the effect of these statutes is, as Millon notes, to "reject the orthodox shareholder primacy principle. . . . By decentering the shareholder, these statutes also reject corporate law's traditional fixation with the shareholder-manager relationship thrust non-shareholders into the limelight as legitimate objects of corporate law's attention": Millon, "Redefining Corporate Law" (1991) 24 Indiana L.R. 223, 277.

106 Generally see, Fink, "The Rebirth of the Tender Offer? *Paramount Communications Inc.* v. *QVC Network Inc.*" (1995) 20 Delaware J. of Corp. Law 133; Millon, "Redefining Corporate Law" (1991) 24 Indiana L.R. 223; Gordon, "Corporations, Markets, and Courts" (1991) 91 Columbia L.R. 1931; Henning, "Corporate Law After the Eighties: Reflections on the Relationship Between Management, Shareholders, and Stakeholders" (1992) 36 St. Louis University L.J. 519.

107 493 A.2d. 946 (1985).

108 *Ibid.*, p. 955.

109 571 A.2d. 1140 (1990).

110 Although in *Paramount Communications Inc.* v. *QVC Network Inc.* 637 A.2d. 34 (1994) the Court has refined the boundary it set in *Time* between *Unocal* and *Revlon Inc.* v. *MacAndrews & Forbes Holdings Inc.* 506 A.2d. 173 (1986) (which requires the directors to get the best price where they have resolved that the company should be sold), by accepting that the directors might unintentionally put the company up for sale, the decision does not indicate a recantation of the rejection of the principle of shareholder primacy.

111 This embraces both hostile takeovers as well as any situation where shareholders seek to remove the incumbent board.

112 Carracher, "Takeovers, Directors and Auctions: A Duty to Sell?" (1991) 7 Australian Bar Rev. 75, considered the application of the *Revlon* "auction duty" to the Commonwealth. He concludes that "Australia is on the cusp of rejecting the Easterbrook and Fischel approach and accepting the legitimacy of defensive tactics simpliciter to defeat takeovers." (p. 82)

113 (1986) 2 B.C.C. 99,024.

114 (1988) 4 B.C.C. 305, 314 (Outer House).

115 [1983] B.C.L.C. 244 (C.A.).

unique, the company having been put up for sale, and any general proposition to that effect was rejected in *Re a Company and Dawson.*

Directors have also been allowed considerable leeway in frustrating takeover bids. In *Pine Vale Investments Ltd.* v. *McDonnell*[116] the directors, faced with a hostile takeover bid, entered into a transaction in considerable haste to purchase a chain of retail stores which was paid for by an allotment of shares. Although the purchase, which McPherson J. accepted was prompted by the appearance of the bid, frustrated the takeover his Honour declined a request by shareholders for an injunction.[117] In Canada it was established in *Teck Corp.* v. *Millar*[118] that the frustration of a takeover was irrelevant if the action was in the company's interests, a matter on which the court would simply accept the directors' word.[119]

It is, of course, true that the law reports are littered with failed attempts by management to block takeover bids, invariably by allotting shares to friendly parties.[120] However, the reason for the courts' intervention does not, it is suggested, flow from a commitment to the exclusive equation between the company's interests and that of shareholders. Rather, it flows from more specific concerns with preventing self-interested behaviour by the board and with upholding the constitutional allocation of power within the company. Thus, in most of the early cases, such as *Frazer* v. *Whalley*[121] and *Punt* v. *Symons & Co. Ltd.*,[122] the directors' actions were struck down as being in bad faith. In the more recent cases, it has been the directors' attempts to manipulate the internal constitutional arrangements which has attracted judicial intervention. In *Howard Smith Ltd.* v. *Ampol Petroleum Ltd.*[123] Lord Wilberforce made it clear that the objection to the allotment lay in the board's attempts to destroy the existing majority. That the courts are concerned with the internal constitutional consequences of the action,[124] rather than whether it

[116] (1983) 1 A.C.L.C. 1294 (S.C., Qld.).

[117] On similar facts, an injunction was also refused in the New Zealand case of *Baigent* v. *D.McL. Wallace Ltd.* (1984) 2 N.Z.C.L.C. 99,122. The recent New Zealand decision of *Utilicorp NZ Inc.* v. *Power New Zealand Ltd.*, (1997) 8 N.Z.C.L.C. 261, 465 (noted by Grantham, "Caretaker Directors?" [1997] N.Z.L.J. 411) where Giles J. attempted to limit the powers of the directors to frustrate the wishes of the majority is both *per incuriam* and out of step with the trend of authority.

[118] (1972) 33 D.L.R. (3d.) 288.

[119] *Re Olympia & York Enterprises Ltd. and Hiram Walker Resources Ltd.* (1986) 59 OR (2d) 254 (Ont. S.C., Ont. Div. Ct.). For comment see, Graftstein, "Whose Company is it Anyway?: Recent Developments in Canadian Takeover Law" (1988) 46 U. Toronto Faculty of Law Rev. 522.

[120] Davies, *op. cit.* n.19 p. 605; Ford, Austin and Ramsay, *op. cit.* n.7, p. 313ff.

[121] (1864) 2 H. & M. 10.

[122] [1903] 2 Ch. 506.

[123] [1974] A.C. 821 (P.C.).

[124] It is often overlooked that, while in Canada the law has developed on the basis of an acceptance that the only limitation on the purpose of corporate powers is that they be used for the benefit of the company, so that the duty of proper purpose and good faith collapse into a single standard, this is not true of the rest of the Commonwealth (see for example, Whincop,

frustrates shareholder wishes, has on occasion been explicitly recognised. In *Pine Vale* McPherson J. accepted that there "is no general principle which precludes directors from using their powers to defeat a take-over, but simply a principle preventing directors from issuing shares in order to create a new majority",[125] while in *Darvall* v. *North Sydney Brick & Tile Co. Ltd.* Clarke J.A. said that "the bald proposition that it is improper to take action to defeat a takeover is too widely stated to constitute a legal principle".[126]

The point of the foregoing discussion is not to suggest that shareholders' interests are not relevant, or even that in most cases they will not be determinative of the corporate interest. Rather, it reveals that the equation of corporate and shareholder interests is no longer a consequence of the shareholders' perceived ownership of the company. The right of shareholders to have the company run exclusively in their interests arose initially because they owned it. Any rejection of this right must, therefore, strongly suggest that the "traditional logic of ownership"[127] has been broken.

F. Limitations on the Shareholder Powers

Much of the explanation for the persistence of the notion that shareholders are the proprietors of the company lies in the rights of shareholders to appoint directors, change the constitution and regularise defective transactions. These rights in particular seemed to emanate from and be explicable as incidents of ownership. That shareholders held these rights as a consequence of their ownership of the company was further reinforced by the fact that historically there were few limits on their rights. Unlike directors, shareholders were not subject to fiduciary duties and could thus exercise the rights in their own partisan interests. Thus in *North-West Transportation* v. *Beatty*[128] the directors in their capacity as shareholders could pardon their own breach of duty. The limits that did exist on shareholder rights (for example limitations on how the constitution could be altered and what actions might be ratified) did not contradict this position. All could be explained either as a consequence of prevailing

"*Gambotto* v. *WCP Ltd.*: An Economic Analysis of Alterations to Articles and Expropriation Articles" (1995) 23 Australian Bus. L.R. 276). The courts of England, Australia and New Zealand insist that there may be more narrowly defined purposes for corporate powers.

125 (1983) 1 A.C.L.C. 1294, 1305 (S.C., Qld.). Sir Robert Megarry V.-C. in *Cayne* v. *Global Natural Resources plc* (unrep., Chancery, 1987) also envisaged situations where the directors would be permitted to defeat a bid.

126 (1989) 15 A.C.L.R. 230, 296. See also *Whitehouse* v. *Carlton Hotel Pty. Ltd.* (1987) 162 C.L.R. 285, where the High Court of Australia accepted that if the constitution allowed the allotment of shares for this purpose there could be no objection.

127 Berle and Means, *The Modern Corporation and Private Property* (rev'd ed., Harcourt, Brace and World, New York, 1967) p. 294.

128 (1887) 12 App. Cas. 589 (P.C.).

views about the state's role in the creation of the company[129] or on the basis of an interference with the property rights of other shareholders.[130]

In recent years, however, the courts have introduced significant limitations on shareholder rights. Thus, the right to appoint directors will be restrained where the shareholders seek to obtain some advantage that does not accrue to all shareholders.[131] The right to alter the constitution must be exercised for the purposes for which the right was conferred,[132] while the right to ratify a breach of the directors' duties is subject to a host of limitations.[133] The basis of most of the limitations is the general equitable principle of fraud on a power.[134] Doctrinally, fraud on a power presupposes two matters about the power held by the donee. First, the power cannot be an original one vesting in the holder as of right. Fraud on a power necessarily assumes that the source of the power is a grant from some other entity. Secondly, and as a consequence of the first, the holder, while not necessarily a fiduciary, does not hold the power free from limitation as to what may be achieved by the exercise. While the shareholders' position as a donee of delegated power may be dismissed as an unimportant artifice necessitated by the formal position of the company as the principal actor, the implication of the use of fraud on the power to implement the limitations is that the

[129] For example, it was quite consistent with the view of incorporation as a concession from the state that the members were not permitted to change the nature of the company's business (initially changes were possible only by Royal Charter or special Act of Parliament), or were permitted to only within limits set by the state (even when alteration of the memorandum was permitted via the Companies Act state scrutiny of the alteration remained). The state's control over the type of business carried on by the company also entailed that the members could not ratify transactions beyond the powers afforded the company by the state.

[130] Thus, the members could not ratify a breach of the directors' duty which involved an expropriation of the company's property (*Cook* v. *Deeks* [1916] 1 A.C. 554 (P.C.)), because that was something in which the other shareholders had a stake by virtue of their shareholding. See Davies, *op. cit.* n.19, p. 646.

[131] *Theseus Exploration N.L.* v. *Mining and Associated Industries Ltd.* [1973] Qld. Rep. 81. See also *Standard Chartered Bank* v. *Walker* [1992] 1 W.L.R. 561 (Ch.D.). See also, Yeung, "Corporate Groups: Legal Aspects of the Management Dilemma" [1997] L.M.C.L.Q. 208, 243–244 and Grantham, "The Liability of Parent Companies for the Actions of the Directors of their Subsidiaries" (1997) 18 Co. Lawyer 138, 146.

[132] *Allen.* v. *Gold Reefs of West Africa Ltd.* [1900] 1 Ch. 656; *Peters' American Delicacy Co. Ltd.* v. *Heath.* (1939) 61 C.L.R. 457; *Gambotto.* v. *WCP Ltd.* (1995) 182 C.L.R. 432.

[133] In the recent Australian case of *Miller* v. *Miller* (1995) 16 A.C.S.R. 73, 86–87 Santow J. said: "Ratification is not available where it would constitute a fraud on the minority . . . or misappropriation of company resources . . . or was entered into by an insolvent company to the prejudice of creditors . . . or defeated a member's personal right . . . or was oppressive or where the majority in general meeting acted for the same improper purpose as directors . . ."

[134] Generally on this subject see: Farwell, *A Concise Treatise on Powers.* (3rd ed., Stevens, London, 1916), Chapter 10; Sugden, *A Practical Treatise of Powers.* (7th ed., Sweet, London, 1845), vol. II p. 181; Finn, *Fiduciary Obligations.* (Law Book Co., Sydney, 1977) paras. 84 and 620–623; Grbich, "Fraud on a Power: Judicial Control of Appointments by Discretionary Trustees" (1977) 3 Monash U.L.R. 210; Benas, "The Nature of Fraud of a Power" (1947) 12 Conv.(N.S.) 106; Hanbury, "Frauds on a Power—An Opportunity for Stocktaking" (1948) 64 L.Q.R. 221; Grantham, "The Powers of Company Directors and the Proper Purposes Doctrine" (1994–1995) 5 King's College L.J. 16.

shareholders' power to appoint directors, alter the constitution and ratify breaches of duty is not perceived doctrinally as arising as of right from their status as proprietor, but because, and only because, the constitution of the company identifies them as the donee. Thus, although it is clear that much of the courts' objective in introducing such limitations was the protection of the minority from abuse of the principle of majority rule,[135] the mechanism employed nevertheless reflects a conception of the company that does not rest on shareholder proprietorship.

G. Summary

Viewed with the benefit of hindsight, the position and influence of shareholders has undoubtedly undergone a radical change. Where shareholders once stood at the centre of the corporate universe, with the undisputed right to control the management and direction of the company and to have it run for their exclusive benefit, this century shareholders have become little more than bystanders.[136] While true to the methodology of the common law latent inconsistencies remain, the law has rejected or limited those rights which were crucial to the shareholders' claims to proprietorship. In doing so, while it is not clear what, if anything, has replaced it, it is clear that the law has rejected the 19th century image of the company as a quasi-partnership.

IV. Residual Rights

It is of course true that shareholder interests still generally give content to the company's interests and that, in being able to appoint the board, approve irregular transactions and alter the constitution, shareholders still have a position of significant power within the company. However, such rights of themselves do not necessarily point to the conclusion that shareholders must be seen as the ultimate proprietors of the company. The vesting of such rights in shareholders is quite consistent with a doctrinal conception of the company that does not rely upon a notion of shareholders as proprietors. In particular, it will always be necessary to make some reference to human actions and attributes when applying the law to a fictional entity such as a company.

Much of the common law was developed for application to

[135] Wedderburn, "Shareholders' Rights and the Rule in *Foss.* v. *Harbottle.*" [1957] C.L.J. 194, 198; Welling, *Corporate Law in Canada: The Governing Principles.* (2nd ed., Butterworths, Toronto, 1991) p. 637.

[136] Bratton, "The New Economic Theory of the Firm: Critical Perspectives From History" (1989) 41 Stanford L.R. 1471, 1475-6.

natural persons.[137] The common law rules are thus predicated upon the assumption that the relevant actors possess certain characteristics. Most notably for present purposes these rules assume, at a functional level, that the bearer of rights and duties is capable of action, intention and may be said to have knowledge. While a truism, it is sometimes easy to forget that it is not in fact the company that signs a contract,[138] conspires to fix prices[139] or knows certain compromising facts[140] but rather the natural persons who represent the company for that purpose. Thus, as Lord Hoffmann has recently reminded us,[141] necessarily the law must have regard to the actions, intentions and knowledge of natural persons when applying these rules of law. The function of much of company law is thus to forge an analogy between the company and natural persons and to identify when and which natural persons are to be treated as though they were the company.[142]

The necessity of these rules referring to natural persons is clearly seen in the application of the criminal law to companies. Most criminal offences require *mens rea.* As a fictional entity the company is of course unable to form an intention, guilty or otherwise, and historically this was seen as an obstacle to corporate criminal liability.[143] However, it is now recognised that the *mens rea* of a company is necessarily to be found in the intentions of natural persons. Thus, criminal liability may be imposed on a company either through vicarious liability[144] or through the direct attribution of the intentions of individuals to the company.[145]

The application of fiduciary duties to companies also illustrates the functional necessity of reference to human action. While formally the beneficiary of the duty is the company, as an artificial entity the company is not sufficiently analogous to a natural person to support the functional requirements of the duty. The central feature of the fiduciary duty is the beneficiary's interest. The fiduciary's principal

[137] Hart, "Definition and Theory in Jurisprudence" (1954) 70 L.Q.R. 37; Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning.* (Yale Uni. Press, New Haven, 1923) Chapters 6 and 7; Radin, "The Endless Problem of Corporate Personality" (1932) 32 Columbia L.R. 643.
[138] *Northside Developments Pty. Ltd.* v. *Registrar-General* (1990) 170 C.L.R. 146.
[139] *Re Supply of Ready Mixed Concrete (No. 2)* [1995] 1 A.C. 456 (H.L.).
[140] *Meridian Global Funds Management Ltd.* v. *Securities Commission* [1995] 2 A.C. 500 (P.C.).
[141] *Meridian Global Funds Management Ltd.* v. *Securities Commission, ibid.*, p. 506.
[142] Hart, Kelsen, Radin, Manne, above; "The Limits and Rationale of Corporate Altruism: An Individualistic Model" (1973) 59 Virginia L.R. 708, 709.
[143] Welsh, "The Criminal Liability of Corporations" (1946) 62 L.Q.R. 345, 346.
[144] While vicarious liability was not employed in English law (Davies, *op. cit.* n.19, p. 229), it served as the doctrinal basis for the imposition of corporate criminal liability in the United States of America: Khanna, "Corporate Criminal Liability: What Purpose Does It Serve?" (1996) 109 Harv. L.R. 1477, and Walsh and Pyrich, "Corporate Compliance Programs as a Defense to Criminal Liability: Can a Corporation Save Its Soul?" (1995) 47 Rutgers L.R. 605.
[145] *Re Supply of Ready Mixed Concrete (No. 2)* [1995] 1 A.C. 456 (H.L.); *Meridian Global Funds Management Ltd.* v. *Securities Commission* [1995] 2 A.C. 500 (P.C.).

duty to is to act in, and only in, the beneficiary's interests.[146] The beneficiary's interest thus not only defines the goal toward which the fiduciary must work, but also provides an objective yardstick against which to test the fiduciary's assertions of loyalty. When applied to natural persons these principles work well enough: the beneficiaries have real interests, independent of the fiduciary's discretion. Their application to companies, however, poses difficulties. The company as an artificial entity does not have real interests. If, therefore, the beneficiaries' interest is to give a justiciable content to the duty, it is necessary for the law to ascribe to the company the real interests of some person or group.[147]

From this perspective the central issue is: which individuals should be treated as the company for this purpose? Historically shareholders were treated as the beneficiaries of the duty because of their status as ultimate proprietors.[148] It would, however, still be rational for a system that has never treated shareholders as owners to make shareholders' interests central. Thus, for example, it may still be appropriate to treat shareholders as the company because of the policy of the particular rule being applied[149] or because the selection of shareholders is likely to promote the efficient operation of the company. As residual claimants, shareholders have the greatest incentive to monitor the conduct of management. Their selection as donees of rights such as those to appoint and remove the board could, therefore, be justified on the basis that they are the most likely to act to prevent managerial abuse and shirking.[150]

The point of the foregoing discussion is merely to demonstrate that whatever may have been the historical reasons for vesting rights in shareholders, their status as proprietor is not a necessary consequence of their possessing these rights. The important rights

[146] For recent statements to this effect see *Bristol and West Building Society* v. *Mothew* [1997] 2 W.L.R. 436, 449 *per* Millett L.J.; *Armitage* v. *Nurse* [1997] 3 W.L.R. 1046, 1053 *per* Millett L.J. See also Finn, *Fiduciary Obligations* (Law Book Co., Sydney, 1977) p. 15; Finn, "Fiduciary Law and the Modern Commercial World" in McKendrick (ed.), *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon, Oxford, 1992) p. 9; Finn, "The Fiduciary Principle" in Youdan (ed.), *Equity, Fiduciaries and Trusts* (Carswell, Toronto, 1989) p. 24

[147] Finn, *Fiduciary Obligations* (Law Book Co., Sydney, 1977) p. 17, says that the fiduciary obligation is premised upon the "notion that those who are, as a matter of law, the beneficiaries of a relationship do have also, as a matter of fact, a real interest in the product of the fiduciaries' activities . . ." See also Grantham, "Reforming the Duties of Company Directors" (1991) 12 Co. Lawyer 27.

[148] Ford, Austin and Ramsay, *op. cit.* n.7, p. 303; Sealy, "The Director as Trustee" [1967] C.L.J. 83, 89.

[149] Thus in *Equiticorp Industries Group Ltd. (in stat. man.)* v. *Attorney-General (No. 47* [1998] 2 N.Z.L.R. 481, 729—730 Smellie J. explained the power of shareholders to ratify a breach of directors' duties in terms of the policy of the fiduciary duty and how, since to vest that power in directors would frustrate that policy, it followed that shareholders should be the donees of that power.

[150] This is most clearly articulated in the modern contractual analysis of the company. See note 152 below.

which shareholders continue to possess do not, therefore, necessarily contradict the conclusion that ownership is no longer the central doctrinal explanation of the position of shareholders. The functional requirements of the rules applied to companies necessitate reference to the actions, intentions and knowledge of natural persons and, in selecting which persons, shareholders are for many other non-ownership-related reasons a plausible choice. Thus even without invoking notions of ownership we still might expect to see shareholder interests as the focus of the directors' duties, and shareholders vested with the rights to appoint directors, alter the constitution and pursue wrongs on behalf of the company.[151]

V. A New Doctrinal Basis for Shareholder Rights

For much of this century the persistent idea that shareholders owned the company served to explain the basis of shareholders' rights. The shareholders' status as the ultimate proprietors of the company entitled them, by virtue of their ownership, to have the company operated for their benefit and to have their will prevail. Shareholder ownership also served to legitimate the corporate form. The economic and social power associated with companies posed no threat to society because it was owned by shareholders, and the right of individuals to own property, regardless of how much, was legally and morally unquestioned.

The law, however, has now rejected that doctrinal footing, a rejection manifested in the attenuation of those rights which were most clearly an incident of the shareholders' ownership of the company. In doing so, however, the law seemed to proceed more from a conviction that the ownership model was no longer appropriate than from any perception of the superiority of a competing model. In respect of those rights which shareholders have held since the inception of the registered company there is, therefore, something of a doctrinal vacuum: shareholders acquired the rights on the basis of a status that the law now denies them. The task facing modern company law, therefore, is to fill this vacuum. If shareholders are to remain donees of rights within the corporate structure and if these rights are to range as widely as they have done in the past, the law must develop a rational and legitimate doctrinal explanation, which is both sustainable in the present environment and consistent with at least the bulk of the present law.

In recent years the most important and academically influential attempt to articulate the doctrinal basis for shareholder rights has

[151] *Equiticorp Industries Group Ltd. (in stat. man.)* v. *Attorney-General (No. 47),* above.

been the Nexus of Contracts Theory ("the Theory").[152] The modern contractual analysis treats the company as little more than a collective noun for the web of contracts that link the various participants, which include shareholders, management, employees and creditors. The function of company law is thus conceived of as the facilitation of the parties' bargains. Unlike previous theories, the contractual analysis has no place for a reified notion of the company and as such there is nothing to own.[153] The position of shareholders is, therefore, explained in terms of their contractual relationship with the other parties, and their rights as contractual entitlements to which all the parties would agree *ex ante*.[154] As well as explaining crucial features of the corporate structure, the Theory also serves to justify the corporate form in terms of the private consensual rights of the contracting parties. In essence, the company is reduced to the rights and duties of individuals, rights which require no further justification than that which already inheres in the notion of private rights.

Although dominating the corporate law debate for most of the last decade, the Theory has not, however, proved compelling. At the normative level,[155] the vision of the company which underlies the Theory remains hotly contested. The Theory asserts that the company should be seen as an essentially private arrangement between the contracting individuals, where entitlements are determined by the terms of the relevant contracts. The important implications of this are that there is little room for state regulation, that shareholder interests remain the central concern and groups with only limited entitlements or with no contractual relationship have no right to consideration, even if they are affected by the company's conduct. While widely supported academically, there is a growing tide of

[152] The leading advocates of this approach are Easterbrook and Fischel, *The Economic Structure of Corporate Law* (Harvard Uni. Press, Cambridge, 1991) and "The Corporate Contract" (1989) 89 Columbia L.R. 1416. See also Macey and Miller, "Corporate Stakeholders: A Contractual Perspective" (1993) 43 Uni. Toronto L.J. 401; Jensen and Meckling, "The Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (1976) J. Fin. Econ. 305 and Cheffins, *Company Law: Theory Structure and Operation* (Clarendon, Oxford, 1997). For outlines of the history and structure of the contractual analysis by non-believers see: Bratton, "The New Economic Theory of the Firm: Critical Perspectives from History" (1989) 42 Stanford L.R. 1471 and Parkinson, "The Contractual Theory of the Company and the Protection of Non-Shareholder Interests" in Feldman and Meisel, *Corporate and Commercial Law: Modern Developments* (Lloyd's of London Press, London, 1996) p. 121.

[153] Easterbrook and Fischel, "Voting in Corporate Law" (1983) 26 J. of Law and Econ. 395, 396; Fama, "Agency Problems and the Theory of the Firm" (1980) 88 J. of Political Econ. 288, 290; Parkinson, "The Contractual Theory of the Company and the Protection of Shareholder Interests" in Feldman and Meisel (eds.), *Corporate and Commercial Law* (Lloyd's of London Press, London, 1996) p. 123.

[154] Cheffins, *op. cit.* n.152, Chapter 6.

[155] At least in the hands of Easterbrook and Fischel, *The Economic Structure of Corporate Law* (Harvard Uni. Press, Cambridge, 1991) the contractual analysis is intended as both a normative principle as well as an explanatory one: DeMott, "Trust and Tension Within Corporations" (1996) 81 Cornell L.R. 1308, 1312.

opinion which rejects this view. Increasingly scholars now stress the social importance and institutional nature of the company and conceive of the company in "communitarian" terms where the interests of all groups must be respected.[156] Indeed, one communitarian scholar has already pronounced contractarianism in company law dead.[157]

From a descriptive perspective the Theory is also problematic. As Cheffins concedes, the contractual "characterization is at odds with the legal conceptualization of the company".[158] This manifests itself principally in three areas. First, the Theory relies on a conception of contracting that modern contract scholars would find quaintly old-fashioned. In its reliance on consent as both the descriptive and normative basis of contracting,[159] the Theory is clearly out of step with modern contractual theory which accepts that contract law is itself informed by a range of considerations.[160] Furthermore, in order to accommodate awkward features of the extant law, the contractual analysis has been forced to adopt an extremely expansive notion of contract. In particular, it is clear that, while technically a contract, the memorandum and articles of association are heavily overlaid by statute and that for most companies the constitution does not result from any real bargaining between the participants.[161] In expanding the notion of contract, however, the contractual analysis has lost much of its explanatory and moral force.[162]

Secondly, and most importantly, the contractual analysis simply does not accurately describe the content of company law. In particular, the presence in the law of non-excludable mandatory rules,

[156] See the essays in Mitchell, *Progressive Corporate Law* (WestView, Colorado, 1995) and the scholarship collected in the bibliography in Millon, "New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law" (1993) 50 Wash. and Lee L.R. 1373.

[157] Branson, "The Death of Contractarianism and the Vindication of Structure and Authority in Corporate Governance and Corporate Law" in Mitchell, *Progressive Corporate Law* (WestView, Colorado, 1995) p. 93.

[158] Cheffins, *op. cit.* n.152, p. 32.

[159] The consensual attributes of the "contract" are important to the Nexus theory. It is from this that it is possible to infer that the corporate structure is efficient.

[160] Coffee, "No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies" (1988) 53 Brooklyn L.R. 919, 937. Generally, see Atyiah, *The Rise and Fall of Freedom of Contract* (Clarendon, Oxford, 1979) and "Contracts, Promises and the Law of Obligations" (1978) 84 L.Q.R. 193. See also, Treitel, *The Law of Contract* (9th ed., Sweet & Maxwell, London, 1995) pp. 1–7.

[161] Eisenberg. "The Structure of Corporation Law" (1989) 89 Columbia L.R. 1641; Brudney, "Corporate Governance, Agency Costs, and the Rhetoric of Contract" (1985) 85 Columbia L.R. 1403.

[162] If the corporate governance structure does not result from a bargain, it is difficult to infer that the resulting structure is efficient. Contract theorists have responded, however, that so long as the governance structure is "priced", through the value of the shares on the stock market, then it is possible to infer efficiency. The validity of this assumption depends on two further assumptions. First, that the stock market is efficient and, secondly, that shareholders trade on the basis of this information rather than "noise". Both assumptions are controversial. See Cheffins, *op. cit.* n.152, pp. 55–58.

such as the fiduciary duties of directors,[163] the right of directors to consider non-shareholder constituencies and mandatory rules relating to takeovers,[164] derivative actions and financial assistance,[165] is at odds with the central prediction of the contractual analysis. If company law is merely facilitative of the parties' bargain there is little room for rules which the parties cannot modify or exclude. While corporate contract scholars have advocated the removal of such rules,[166] these exhortations have largely fallen on deaf ears.

Finally, the contractual analysis does not describe the processes underlying the development of company law. It is simply not plausible, even in the United States, where the Theory originated, to suggest that the legislature and the courts have sought to develop the law exclusively on the basis of what, *ex ante*, the parties would have agreed to had transaction costs not been prohibitive.[167] On the contrary, it is clear that both Parliament and the courts have been motivated by other considerations. As Cheffins explains,[168] legislatures in most jurisdictions have been concerned with issues of fairness,[169] social justice[170] and the effects on society of corporate transactions.[171] Thus, for example, concerns with morality underpin the Company Directors Disqualification Act 1985[172] and the oppression remedy in section 459 of the Companies Act 1985 has been said to be concerned with "a visible departure from the standards of fair dealing and a violation of the conditions of fair play".[173] The approach of Commonwealth courts is also informed, explicitly on occasion, by notions of fairness, propriety and morality. Thus in *Northside Developments Pty. Ltd.* v. *Registrar-General* Mason C.J. invoked principles of "commercial morality" to justify the balance struck

[163] That a fiduciary's obligations are not entirely excludable was confirmed recently by the Court of Appeal in *Armitage* v. *Nurse* [1997] 3 W.L.R. 1046, 1056 where Millett L.J. said: "there is an irreducible core of obligations owed by trustees . . ." For an overview of the arguments see, Coffee, "The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role" (1989) 89 Columbia L.R. 1618.

[164] For example, the requirement in the *City Code on Takeovers and Mergers* of equal treatment of shareholders (General Principle 1) and mandatory bids (General Principle 10 and Rule 9).

[165] Cheffins, *op. cit.* n.152, p. 228.

[166] Easterbrook and Fischel, *The Economic Structure of Corporate Law* (Harvard Uni. Press, Cambridge, 1991) p. 15.

[167] This largely conceded by Cheffins, *op. cit.* n.152, p. 142ff.

[168] *Ibid.*

[169] Cheffins, *op.cit.* n.152, p. 142ff.

[170] For example, the concern with the position of employees reflected in section 309 of the Companies Act 1985.

[171] This seems to underlie the anti-takeover statutes in America. In particular, the effect on the state economy of takeovers which may result in a relocation of the business in another state: Henning, "Corporate Law After the Eighties: Reflections on the Relationship Between Management, Shareholders, and Stakeholders" (1992) 36 St. Louis L.J. 519, 526.

[172] Wheeler, "Directors' Disqualification: Insolvency Practitioners and the Decision-Making Process" (1995) 15 Legal Studies 283, 289.

[173] *Elder* v. *Elder & Watson Ltd.* [1952] S.C. 49, 55 *per* Lord Cooper, speaking of an earlier formulation.

between corporate insiders and creditors by the rule in *Turquand's case*.[174]

The failure of the Theory to capture the content and policy of the law does not mean, however, that contract is not important as a doctrinal explanation of shareholder powers. Clearly, contract has played and will continue to play an important role in company law.[175] In particular, the actual agreement between the shareholders will be a central feature in respect of "quasi-partnership" companies. However, it is equally clear that contract is not and cannot be the sole explanation of the content of company law or the rights of shareholders. The historical development of company law, and the policy considerations which have informed the legislative and judicial interventions suggest that in addition there are at least two other important doctrinal bases for shareholder rights: the ownership of the share and the wider policy goals of company law.

A. Ownership of the Share

However much shareholders may have been displaced as the centre of the corporate universe, they remain the owners of their shares. The share entitles the holder to a bundle of rights both in and against the company. Central among these rights are the claim on the company's income, by way of dividend, and on its capital on winding up. Although in practical terms these are the most important rights, they are not in substance much different from the rights held by other creditors.[176] What distinguishes the shareholder is that the share also affords rights in the company. By virtue of his or her ownership of the share the holder is entitled to a voice in both the structure and management of the company, rights not normally granted to other creditors.[177]

While ownership of the share, rather than ownership of the company, is clearly of more limited explanatory effect, in determining the nature and extent of the rights implied by this ownership, two important points must be made. First, despite the tendency, particularly in the public company context,[178] to view the share as little more than a contractual entitlement to a portion of the income

[174] (1990) 170 C.L.R. 146, 164–165.

[175] This continues to be reflected in English and Australian company law through the contractual status afforded the memorandum and articles of association by the Companies Act: Companies Act 1985, s.14. In jurisdictions such as New Zealand and Canada which have abandoned the contractual basis in favour of a wholly statutory one, contract is less likely to feature as a doctrinal explanation in the future.

[176] In the sense that debtors also have a claim on the company's income (interest) and its capital (the loan principal).

[177] Although, in the case of preference shares, holders may not get a vote, while the level of control vested in some debtors is often greater than shareholders: see Davies, *op. cit.* n.19, p. 361.

[178] Prompted, in part, by the contractual analysis of the company and in part by the increasing fungibility of public company shares.

stream,[179] the share, and the rights it comprises, cannot be reduced to a mere contractual entitlement. The related concepts of property and ownership have a normative force and content that goes beyond that inherent in contractual rights. In particular, whether framed in traditional moral terms[180] or in terms of the liability rule/property rule dichotomy,[181] labelling the right as "property" implies that it may not be expropriated. This implication was recently affirmed in *Gambotto* v. *WCP Ltd.* where the High Court of Australia rejected a characterisation of the share as merely a "capitalised dividend stream"[182] and limited the power of the majority to expropriate minority shares, much to the dissatisfaction of Australian commentators.[183] The concept of ownership is, therefore, still necessary to explain at least some of the rights and powers held by shareholders.

Secondly, the unique nature of the shareholder's investment justifies greater rights than might appear to be implied by ownership merely of the share. While creditors are able expressly to stipulate all the terms of their bargain, the investment made by shareholders is both indefinite in term and residual in nature. These two factors combine to make explicit contracting almost impossible.[184] The result of these transactional difficulties is that it is rational for shareholders to stipulate for rights that are both greater in extent than, and different in nature from, those rights granted to other creditors. In particular, because the terms of the investment are necessarily open-textured and subject to unilateral change by management, shareholders would rationally insist on some control over the level of risk which might be undertaken in the future.[185] It is possible,

[179] See, for example, Manne, "Our Two Corporation Systems: Law and Economics" (1967) 53 Virginia L.R. 259, 260–261; Buxhaum, "Corporate Legitimacy, Economic Theory, and Legal Doctrine" (1984) 45 Ohio St. L.J. 515, 526.

[180] Which sees property as an outgrowth of the person and a matter of "natural right". This is most apparent in the work of John Locke, *The Second Treatise of Civil Government* (Dent, London, 1949).

[181] Calabresi and Melamed, "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral" (1972) 85 Harv. L.R. 1089.

[182] (1995) 182 C.L.R. 432, 447.

[183] Ramsay (ed.), *Gambotto* v. *WCP Ltd: Its Implications for Corporate Regulation* (Centre for Corporate Law and Securities Regulation, Melbourne, 1996).

[184] Other stakeholders in the company, such as employees, also face contracting difficulties. This has led some to argue that governance structures should also confer rights on employees. This is explained either in terms of implicit contractual rights (Stone, "Labour Markets, Employment Contracts, and Corporate Change" in McCahery, Picciotto and Scott (eds.), *Corporate Control and Accountability: Changing Structures and the Dynamics of Regulation* (Clarendon, Oxford, 1993) p. 61; O'Connor, "Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers" (1991) 69 N.C.L.R. 1189) or transactional failure (Daniels, "Stakeholders and Takeovers: Can Contractarianism be Compassionate?" (1993) 43 Uni. Toronto L.J. 315; Howse and Trebilcock, "Protecting the Employment Bargain" (1993) 43 Uni. Toronto L.J. 751). Proponents of the Nexus approach, however, contend that governance rights should only be vested in the residual claimant, and that shareholders are the appropriate residual claimant. Their incentives are to maximise the value of the whole firm, not (as with employees) merely the value of their return.

[185] Macey and Miller, "Corporate Stakeholders: A Contractual Perspective" (1993) 43 Uni. Toronto L.J. 401, 423; Williamson, *The Economic Institutions of Capitalism* (Free Press, New York, 1985)

therefore, to explain the rights such as those to remove the directors, approve major transactions and have the company wound up for a failure of the substratum as incidents of the ownership of the share.

B. Shareholders as an Instrument of Policy

There are features of the typical corporate governance structure that are not readily understandable in terms either of a bargain between the participants or of ownership of the share. This seems particularly true of rights such as those to alter the constitution, approve irregular transactions and pursue wrongs done to the company. The rights to participate in the income and capital of the company do not obviously extend to pursuing claims on behalf of the company or altering the constitution and, as such powers arise largely from statute[186] or judicial intervention, they do not seem to flow from the shareholders' agreement.[187] While historically such rights could be explained as a consequence of the shareholders' status as owner, rejection of that doctrinal foundation means that the decision to leave such rights in the hands of shareholders must rest on other bases. A clue to identifying a basis for such rights may be found in the function of these rights and the role they play in the state's goals for corporate governance. In broad terms, the state is concerned to see that companies are managed efficiently and fairly, are free from abuse, and retain flexibility as a vehicle for commerce.[188] The state is thus interested in the nature of the business conducted by the company, in ensuring that its internal procedures are fair, and that abuses by corporate management are pursued. These concerns are reflected in the intervention of the state in major changes in the company's business,[189] the creation of remedies for unfair and oppressive conduct,[190] the statutory mitigation of the effects of the

pp. 304–306; Williamson, *The Economic Analysis of Institutions and Organisations: in General and With Respect to Country Studies,* (O.E.C.D. Economic Department Working Paper No. 133, Paris, 1993).

[186] The power to alter the corporate constitution is contained in sections 4 and 9 of the Companies Act 1985. The power of amendment cannot, furthermore, be excluded: *Bushell* v. *Faith* [1969] 2 Ch. 438; *Russell* v. *Northern Bank Development Corporation Ltd.* [1992] 1 W.L.R. 588 (H.L.).

[187] Of course, as mentioned above, the expansive notion of agreement employed by the Nexus of Contacts Theory means that almost anything can be justified as consensual. However, it is still the case that powers which owe their origins to statute do not result directly from the agreement embodied in the memorandum and article of association. This is reinforced in the case of alterations to the constitution by the fact that the power of alteration cannot be excluded by agreement.

[188] Thus, for example, see the long title to the New Zealand Companies Act 1993. See also Cheffins, *op. cit.* n.152, p. 126ff.

[189] Historically, a change to the objects set out in the memorandum of association could be achieved only by special act of Parliament. Even now, alterations to the memorandum are subject to judicial scrutiny: Companies Act 1985, s. 5.

[190] Companies Act 1985, s. 459.

corporate form on outsiders[191] and the extent to which abuses within the company may be pursued by state officials.[192]

Historically, the state sought to achieve its goals for company law through a strategy of "command and control".[193] The state, either through legislation or judicial intervention, would specify what should or should not happen and impose sanctions for failure to observe those injunctions.[194] The limitations of this approach, however, have been increasingly recognised. Direct stipulation of desired conduct or outcomes is unlikely to be effective, is likely to divert effort into avoidance and is likely to be costly.[195] Increasingly, the state has turned to indirect means to achieve its goals. This approach, known variously as constitutive,[196] responsive[197] or light-handed[198] regulation, seeks to achieve regulatory goals by creating a self-balancing system that creates, and relies upon, incentives for the individuals involved to bring about the desired result or conduct. Thus, rather than the state, through the courts or other officials, directly undertaking tasks such as the approval of irregular transactions, the approval of changes in the corporate constitution and the pursuit of delinquent directors, the state may perform these tasks indirectly by vesting rights in suitably motivated groups, both within[199] and outside[200] the

[191] Thus, the reformation of both the *ultra vires* doctrine and the rule in *Turquand's Case* (sections 35 and 35A of the Companies Act 1985) reflects a desire to protect those dealing with the company from all the consequences of the corporate form. See Prentice, *Reform of the Ultra Vires Rule: A Consultation Paper* (D.T.I., London, 1986) p. 14. This policy is also explicit in the First Directive on Company Law.

[192] Pursuant to section 432 of the Companies Act 1985 the Secretary of State may appoint inspectors to investigate the affairs of the company.

[193] Generally see, Ayres and Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (O.U.P. Oxford, 1992) pp. 7–18; Shearing, "A Constitutive Conception of Regulation" in Grabosky and Braithwaite (eds.), *Business Regulation and Australia's Future* (Australian Institute of Criminology, Canberra, 1993) p. 67; Cheffins, *op. cit.* n.152, Chapter 5; Sugarman, "Reconceptualising Company Law: Reflections on the Law Commission's Consultation Paper on Shareholder Remedies: Part 1" (1997) 18 Co. Lawyer 226, 237; Corbett, "A Proposal for a More Responsive Approach to the Regulation of Corporate Governance" (1995) 23 Federal L.R. 277, 279.

[194] The prohibition on financial assistance in the purchase of the company's shares (Companies Act 1985, s. 151) and the prohibition of insider trading (Criminal Justice Act 1993) are obvious examples.

[195] Cheffins, *op. cit.* n.152, p. 227; Corbett, *above*, pp. 301–305.

[196] Shearing, *above*

[197] Ayres and Braithwaite, *op. Cit.* n.193.

[198] The name commonly given to New Zealand's approach to the regulation of the telecommunications industry: Ahdar, "The Privy Council and 'Light-Handed' Regulation" (1995) 111 L.Q.R. 217; Vautier and Bollard, "Competition Policy in New Zealand" in Green and Rosenthal (eds.), *Competition Regulation in the Pacific Rim* (Oceana Publications, New York, 1996) p. 382.

[199] One notable example may be found in the New Zealand provisions prohibiting insider trading. Unlike most other jurisdiction which provide for enforcement by the State, the Securities Amendment Act 1988 leaves enforcement almost entirely up to the shareholders. For an overview see, Rickett and Grantham (eds.), *Essays on Insider Trading and Securities Regulation* (Brooker's, Wellington, 1997).

[200] Thus, for example, in Australia the Corporations Law vests rights in creditors to seek an injunction to restrain corporate conduct: Corporations Law, ss. 1323, 1324.

company.[201] In this respect, shareholders are particularly well suited to serve as an agent of the state as their incentives largely coincide with those of the state. The state's concern to see that companies are managed efficiently and fairly are goals which shareholders as residual claimants also share, albeit for different reasons. As entities motivated by rational self-interest shareholders can, furthermore, be trusted actively to pursue these aims.

We may, therefore, account for the decision to vest rights in shareholders, especially in jurisdictions where company law is wholly statutory, in instrumental terms. Shareholders are vested with rights not as a consequence of their status, though they are intended to pursue their self-interest. Rights are vested in shareholders so that they may perform tasks that would otherwise be undertaken by the state directly. Thus, for example, at one time the state exercised its supervisory role over the content of the corporate constitution by requiring a direct appeal to the sovereign or a special Act of Parliament. The state's policy goals with respect to the content and amendment of the constitution are now pursued through the agency of shareholders. Their rational self-interest can be relied upon to permit only those amendments that further the shared goals of state and shareholder. The rights to approve irregular transactions and pardon breaches of directors' duties may be explained, it is suggested, in a similar way.

The instrumentalist justification for shareholder rights, however, has two important consequences. First, it is only proper to vest rights in shareholders where to do so serves the regulatory goals of the state. While for most purposes the state and shareholder interests will be aligned, at the margins shareholder incentives will diverge. In these cases it is no longer appropriate for shareholders to have these rights and, indeed, this is reflected in the law. The right of shareholders to ratify breaches of duty is withdrawn where the company is insolvent. The incentives of shareholders at this point, to continue to trade the company using creditor's funds, do not align with those of the state: it is no longer efficient to permit shareholders to rely on limited liability. The boundaries of the shareholders' right to pursue a derivative action may also be explained in these terms. While normally it is advantageous to permit shareholders to pursue delinquent directors, there are circumstances where although shareholders will wish to pursue the claims it is not efficient or

[201] Ayres and Braithwaite, *op. cit.* n.193, p. 103: "a form of subcontracting regulatory functions to private actors. In particular, [responsive regulation] envisions that in particular contexts it will be more efficacious for the regulated firms to take on some or all of the legislative, executive, and judicial regulatory functions." See also, Hill, "Changes in the Role of the Shareholder" in Grantham and Rickett (eds.), *Corporate Personality in the 20th Century* (Hart, Oxford, 1998) Chapter 10.

desirable to do so.[202] Thus, the judicial scrutiny to which derivative actions are subjected[203] and the limitation of derivative actions where there is an impartial group within the company[204] are explicable in terms of the divergence of shareholder incentives and the state's regulatory goals.

Secondly, while shareholders might have the necessary motivation to act as a proxy for the state, the success of "delegation" as a regulatory strategy is also dependent upon the ability of shareholders to make rational decisions about complex matters. That they can is of course a central tenet of the neo-classical economic foundations of the regulatory strategy now employed in the company and securities area in most common law jurisdictions. While a detailed consideration of the empirical validity of this premise is beyond the scope of this paper,[205] one point can be made. If shareholders are to have any chance of making rational decisions it is clear these decisions must be informed. Yet it is also clear that shareholders had no right at common law of access to the company's files.[206] From this perspective, then, disclosure requirements such as those which have come to mark securities laws in most jurisdictions may be a necessary procedural accompaniment to the substantive powers of review vested in shareholders.[207]

VI. Conclusion

Although the company was recognised by the House of Lords over 100 years ago as a legal right-and-duty bearing entity, distinct from the natural persons involved with it, the suggestion that shareholders do not own the company may strike some as a radical proposition. The company, after all, exists by virtue of the will, enterprise and capital of the shareholders. The proposition appears even more radical when it is asked: if shareholders are not the owners, then who is? The idea that the company, and its wealth and social power, are

[202] A shareholder's sense of aggrievement may compel him or her to pursue the claim, although the costs to the company in terms of disruption, publicity and staff involvement may not warrant prosecution of the claim.

[203] See, for example, the Law Commission's proposals for a derivative action: Law Commission, *Shareholder Remedies,* Consultation Paper No. 142 (1996) and Final Report No. LC246 (1997). The proposals are outlined and critiqued by Sugarman, "Reconceptualising Company Law: Reflections on the Law Commission's Consultation Paper on Shareholder Remedies" (1997) 18 Co. Lawyer 226 and 274.

[204] *Smith* v. *Croft* (No. 2) [1988] Ch. 114.

[205] See Hill, "Changes in the Role of the Shareholder" in Grantham and Rickett (eds.), *Corporate Personality in the 20th Century* (Hart, Oxford, 1998) Chapter 10.

[206] *Butt* v. *Kelson* [1952] Ch. 197 (C.A.). The Companies Act 1985 now creates rights to information; see, for example, sections 251 and 253.

[207] Thus, in the New Zealand statutory provisions which prohibit insider trading, enforcement is left up to shareholders, but shareholders' right of access to information is enhanced. See note 196 above.

not owned by natural persons is deeply threatening to both the individual and the state.

The heterodox nature of these suggestions, however, does not lie in the need for a wholesale revision of the content of the present law. In the course of the past century, as the influence of the ownership paradigm waned, those rules which were immutably tied to that paradigm were removed or altered, while in respect of those remaining the latent inconsistencies inherent in the historical basis of these powers being the ownership paradigm were ignored. The rejection of the ownership paradigm does, however, have radical implications for the legitimation of the corporate form. For much of this century the persistent idea that shareholders owned the company served this function. However, once it is accepted that this is not so, then the benign and hallowed notion of private property cannot perform this role. While the articulation of a new justification will occupy scholars well into the next century, the doctrinal bases of shareholder powers identified here suggests that any such justification will be found in the undoubted economic benefits which flow from the corporate form and the extent to which those benefits outweigh the social costs. The truly radical aspect of the "ownerless"[208] company is in the acceptance that those costs and benefits cannot be viewed through the single conceptual lens of ownership.

[208] Dan-Cohen, *Rights, Persons, and Organizations: A Legal Theory for Bureaucratic Society* (University of California Press, 1986) p. 21.