The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise

Simon Deakin[*]

Shareholder primacy, or the idea that corporate managers are agents of shareholders and should act exclusively in their financial interests, holds growing sway over the law and practice of corporate governance. The shareholder primacy model has its roots in economic theories which argue that it is efficient for shareholders to be constituted as the residual owners or claimants of the firm. The model is conceptually elegant and is effective in generating hypotheses for empirical testing, but it fails to describe certain core features of the legal structure of the business corporation—in particular, the autonomy granted to managers (via the board) to organize the business of the company free from immediate control by any one of the corporate constituencies or stakeholders (including shareholders) whose inputs are needed for the firm to thrive. The increasing alignment of managerial interests with those of shareholders, through corporate governance innovations such as share options and independent boards, created incentives for excessive risk-taking, and thereby helped to precipitate the global financial crisis that began in 2007. Partly as a result of growing evidence linking shareholder influence before the crisis with a higher failure rate of financial sector companies during the crisis, attention is now turning to alternative models of the firm.

One such model, the author suggests, is that of the corporation as commons: a shared resource whose sustainability depends on the participation of multiple constituencies in its governance (not just shareholders, but employees, core suppliers and customers). The idea of the commons better describes the legal structure of the business enterprise than does the shareholder primacy model: the firm's various stakeholders have overlapping property claims in relation to its assets, including rights of access, withdrawal, management, exclusion and alienation. Furthermore, as in a commons, the right of alienation is not the most salient right in a corporation. Applying to the corporation the property rights and institutional design associated with the commons would help sustain the corporate enterprise and deliver benefits for all of its stakeholders and for society as a whole.

---

* University of Cambridge (s.deakin@cbr.cam.ac.uk). This is a revised version of a paper originally presented as an Osler Lecture at the Faculty of Law, Queen's University, in September 2011. I am grateful for comments received on the occasion of the lecture.

Introduction

Over the course of the past quarter century or so, legal scholarship, initially, and judicial and legislative practice, increasingly, have looked to economic theory for models through which to understand the structure of the business enterprise and its relationship to the legal system. Developments in new institutional economics gave rise to the idea of the firm as a governance structure mitigating the effects of transaction costs within the process of production.[1] These concepts were then used to generate a "functional" theory of corporate law which promised to uncover the economic structure of the legal rules governing the firm.[2] This research project provided a toolkit

1. The modern economic literature on the theory of the firm begins with Ronald H Coase, "The Nature of the Firm" (1937) 4:16 Economica 386. The strand of new institutional economics which developed the theory of the firm as a transaction cost-minimizing device is best represented in a number of works by Oliver E Williamson, in particular *Markets and Hierarchies: Analysis and Antitrust Implications* (New York: Free Press, 1975); *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985) at ch 1, 3, 6, 12; *The Mechanisms of Governance* (Oxford: Oxford University Press, 1996) at ch 3–4, 6–7, 9. A valuable synthesis in the Coasean and Williamsonian tradition is that of Luigi Zingales, "Corporate Governance" in Peter Newman, ed, *The New Palgrave Dictionary of Economics and the Law* (New York: Stockton Press, 1998) 497.

2. The use of the term "functional" to describe the modern, economically informed theory of corporate law originates in the analysis of Henry Hansmann

through which researchers were able to operationalize the study of corporate law "in action", generating a wealth of new empirical insights. It also supplied a set of normative principles, derived from economic notions of efficiency, for evaluating the wealth and welfare effects of corporate law rules and doctrines. By the turn of the millennium, corporate law scholarship had reached a consensus on both fronts: analyses predicted the global convergence of corporate law and practice around the norm of shareholder primacy, in large part because of the efficiency gains then widely associated with shareholder-oriented corporate governance.[3]

A decade on, this prediction looks unlikely to be fulfilled, not simply because of the widely reported resistance of national systems to convergence of corporate governance rules and practices,[4] but also as a consequence of the global financial crisis and the reaction to it. Emerging empirical research suggests that evidence of a link between shareholder-oriented corporate governance and bank failure is more than just circumstantial: banking and financial sector firms characterized by a higher degree of shareholder influence over managerial decision making (as indicated by a more prominent role for independent directors

---

& Reinier Kraakman, "What is Corporate Law?" in Reiner Kraakman et al, eds, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford: Oxford University Press, 2004) 5. In a later edition, their analysis has been updated and extended in collaboration with John Armour in the introductory chapter. See John Armour, Henry Hansmann & Reinier Kraakman, "What is Corporate Law?" in Reiner Kraakman et al, eds, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 2d ed (Oxford: Oxford University Press, 2009). Subsequent references are to the later version. Antecedents of the "functional" approach, although not termed such, are to be found in the seminal (if much contested) work of Frank H Easterbrook & Daniel R Fischel, *The Economic Structure of Corporate Law* (Cambridge, Mass: Harvard University Press, 1991).

3. Henry Hansmann & Reinier Kraakman, "The End of History for Corporate Law" (2001) 89:2 Geo LJ 439 [Hansmaan & Kraakman, "End of History"].

4. For a recent overview of the empirical corporate governance literature which stresses the diversity of practice revealed by research in economics, organization studies and related fields, see Ruth V Aguilera & Gregory Jackson, "Comparative and International Corporate Governance" (2010) 4:1 The Academy of Management Annals 485.

on boards, greater use of share options in executive remuneration, and greater exposure to the effects of hostile takeovers as either bidders or targets), were more exposed to risk in the run-up to the crisis and more likely to fail during it.[5] The crisis has amply fulfilled the fears of those who warned that "precisely because corporate law goads directors to create wealth for their stockholders, and gives stockholders increasingly potent tools to hold directors accountable for failing to produce profits, it creates a stimulus for risk-taking up to the bounds of positive law", and who predicted that "[i]f those bounds are too loose, risk-taking can get out of hand, causing the potential for firm failure".[6]

5. On board independence, executive pay and CEO incentives, see Andrea Beltratti & Rene M Stulz, "Why Did Some Banks Perform Better During the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation", *Fisher College of Business Working Paper No 2009-03-012*, online: Social Science Research Network <http://ssrn.com> ("banks with more shareholder-friendly boards performed worse during [the crisis]" at 21); David H Erkens, Mingyi Hung & Pedro Matos, "Corporate Governance in the 2007–2008 Financial Crisis: Evidence from Financial Institutions Worldwide" (2012) 18:2 Journal of Corporate Finance 389 ("firms with more independent boards and higher institutional ownership experienced worse stock returns during the crisis period" at 389); Rūdiger Fahlenbrach & Rene M Stulz, "Bank CEO Incentives and the Credit Crisis", *Fisher College of Business Working Paper 2009-03-013*, online: Social Science Research Network <http://ssrn.com> ("there is no evidence that banks with CEOs whose incentives were less well aligned with the interests of their shareholders performed worse during the crisis" at 25); Peter O Mūlbert, *Corporate Governance of Banks after the Financial Crisis – Theory, Evidence, Reforms*, European Corporate Governance Institute Law Working Paper No 130/2009 at 8–9, online: Social Science Research Network <http://ssrn.com> (including a summary of recent findings that poor corporate governance of banks was an important cause of the financial crisis). On the role of hostile takeovers in triggering bank collapses, see UK, Financial Services Authority, *The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report* (London, UK: Financial Services Authority, 2011) online: <http://www.fsa.gov.uk> [FSA, *Royal Bank of Scotland*] ("it is clear that the acquisition [of ABN AMRO] undoubtedly contributed significantly to RBS's vulnerability . . . [the RBS board's] decision to make a bid of this scale on the basis of limited due diligence entailed a degree of risk-taking that can reasonably be criticised as a gamble" at 160).

6. Leo E Strine Jr, "The Role of Delaware in the American Corporate Governance System, and Some Preliminary Musings on the Meltdown's Implications for Corporate Law" (Lecture delivered at the Molengraaff Institute

Under these circumstances, as the effects of the crisis play out, alternative models of corporate governance are being considered which are capable of addressing the need for more sustainable forms of enterprise. While the search for alternatives need not imply a turning away from economics or the social sciences more generally as sources of insights for legal research and policy analysis, it does necessitate a reconsideration of the dominant legal-economic theory of the corporation of recent decades—that is, the shareholder primacy model.

This paper is intended as a contribution to that process. Its central argument is that a more realistic model of corporate law is needed—one which is consistent with the multiple functions that business firms and the laws constituting and regulating them play in a market economy. The "functional" theory of corporate law which is derived from transaction cost economics takes us only part of the way. Part I below considers the importance of model building for both positive and normative analysis, and argues that empirical grounding is more important than elegance in a model. Part II outlines the elements of a "juridical" model of the firm which extrapolates from what is known empirically about the ways in which legal systems define and conceptualize the business enterprise. Part III takes the argument to a further stage by putting forward the idea of the corporation as a *commons*—a resource whose sustainability depends on the participation of multiple corporate constituencies in the formulation of the rules governing it. The Conclusion follows.

I. Model Building and the Theory of the Firm in Economics and Law

Current company law is heavily influenced by the "theory-driven" shareholder primacy model of the firm. This part will explain the flaws of this model and their implications, and will argue that a "data-driven" model would provide a sounder basis for formulating corporate law.

---

for Private Law, Utrecht University, 13 December 2008) at 2 [unpublished, on file with the author].

The method of "law and economics", or "economic analysis of law" as it was originally and perhaps more accurately known,[7] is to describe legal phenomena using economic-theoretical terms such as transaction costs, externalities, welfare and efficiency. The approach is reductive, abstracting from the dense linguistic and behavioural textures of legal forms and processes, in order to throw light on the economic structure which undergirds legal rules. From this perspective, the terms used by the legal system to describe juridical relations do not necessarily give a good account of the functions of legal rules. Legal concepts, beginning for present purposes with the notion of the "corporation" itself, are "fictions" which are liable to conceal the true nature of the forces at work. If the "private corporation or firm is simply one form of legal fiction which serves as a nexus for contracting relationships",[8] it is a short step to describe the shareholder-manager relationship as one between "principals and agents", and the structure of the firm as deriving from "an agency conflict between the owner-manager and outside shareholders".[9] Almost the entirety of the modern economics-inspired tradition of corporate law scholarship is derived from this methodological move, which is so generally accepted as to be almost taken for granted. This is, however, a research strategy which comes at a cost, whatever its advantages in terms of simplification and clarification may be.

Part of the cost becomes clear when we consider an alternative approach. This would involve inverting the focus of analysis and asking how the legal system views the economic phenomenon of the business firm. From this angle, corporate law appears as more than just a functional response to the "agency conflict" which is said to be inherent in shareholder-manager relations. Company law represents a kind of crystallization or "summary

7. The source of what became the law and economics movement clearly remains. See Richard A Posner, *Economic Analysis of Law* (Boston: Little, Brown and Company, 1972).

8. Michael C Jensen & William H Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3:4 Journal of Financial Economics 305 at 311.

9. *Ibid* at 313.

representation" of solutions to collective action problems arising in the context of the business enterprise, and which have been incorporated over time into the discourse of the legal system.[10] From this point of view, company law regimes are complex emergent phenomena, which have co-evolved alongside the emergence of firms and markets in industrial societies.[11] They have both shaped and been shaped by the long-run processes of economic and technological development associated with industrialization.[12] The aim of economically-informed corporate law scholarship should be to explain the multiple functions that company law concepts perform, both within national systems and in a comparative and global perspective.[13] When corporate law is viewed from this kind of historical and comparative perspective, what becomes clear is the great variety of solutions to

10 . See Masahiko Aoki, *Corporations in Evolving Diversity: Cognition, Governance, and Institutions* (Oxford: Oxford University Press, 2010).

11. See Simon Deakin & Fabio Carvalho, "System and Evolution in Corporate Governance" in Peer Zumbansen & Gralf-Peter Calliess, eds, *Law, Economics and Evolutionary Theory* (Cheltenham, UK: Edward Elgar, 2011) 111.

12 . See Beth Ahlering & Simon Deakin, "Labor Regulation, Corporate Governance and Legal Origin: A Case of Institutional Complementarity?" (2007) 41:4 Law & Soc'y Rev 865.

13. This paper will make an argument, then, for a more complete but still economically-informed theory of corporate law. The argument is not that we should turn away from the insights of economics and other social sciences. While it will be suggested that economic theories have paid insufficient attention to legal language and discourse, this does not imply that a focus on legal language to the exclusion of economic insights is required. Nor is the argument presented here one for reviving past so-called juristic theories of the corporation, such as the "state concession" theory, the "shareholder collective" theory or the "real entity" theory. Although these theories have considerable historical interest and the normative claims they make still speak to us today, in methodological terms they have been overtaken by the insights of functional or economic analysis, and little would be gained from making them once again the focus of debate. On this point, see Jean-Philippe Robé, "The Legal Structure of the Firm" (2011) 1:1 Accounting, Economics, and Law, Article 5 at 11–13; William W Bratton, "The New Economic Theory of the Firm: Critical Perspectives from History" (1989) 41:6 Stan L Rev 1471; William W Bratton, "Reuven Avi-Yonah's 'Citizens United and the Corporate Form': Still Unuseful" (2011) 1:3 Accounting, Economics, and Law, Article 3 (discussing Reuven S Avi-Yonah, "Citizens United and the Corporate Form" (2011) 1:3 Accounting, Economics, and Law, Article 1).

coordination problems which have emerged in different contexts and at particular points in the evolution of the corporate form.

Taking due account of the empirical diversity of corporate law systems need not lead to an abandonment of model building. There is, however, a distinction to be drawn between different approaches to the construction of models. In this context, a *data-driven* approach to the modeling of the corporation can be contrasted with the *theory-driven* approaches associated with the principal-agent model[14] and its variants, including the property rights theory of the firm.[15] These models have been prized for their mathematical elegance and for the precision and rigour they are said to have brought to the identification of hypotheses for empirical testing. They are, however, unable to account for some of the most basic features of the legal structure of the firm.

In theory-driven approaches, a model is constructed using fundamental axioms, such as the axioms of rationality and equilibrium (which underpin, in one form or another, much of modern economic analysis). These axioms generate hypotheses which are then subjected to empirical testing. Even when certain claims are refuted or questioned through empirical research, the fundamental axioms tend to remain intact until such time as a better theory is formulated. In this approach, the value of a model is determined not by how well it captures elements of the empirical reality revealed by analysis of data, but by its usefulness in generating falsifiable claims.[16] The problem with theory-driven

14. See Jensen & Meckling, *supra* note 8.

15. See Oliver M Hart, *Firms, Contracts and Financial Structure* (Oxford: Oxford University Press, 1995).

16. On the irrelevance (according to the theory-driven view) of claims that the assumptions used in economic models should be "realistic", see the canonical interpretation of positivist economic theory of Milton Friedman, *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953) (it is "fundamentally wrong" to suppose that "the conformity of [a model's] 'assumptions' to 'reality' is a test of the validity of the hypothesis *different from* or *additional to* the test by implications"—that is, by reference to the empirical testing of predictions, with the result that "a hypothesis must be descriptively false in its assumptions" at 14). On the related idea that empirical refutation of aspects of a theory is insufficient in itself to cast doubt on that theory until a better one can be formulated, see George J Stigler, "The Process and Progress of Economics" in Karl-Gōran Māler, ed, *Nobel Lectures: Economic Sciences, 1981–*

approaches, however, is that they "will, almost by construction, be less open to signals in the data suggesting the theory is incorrect or in need of modification and will, therefore, run the risk of producing empirically irrelevant and misleading results".[17]

A data-driven approach, while not abandoning theory or the need for modeling, seeks to build a theoretical model on the basis of phenomena which have been validated by a body of empirical observation. The model is tested and periodically updated by reference to what can be determined, empirically, about the phenomena that the model is attempting to capture. In the context of econometric modeling, data-driven approaches seek to allow "the data to speak as freely as possible about empirical regularities" in order "to avoid constraining the data from the outset in a theoretically pre-specified direction, as it then would be impossible to distinguish between results that are due to the assumptions made and results that are genuine empirical facts".[18] The models used in law and economics research are verbal formulations more akin to ideal types than to the mathematical expressions used in econometrics or in formal economic theory, but the same point applies: models, precisely because they provide a focus for empirical research, should direct that research in ways which reflect the nature of the phenomena being studied, and in particular should be able to accommodate diversity of observed forms.

A legal-economic model of the firm should accommodate, as far as possible, what is known empirically of the way legal

---

1990 (Singapore: World Scientific Publishing, 1992) 57, (referring to "that fundamental rule of scientific combat: it takes a theory to beat a theory" at 67).

17. Katerina Juselius, "Time to Reject the Privileging of Economic Theory Over Empirical Evidence? A Reply to Lawson" (2011) 35 Cambridge Journal of Economics 423 at 425. See also David Colander et al, "The Financial Crisis and the Systemic Failure of the Economics Profession" (2009) 21:2–3 Critical Review 249 ("[o]ver the past three decades, most economists have developed and come to rely on models that disregard key factors—including the heterogeneity of decision rules, revisions of forecasting strategies, and changes in the social context—that drive outcomes in asset and other markets" at 250). See also these authors' suggestion that "[t]he failure of economists to anticipate and model the financial crisis has deep methodological roots". *Ibid* at 251.

18. Juselius, *supra* note 17 at 426.

systems constitute and regulate the business enterprise. This means taking seriously the language used by the law to describe the firm, starting with and moving out from the legal concept of the "corporation". It also implies that model building should engage with empirical research on company law rules as they operate at the level of corporate practice. A working hypothesis drawn from a growing body of empirically-informed theoretical research would be that the legal form of the business enterprise matters. This research has shown that because business firms in market economies operate largely through the legal form we know as the corporation, legal discourse and process shape the way enterprises operate.[19] Corporate law is not trivial,[20] in that it does not merely set a series of default rules on the basis of which, or around which, parties can contract, or a series of mandatory rules to which they would anyway agree. The rules of corporate law, both default and mandatory, operate as focal points that shape equilibrium outcomes in the context of the interactions of different agents making inputs for the process of production.[21]

A data-driven model of corporate law is also needed in order to better inform policy in the area of corporate governance and regulation. Legal-economic models do not just shape empirical research; they also influence normative judgments on the content of legal rules. At the height of its influence during the 2000s, the shareholder-oriented theory of the corporation was advanced on the ground that it was theoretically the most coherent model available. It was claimed that alternatives such as stakeholder theory did not offer a similarly robust account of how

19. See Robé, *supra* note 13.

20. On the "triviality hypothesis", see Bernard S Black, "Is Corporate Law Trivial? A Political and Economic Analysis" (1990) 84:2 Nw UL Rev 542.

21. See Aoki, *supra* note 10 at 13 (developing the idea that laws and regulations serve as focal points for societal coordination); Aoki describes legal and other institutions as "commonly-cognized patterns by which the societal games are being recursively played and are expected to be played". *Ibid* at 69. See more generally the analysis of legal and economic coevolution set out in Deakin & Carvalho, *supra* note 11.

corporations actually worked.[22] This argument from theoretical coherence generated two further, closely related but separate claims: an empirical argument to the effect that shareholder-oriented firms would displace others over time because they were inherently more efficient,[23] and a normative claim that company law reform should reflect the principle of shareholder primacy in order to enhance efficiency and hence improve aggregate economic welfare.[24] But what if the model of shareholder primacy, while formally coherent and conceptually elegant, was empirically mistaken? If the model was defective in its account of the legal structure of the business enterprise, it is likely to have generated normative arguments at odds with the functions that corporations are capable of performing.[25] Consistent with this view is the evidence that the global financial crisis may have been triggered and was at the very least exacerbated by the increasing alignment of managerial behaviour and incentives with shareholder interests

22. See Michael C Jensen, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function" (2010) 22:1 Journal of Applied Corporate Finance 32.

23. See Hansmann & Kraakman, "End of History" *supra* note 3 ("firms organized and operated according to the standard shareholder-oriented model . . . can be expected to have important competitive advantages over firms adhering more closely to other models" at 450). For an earlier influential formulation of the same idea, see Eugene F Fama & Michael C Jensen, "Separation of Ownership and Control" (1983) 26:2 JL & Econ 301 ("[c]ontracts that direct decisions towards the interests of residual claimants . . . add to the survival value of organizations" at 303; note that "residual claimants" in this context refers to shareholders).

24. See generally Lucian A Bebchuk, "The Case for Increasing Shareholder Power" (2005) 118:3 Harv L Rev 833. It is surely no surprise that positive and normative accounts of the corporation should have influenced each other in this way. As Milton Friedman noted, "[t]he conclusions of positive economics seem to be, and are, immediately relevant to important normative problems, to questions of what ought to be done and how any given goal can be attained", because "[a]ny policy conclusion necessarily rests on a prediction about the consequences of doing one thing rather than another, a prediction that must be based—implicitly or explicitly—on positive economics" (Friedman, *supra* note 16 at 4–5).

25. See Aoki, *supra* note 10 at 181 (developing the claim that arguments for shareholder value and financial deregulation during the 1990s and 2000s did not reflect the need for long-term investment in the cognitive assets of business firms).

during the course of the 1990s and 2000s.[26] This alignment was due, in no small part, to the influence achieved by the principal-agent model of the corporation.[27]

II. The Nature of the Firm: A Juridical Perspective

A. Distinguishing between the "Firm" and the "Corporation"

In developing an alternative, legally-informed model of the firm, a first step is to draw a clear distinction between the economic phenomenon of the business "firm" or "enterprise" and the legal concept of the "corporation". The firm may be defined as an organization engaged in the production of goods or services, to which end it combines physical, human and virtual assets. The business enterprise, understood as a particular type of organization or firm, is more or less successful according to how far it can realize a surplus from this process. The task of combining the different inputs which go into the production process rests with the specialized agency within the firm that we know as "management". When the task of management is performed effectively, the firm is able to meet its contractual commitments to the original owners of the assets it puts to use (investors, creditors, workers), and retain the surplus or reinvest it with a view to the firm's future development. What separates the enterprise from an individual producer or trader is, above all, its organizational capacity—that is, the power to undertake tasks requiring the combination of complex physical and cognitive resources.[28] This capacity means that the activities of the firm are

26. See the works cited at *supra* note 5.

27. See generally Frank Jan De Graaf & Cynthia A Williams, "The Intellectual Foundations of the Global Financial Crisis: Analysis and Proposals for Reform", in Peer Zumbansen & Cynthia A Williams, eds, *The Embedded Firm: Corporate Governance, Labour, Finance Capitalism* (Cambridge, UK: Cambridge University Press, 2011) 383.

28. See Aoki, *supra* note 10 at 5–6. Aoki refers to corporations as systems of associational cognition which "can cognize and store what a mere collection of individuals cannot". *Ibid* at 5. See also the use of the term "organizational

likely to affect third parties, both positively and negatively, to a greater extent than the activities of an individual agent, or a group of agents acting collectively but without the organizational umbrella of the firm. On the other hand, the firm's organizational capacity also means that it can absorb, control and diffuse the risks of harm to third parties (negative externalities) more effectively than any single individual or group of individuals.[29]

Although the corporation can be defined from an economic perspective as an association of natural persons engaged in joint or concerted activity within a framework of commonly accepted norms or rules of conduct,[30] the term "corporation" will be used

---

capability" to describe the economic capacity of the business enterprise in Alfred D Chandler, "Organizational Capabilities and the Economic History of the Industrial Enterprise" (1992) 6:3 J Econ Persp 79, and, in the context of an analysis of the role played by company law in underpinning the enterprise. See Margaret M Blair, "Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century" (2003) 51:2 UCLA L Rev 387 at 393.

29. On the idea that the business enterprise is, on the one hand, more likely than individuals, acting singly or together, to displace uncontracted for harms on to third parties ("negative externalities") but is conversely better able than individuals to manage, absorb and diffuse the risks of such harms, see Simon Deakin, "'Enterprise-Risk': The Juridical Nature the Firm Revisited" (2003) 32:2 Indus LJ 97 [Deakin, "Enterprise-Risk"].

30. See Aoki, *supra* note 10 (who defines corporations as "voluntary, permanent associations of natural persons engaged in some purposeful associative activities, having unique identity, and embodied in rule-based, self-governing organizations" at 4). This definition is important in stressing the rule-bound and associative character of the "corporation" as the social or economic entity within which the organizational structure of the "firm" is embedded. Aoki argues that legal features of the corporation, such as separate personality and limited liability, are "substantive representations of the 'unique identity' and 'self-organizing' dimensions of the corporation". *Ibid* at 9. This is not inconsistent with the claim made here—that company law makes a difference to how business firms are organized—because, as already noted, legal rules both reflect or "represent" practice and also shape it by framing the equilibrium selections made by the parties. See references at *supra* note 20. For the purposes of the discussion in the text it is helpful to isolate the legal form of the corporation from its economic or social form, and to avoid unnecessary confusion, to reserve the term "corporation" (as far as possible) for its specific legal use, while recognizing that,

here in a more institutionally specific sense to denote the legal mechanism, or set of mechanisms, which describes and underpins the economic entity of the "firm". The corporation is first and foremost a legal mechanism, and the principal legal-institutional device through which business firms operate in contemporary market economies.[31] To put the issue this way is to pose as a working hypothesis, open to empirical observation, that the nature and extent of economic activity in those economies is shaped by the existence of the corporation as a legal form which is available for business parties to use.

The first task of the "corporation" is to ascribe legal personality to the firm. This gives the firm a form of legal capacity that underpins its economic or organizational capacity. The corporation can hold property, make contracts and so on, in much the same way that a natural person can. But because these features of legal capacity are now associated with a particular organizational form, the firm (as the corporation) can undertake activities on a scale and over a period of time that is beyond the capacity of an individual actor or of a number of individuals

---

as Aoki argues, the corporation has a social and economic identity as well as a legal one.

31. See Robé, *supra* note 13 at 3:

> The firm and the corporation are very often confused in the literature on the theory of the firm. The two words are often used as synonyms. They correspond, however, to totally different concepts: a corporation is a legal instrument, with a separate legal personality, which is used to legally structure the firm; a firm is an organized economic activity, corporations being used to legally structure most firms of some significance.

In light of Aoki's analysis (see *supra* note 10), we might add that the "structuring" role of corporate law is performed not just by the law but also by the social norms and routines which Aoki identifies as inherent in the wider economic institution of the "corporation". The answer to the question of whether the corporation should be thought of primarily as a legal or an economic notion is context-dependent and also turns on the broader consideration of a set of issues concerning the ontological status of legal rules and the nature of their relationship to social and economic structure. A full treatment of these issues is beyond the scope of this article, but they are discussed in Deakin & Carvalho, *supra* note 11, and in Simon Deakin, "Legal Evolution: Integrating Economic and Systemic Approaches" (2011) 7:3 Review of Law and Economics 659.

linked together solely by contract. Thus, the "permanence" of the corporation facilitates and underpins the organizational continuity of the firm. One aspect of this is the *entity shielding* which flows from separate legal personality; the firm's assets are protected against legal claims made by creditors of its principal suppliers of inputs, whether they be investors, banks, commercial contractors or workers.[32] The separation of the firm's legal identity from those of its members at any given time has the further effect of maintaining the *continuity* of its asset base, and this in turn enables the suppliers of inputs to make credible commitments over an extended time.[33]

Separate legal personality, because it facilitates the partitioning and continuity of assets, is the starting point for all of the various forms of corporation or company recognized as such by legal systems, including not just companies limited by share capital but also by partnerships (where they operate with separate personality, as they increasingly do), cooperatives of workers, customer-owned mutuals, companies limited by guarantee and similar public-interest corporations, and charities or non-profits.[34] Many of these forms do not have a strong association with the business enterprise. Those which do—companies limited by share

---

32. See Henry Hansmann & Reinier Kraakman, "The Essential Role of Organizational Law" (2000) 110:3 Yale LJ 387 [Hansmann & Kraakman, "Essential Role"]. The historical origins of asset partitioning rules are analyzed in Henry Hansmann, Reinier Kraakman & Richard Squire, "Law and the Rise of the Firm" (2006) 119:5 Harv L Rev 1333. Those authors argue that the benefits of entity shielding (which include reduced creditor monitoring costs, more efficient bankruptcy administration and protection of the going concern value of the firm) generally outweigh its costs, which include a risk of debtor opportunism, and that (importantly for the present argument) these benefits cannot efficiently be supplied by contract alone; they require a form of "entity law" which creates a distinct property rights regime for the firm, binding on third parties. *Ibid* at 1343. Although elements of "entity shielding" were historically provided by the law merchant and by the partnership form, the emergence of "free" incorporation in England and the United States in the course of the nineteenth century enhanced the effectiveness of asset partitioning rules. *Ibid* at 1386, 88 ff.

33. Robé, *supra* note 13 at 18 (referring to the transaction-cost minimizing effects of separate personality) and at 25 (discussing entity shielding).

34. See generally Henry Hansmann, *The Ownership of Enterprise* (Cambridge, Mass: Belknap Press of the Harvard University Press, 1996).

capital, of which joint stock companies with diffuse shareholder ownership are one variant—possess additional features which correspond to the functional needs of private sector business firms: delegated management under the board, limited liability for shareholders and transferable shares. It is thanks to the functional theory of corporate law that we can see these various legal rules and principles as complementary aspects of an enterprise model based on a division of labour between investors and managers, the specialization of the management function, and the diversification of shareholder ownership across companies whose shares and other securities are publicly traded.[35]

While we would not have got as far as we have in understanding the legal structure of the business enterprise without the contribution of the functional theory of corporate law, we might ask whether this theory goes far enough in its recognition of the importance of the law for the structuring of business. The multiple functions of the corporate form are such that it is implausible to think of the corporation as a legal fiction. The corporation is first and foremost a legal device or mechanism, which should not be confused with the organizational structures that it comprises.[36] However, it is no more a fiction to assign legal personality to those organizational structures than it is to grant it to natural persons. "Capacity" is not a natural concept but an institutional one, through which the law constructs its own notions of economic agency.[37] Legal capacity is not conferred equally on all natural persons; until the middle of the nineteenth century, many European legal systems denied full capacity to some adults, in particular to married women, and such capacity continues to be restricted today for minors and those deemed incapable of acting in their own best interests. In the course of the eighteenth and nineteenth centuries, the law adjusted to the idea of universal citizenship by extending

35. See Armour, Hansmann & Kraakman, *supra* note 2 at 4–16.

36. See Robé, *supra* note 13 at 13.

37. See generally Simon Deakin, "*Capacitas*: Contract Law, Capabilities and the Legal Foundations of the Market" in Simon Deakin & Alain Supiot, eds, *Capacitas: Contract Law and the Institutional Preconditions of a Market Economy* (Portland, Or: Hart, 2009) 1 [Deakin, "*Capacitas*"].

contractual capacity to all individuals with only a few exceptions, including stopping short of conferring it on private organizations; as Savigny put it, it was not just "every single human being" who enjoyed capacity, but "only the single human being".[38] Legal capacity had already been recognized for the state and for quasi-public structures such as churches and universities, but the granting of it to private business enterprises was a controversial and contested step.[39] While it is unclear whether the extent of industrial development was affected by the timing of legal reforms which saw the adoption of rules of free incorporation in western Europe and North America, there is evidence to suggest that the nature of industrialization was affected by the scale and pace of legal reforms in different countries at the time.[40]

If we take the view, as a working hypothesis, that the law actively shapes the operation of business firms within the economy rather than simply responding to their existence, it becomes necessary to specify more precisely how that is done. In this context, it is a misleading strategy to treat the law as a "fiction" which conceals "real" relationships of a fundamentally different kind than those implied by the law's account of juridical relations. This point goes to the most fundamental feature of the shareholder-oriented model of the firm, namely its account of ownership rights and the related division of shareholders and managers into "principals" and "agents".

B. Ownership Within and of the Firm

From a legal perspective, shareholders own neither the "firm" nor the "corporation" nor its assets. The "firm", understood as the organizational structure corresponding to the enterprise in an economic or social sense, is not an entity recognized as such by

38. Alain Wijffels, "Rationalisation and Derationalisation of Legal Capacity in Historical Perspective: Some General Caveats" in Deakin & Supiot, *supra* note 37 at 60, quoting Friedrich Carl von Savigny.
39. See Robé, *supra* note 13 ("[e]ven for lawyers, perceived as being prone to live in a world of fiction, accepting the idea that there can be legal persons who are not individuals has been a lengthy and painful process" at 12).
40. See Ahlering & Deakin, *supra* note 12 at 892–99.

the legal system.[41] The totality of relations which make up the firm cannot, as such, be the subject of an ownership claim. The *assets* of the firm (including physical capital, intellectual property and more loosely defined business goodwill) can be owned as property, but not by the shareholders; they vest in the separate legal person of the "corporation".[42] The corporation, in turn, cannot be owned as a "thing" precisely because (juridically speaking) it is a person—a legal subject—in its own right.[43]

Shareholders have many rights, ranging from voice and voting rights to rights in relation to distributions, which stem from the property they have in their *shares*. However, none of these rights either derives from or confers a right to property in the firm itself or its assets, nor do any property claims which shareholders might have give them a right to manage the assets of the firm. Ownership of a share does not confer the right to a pro-rata portion of the corporation's assets while it is a going concern.[44] If

41. See Robé, *supra* note 13 ("the corporation is recognized by the legal system as being a juridical person having rights and liabilities; the firm is an economic organization which is not a juridical person and is structured using several legal institutions" at 5).

42. *Ibid* ("[w]hat shareholders own are shares issued by the corporation; and the corporation owns the assets" at 27).

43. See Katsuhito Iwai, "Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance" (1999) 47:4 Am J Comp L 583 ("the shareholders own the corporation as a legal thing and the corporation as a legal person in turn owns the corporate assets" at 585). But as Jean-Phillipe Robé suggests, the more generally accepted view, among company lawyers, is that "[t]he corporation is a juridical person in its own right rather than a mere asset or a bundle of assets". *Supra* note 13 at 28, citing American Bar Association, *Report of the Task Force of the ABA Section of Business Law Corporate Governance Committee on Delineation of Governance Roles & Responsibilities* (1 August 2009) at 5, online: American Bar Association <http://www.americanbar.org> [American Bar Association, *Task Force Report*].

44. See Robé, *supra* note 13 at 28–29; Paddy Ireland, "Company Law and the Myth of Shareholder Ownership" (1999) 62:1 Mod L Rev 32 at 49 [Ireland, "Company Law"]. Historically, the position may have been different, but pro-rata ownership was a feature of unincorporated associations operating without the benefit of legal institutions, including separate personality and limited liability, which underpin the modern form, and protect enterprise assets from depletion by the shareholders. See Paddy Ireland, "Capitalism Without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern

the company makes a distribution through a dividend or share buy-back, the shareholders are entitled to be treated fairly in the context of that distribution, which generally implies that it be on a pro-rata basis. However, virtually all national company law systems give the board discretion over the size and regularity of dividend payments, which may amount to a discretion not to make them at all.[45] The idea that the surplus should be returned to the shareholders on a regular basis owes little or nothing to the legal framework of company law. It owes much more to late twentieth century finance theory, which argued that companies should distribute "free cash flow" to shareholders in order to promote capital efficiency,[46] and to the practice of listed companies in some countries (most notably the USA and UK from the early 1980s onwards), of rewarding shareholders through increased dividend payments, and in particular through share buy-backs.[47] The prevalence of such buy-backs is a recent development; as late as the 1980s they were unlawful in many jurisdictions, or at least highly restricted, on the ground that they were contrary to the principle of the maintenance of capital.[48] Nineteenth century company law was clearer on this point, maintaining that the shareholders were locked into an indeterminate relationship with the firm and could not get their capital back on demand, a view which favoured long-term investment and the growth of industrial enterprise.[49]

Doctrine of Separate Corporate Personality" (1996) 17:1 J Legal Hist 41 [Ireland, "Capitalism"]; Blair, *supra* note 28 at 414–23.

45. See e.g. American Bar Association, *Task Force Report*, *supra* note 43 at 6; Robé, *supra* note 13 at 27.

46. See generally Jensen & Meckling, *supra* note 8.

47. A share "buy-back" or "repurchase" occurs where a company repurchases shares from its own shareholders, "retiring" the share capital in return for a cash disbursement to the members. For an early analysis of this trend and an explanation of its logic, see Laurie S Bagwell & John B Shoven, "Cash Distributions to Shareholders" (1989) 3:3 J Econ Persp 129.

48. See the movement in the case of English law, for example, from the nineteenth century prohibition in *Trevor v Whitworth* (1887), [1886–90] All ER 46, 12 App Cas 409 HL, to a more relaxed regime, culminating in the provisions currently in force in the *Companies Act 2006* (UK), c 46, s 18.

49. See Blair, *supra* note 28 (the author writes that regarding the US case, shareholder lock-in "made it possible to build lasting institutions. Investments

Nor do the shareholders have an unqualified right to a pro-rata distribution on the liquidation of the company. Where the company is insolvent, the shareholders stand last in line after all the creditors. They may share proportionally in what is left after the creditors have been satisfied and the costs of the insolvency met, but this is by definition not a claim with much, if any, substance to it in the vast majority of involuntary insolvencies. So-called "corporate rescue" laws, which permit a company to enter into bankruptcy or administration as a defensive response to the threat of a creditor-initiated breakup, generally do so not with the aim or effect of protecting shareholder equity. Rather, their purpose is to make it possible for the enterprise to survive as a going concern, often with a new corporate identity—an outcome which tends to benefit managers and employees more than the shareholders as such.[50] While it is possible in most jurisdictions to wind up a solvent company and return the assets to the shareholders,[51] to cease trading in this way may give rise to liabilities to third parties because of the ongoing and overlapping nature of the firm's business commitments, with the result that shareholders' rights may therefore be qualified by steps taken by the liquidator of a solvent company to protect these third party claims.[52] A takeover bid or agreed merger by share purchase may provide the occasion for the shareholders to (in effect) remove capital from the firm, and to adjust their relationship with the other corporate constituencies to the detriment of those constituencies. This is especially where the change of ownership

could be made in long-lived and specialized physical assets, in information and control systems, in specialized knowledge and routines, and in reputation and relationships, all of which could be sustained even as individual participants in the enterprise came and went" at 454).

50. On the interplay of shareholder, creditor and employee interests in the context of "corporate rescue laws", see John Armour & Simon Deakin, "Insolvency and Employment Protection: The Mixed Effects of the Acquired Rights Directive" (2002) 22:4 Int'l Rev L & Econ 443; Sandra Frisby, "Insolvency Law and Insolvency Practice: Principles and Pragmatism Diverge?" (2011) 64:1 Curr Legal Probs 349.

51. For example, the members' voluntary liquidation procedure in the *Insolvency Act 1986* (UK), c 45, ss 89–90.

52. *Ibid*, s 165.

excludes the latter from continued access to physical assets which are complementary to firm-specific skills or know-how. Here, however, there are limits to shareholder influence which reflect the explicit and implicit contractual claims of employees and creditors; many jurisdictions allow companies to tie their own hands in responding to takeover bids, through the adoption of "poison pills" and other anti-takeover defences which qualify shareholder claims.[53]

The description of the shareholders as the "principals" cannot, therefore, be based on how company law actually describes their ownership claims. Nor can it be derived from their rights to manage the company's assets, which are close to zero. This is the effect of the principle of "delegated management": the power to manage the business of the company is almost invariably vested in the board, which in turn delegates some of those powers to the officers and employees of the company.[54] Shareholders have rights (which in some jurisdictions can be heavily qualified by company bylaws or articles of association) to remove the members of the board and replace them with new directors, but this is not the same thing as the right to intervene directly in management decisions, and even a majority shareholder does not have a direct right of control in this sense.[55] Through law or contract, depending on context, shareholders may have the right to be consulted about and vote on major corporate transactions,[56]

53. For a comparative overview, see Simon Deakin & Ajit Singh, "The Stock Market, the Market for Corporate Control and the Theory of the Firm: Legal and Economic Perspectives and Implications for Public Policy" in Per-Olof Bjuggren & Dennis C Mueller, eds, *The Modern Firm, Corporate Governance and Investment* (Cheltenham, UK: Edward Elgar, 2009) 185.

54. See Armour, Hansmann & Kraakman, *supra* note 2 at 12–14.

55. See Robé, *supra* note 13 ("[t]he board of directors, even if it can be changed by the . . . majority shareholders, is still under [a] duty to manage the corporate assets in the corporation's interest" at 27, n 70, the interest of the company not being synonymous with those of the shareholders (on which, see further, below)).

56. For example, the *Financial Services Authority United Kingdom Listing Rules*, Listing Rule 10.5, online: Financial Services Authority <http://www.fsa.gov.uk/handbook> requires shareholder approval for Class 1 transactions representing a certain proportion of the company's assets.

but this is generally a blocking power rather than a right to direct how a given asset will be deployed.

The founding writings on the agency-theoretical model of the firm[57] and its legal applications[58] were careful not to claim that shareholders were the owners of either the firm or the corporation. These authors correctly noted that it was shareholders' residual claimant status—their exposure to risk of the firm's non-performance—which explained, in a functional sense, the voice and voting rights which they held to the exclusion of all other corporate constituencies. Nevertheless, the authors insisted on characterizing shareholders as the principals and the managers as their agents. From a legal point of view, *this really was a fiction*: company law views the directors as the agents of the company, not of the shareholders.[59] Of course, if the company were simply a "fiction" around which a nexus of contracts was constructed, it would make no sense to talk of the corporation as an entity to which duties can be owed. However, the mechanism (not "fiction") of corporate personality has a number of functions beyond serving as the central point for a nexus of contracts. One of those functions, in this context, is to insulate the board (and through the board, the company's management) from direct shareholder pressure.

This can be seen in the way company law systems frame directors' duties. In the civil law world, directors' duties are described in terms of an obligation to pursue the "company interest", which is conventionally defined as a duty to maintain the enterprise as a going concern in order to ensure that value is returned to each of the different constituencies.[60] In common law

---

57. See Jensen & Meckling, *supra* note 8; Fama & Jensen, *supra* note 23.

58. See Easterbrook & Fischel, *supra* note 2.

59. See e.g. Paul L Davies, *Gower and Davies: Principles of Modern Company Law*, 8th ed (London, UK: Sweet and Maxwell, 2008) at 155 ff.

60. See e.g. Marc Viénot, *The Boards of Directors of Listed Companies in France* (Paris: Conseil National du Patronat Français & Association Française des Entreprises Privées, 1995) at 7, online: European Corporate Governance Institute <http://www.ecgi.org>:

> In Anglo-American countries, the emphasis in this area is on enhancing share value, whereas in continental Europe, and particularly in France, it tends to be on the company's

jurisdictions, the idea of "enlightened shareholder value" frames the duties of directors somewhat differently, in stipulating that their task is to return value to the shareholders over the long run.[61] However, the common law and civil law positions are less far apart than they might seem because the common law board is seen as having a discretion over how to balance the interests of shareholders with those of other constituencies in the short- to medium-term, and also, critically, to determine the timescale within which the adequacy of shareholder returns is to be judged.[62] No legal system, whether of common law or civil law origin, imposes a duty on managers to *maximize* shareholder value regardless of the effect on other corporate constituencies or on the company's reputational and other assets.

C. The Managerial Function, Corporate Responsibility and Enterprise Risk

The gap between theory and practice in the dominant economic model of the firm is also apparent when we move beyond the basic structure of the corporate form to consider other features of the modern business enterprise and how they are described by the legal system. Although company law has a great deal to say about shareholders' rights and board structure, it has surprisingly little to say about how management is constituted and operates within the firm. Company law, as we just have seen, goes part of the way to providing a legal description of the management function in its recognition of board autonomy from shareholder pressure. However, it offers no account of how

---

> interest. . . . The interest of the company may be understood as the over-riding claim of the company considered as a separate economic agent, pursuing its own objectives which are distinct from those of shareholders, employees, creditors including the internal revenue authorities, suppliers and customers. It nonetheless represents the common interest of all of these persons, which is for the company to remain in business and prosper.

61. See *Companies Act 2006, supra* note 48, s 172, for the UK case.

62. See Mathias M Siems, *Convergence in Shareholder Law* (Cambridge, UK: Cambridge University Press, 2008) at ch 5.

management performs the task of coordinating the production of goods and services.

This account can be found instead in employment law, which conceptualizes management's authority to direct the process of production in the form of the open-ended duty of obedience that is implied into the contract of employment or employment relationship.[63] As Coase recognized in his account of the economic nature of the firm, the point of this legal formulation is to reduce transaction costs associated with specifying the contents of the employment contract;[64] to argue, in the manner of Alchian and Demsetz,[65] that the essence of the employment relationship is continuous renegotiation of the terms of the contract is to deny this essential functional feature of employment law.[66]

While the employment contract gives a juridical form to the notion of managerial prerogative, and thereby underpins management's coordinating role within production, it is not limited to this function. Employment law recognizes a trade-off between "subordination" and protection against the risk inherent

---

63. It is generally recognized that this is a feature of virtually all employment (or labour) law systems, again regardless of their origin in the common law or civil law. See classically, Otto Kahn-Freund, *Labour and the Law* (London, UK: Stevens & Sons, 1972) ("[t]he relation between an employer and an isolated employee or worker is typically a relation between a bearer of power and one who is not a bearer of power. In its inception it is an act of submission, in its operation it is a condition of subordination, however much the submission and the subordination may be concealed by that indispensable figment of the legal mind known as the 'contract of employment'" at 8). Alain Supiot, *Critique du droit du travail* (Paris: Presses Universitaires de France, 1994) discusses the different conceptualizations of the employment relationship in the French, German and British labour traditions.

64. Coase, *supra* note 1. Having set out his economic model of the firm, Coase proceeded to ask "whether the concept of a firm that has been developed fits in with that existing in the real world". He went on to suggest that "[w]e can best approach the question of what constitutes a firm in practice by considering the legal relationship normally called that of 'master and servant' or 'employer and employee'". *Ibid* at 403. This is a striking inversion of the view that legal forms are merely "fictions" which it is the task of economic analysis to unravel. See Jensen & Meckling, *supra* note 8 at 311.

65. Armen A Alchian & Harold Demsetz, "Production, Information Costs, and Economic Organization" (1972) 62:5 Am Econ Rev 777.

66. See Robé, *supra* note 13 at 38–40.

to the employment relationship, essentially along the same lines as the economic model described by Simon.[67] Thus, management's power of coordination is conditioned by the assumption by the employing entity of responsibility for the physical, economic and psychological well-being of the worker.[68] While the extent of the employer's inherent duties is contingent and contested, few if any legal systems can be said to regard them as completely absent from the indeterminate-duration employment contract. Even in the case of the US employment-at-will model, which offers a more minimal account than most, a residual role for notions of good faith and respect for fundamental rights, such as freedom of speech, can be identified.[69]

A further source of legal perspectives on the role and functions of management is the law of enterprise liability.[70] Health and safety laws, for example, generally specify the particular management position within the firm, and sometimes the individual officer, responsible for delivering a safe and sustainable workplace environment.[71] They often also impose

---

67. Herbert A Simon, "A Formal Theory of the Employment Relationship" (1951) 19:3 Econometrica 293.

68. On these three aspects of protection against risk inherent in the employment relationship, see Guy Davidov, "The Three Axes of Employment Relationships: A Characterization of Workers in Need of Protection" (2002) 52:4 UTLJ 357.

69. See Katherine VW Stone, "Revisiting the At-Will Employment Doctrine: Imposed Terms, Implied Terms, and the Normative World of the Workplace" (2007) 36:1 Indus LJ 84.

70. The term "enterprise liability law" refers in this context to aspects of the common law of tort, such as vicarious liability, employer's liability and product liability (which are concerned with the legal responsibilities of the enterprise to employees and third parties exposed to the risk of physical and other harms by virtue of its activities), and to areas in which statute has developed extensive systems of regulation directed to the same end, such as occupational health and safety law, environmental law and consumer protection law.

71. A prime example of this technique is mines legislation. From the late-nineteenth century onwards, UK statutes on mine safety put in place a complex structure of rules which identified the health and safety responsibilities of a series of supervisory and managerial employees, up to and including the colliery manager. See e.g. *Mines and Quarries Act, 1954* (UK), 2 & 3 Eliz II, c 70 (identifying the offices of mine manager, under-manager, surveyor, and other "officials and technicians", ss 2–21). The Act required the mine manager to undertake daily supervision of the mine, imposed limits on the number of mines

individual liability on particular officers and board members who are identified as having managerial "capacity" or as exercising the "function" of management.[72] The directors and senior executive officers of firms which, while constituted as privately held or publicly-listed companies, perform public interest functions in sectors such as banking or utilities, are frequently subject to a similar type of regulation.[73]

---

of which any individual could be the manager, and imposed certification and minimum age requirements for the holders of the post of manager. *Ibid.*

72. See e.g. *Health and Safety at Work etc Act 1974* (UK), c 37, s 37, which provides that:

> (1) Where an offence under any of the relevant statutory provisions committed by a body corporate is proved to have been committed with the consent or connivance of, or to have been attributable to any neglect on the part of, any *director, manager, secretary or other similar officer of the body corporate or a person who was purporting to act in any such capacity*, he as well as the body corporate shall be guilty of that offence and shall be liable to be proceeded against and punished accordingly.
>
> (2) Where the affairs of a body corporate are managed by its members, the preceding subsection shall apply in relation to the acts and defaults of a member in connection with his *functions of management* as if he were a director of the body corporate [emphases added].

73. For example, senior executives in the UK banking sector have specific statutory duties under the *Financial Services and Markets Act 2000* (UK), c 8, breach of which can lead to fines and a form of disqualification. It was this power that was used by the Financial Services Authority (FSA) against just one individual in the case of the failure of RBS, the former head of the company's investment banking division, which led to a negotiated settlement under which he undertook not to assume full-time employment or to exercise a "significant influence function" in the financial services industry. No enforcement action was taken against the directors of the company, as the FSA considered that although the level of due diligence carried out with regard to the ABN AMRO takeover was "low", it was not "so far outside of the range of reasonable actions prevailing at the time as to give rise to an actionable enforcement case". See FSA, *Royal Bank of Scotland*, *supra* note 5 at 421. In general, specific regulatory duties applying to *executives* tend to be more significant than the duty of care and related obligations imposed by company law on *directors* in framing the exercise of managerial responsibilities within the firm. See Simon Deakin, "What Directors Do (and Fail to Do): Some Comparative Notes on Board Structure and Corporate Governance" (2011) 55:2 NYL Sch L Rev 525 [Deakin, "Directors"].

The presence in the law of enterprise liability of a legal description of the operation of management is an indication that the legal system not only recognizes the principle of the firm's responsibility for the hazards it creates for its employees and third parties, but also the risk-bearing capacity of the firm, which is a function of its organizational capacity. The firm can control these risks by deploying managerial power—that is, the power of coordination—to reduce the scale and incidence of harms; it can also use its financial resources to diffuse and diversify those risks through insurance.[74] The law acknowledges that the enterprise can operate as a conduit for the pricing of risks through insurance markets of various kinds, and in numerous instances mandates that it should do so.[75]

In these various ways, the legal model of the firm is wider than the concept of the corporation and the related rules and principles of company law. The law structures the business enterprise through devices which complement the operation of company law, in particular through employment law and the law of enterprise liability. Yet in one respect, this legal model is highly incomplete; although, as we have seen, the first task of the legal notion of the corporation is to ascribe legal personality to the firm,[76] the fit between the corporation and the firm is not exact. As such, the firm or enterprise is not a legal person or actor.[77] The concept of the corporation and the wider body of company law rules together account for only a fraction of the activities of the firm. It is necessary to bring in insolvency law, employment law, tort law and, arguably, competition law and tax law, to get the full picture. There is no single, all-encompassing legal vision of the enterprise, but rather a series of fragmented,

74. See generally Deakin, "Enterprise-Risk", *supra* note 29, discussing the evolution of vicarious liability concepts in a number of common law jurisdictions and comparing the approach of the Supreme Court of Canada in *Bazley v Curry*, [1999] 2 SCR 534 with that of the House of Lords in *Lister v Hesley Hall Ltd*, [2001] UKHL 22, [2002] 1 AC 215.

75. See generally Robert Merkin, "Tort, Insurance and Ideology: Further Thoughts" 75 Mod L Rev [forthcoming in 2012].

76. See Part II.A, above.

77. See Robé, *supra* note 13 at 53.

domain-specific perspectives.[78] The fragmentation of the legal model makes the task of fitting the rules of the legal system to the reality of contemporary corporate practice problematic in a number of respects.

The most important of these problems arises from the limited ability of the legal system to deal with misuses of the corporate form. The corporate form can be used, on the one hand, to enhance the organizational capacity of the firm but also, on the other, to avoid liabilities which natural persons could not avoid (or at least not to the same degree). In practice, all modern business firms above a certain size are multi-corporate enterprises;[79] at a legal level, the organizational unity of the firm is divided among several different corporate persons. The law has difficulty distinguishing between the use of parent-subsidiary structures for legitimate uses of entity shielding and its use for creative avoidance (artificially minimizing tax and regulatory obligations) and regulatory arbitrage (locating corporations in low-regulation jurisdictions). The law of corporate groups cannot deal effectively with avoidance strategies of this kind, partly because the techniques used (such as "lifting the veil") are too crude,[80] but also because courts and legislators in some jurisdictions are willing to condone and even encourage such strategies.[81]

---

78. See Deakin, "Enterprise-Risk", *supra* note 29 at 97–99.

79. See Iván Guevara-Bernal, *In Search of the Multi-Corporate Enterprise: A Comparative Study in Law and Economics* (PhD dissertation, University of Cambridge, 2002) at ch 1 [unpublished, on file with the author].

80. See Kurt A Strasser & Phillip I Blumberg, "Legal Models and Business Realities of Enterprise Groups—Mismatch and Change" (2009) 5:3 Comparative Research in Law & Political Economy, Paper No 18 (arguing for "a theory of enterprise analysis . . . to counteract the legal thinker's ingrained tendency to yield to the seduction of traditional concepts of corporate separation and 'veil piercing'" at 22). For discussion, see Robé, *supra* note 13 at 50–51.

81. On judicial willingness to facilitate corporate flight and the case, conversely, for regulating the process of "regulatory competition" in corporate law (and by extension in labour and tax law), see Simon Deakin, "Regulatory Competition versus Harmonization in European Company Law" in Daniel C Esty & Damien Geradin, eds, *Regulatory Competition and Economic Integration: Comparative Perspectives* (Oxford: Oxford University Press, 2001) [Deakin, "Regulatory Competition"].

III. The Corporation as Commons: Reconceptualizing Corporate Property

The analysis of the legal structure of the firm that has just been offered has implications for the prevailing economic theorization of corporate law, and more generally of corporate governance. The core juridical features of the firm—beginning with the idea of the corporation and its ancillary conceptual devices, including the paradigmatic indeterminate-duration form of the employment relationship and notions of enterprise liability under both private law and statute—are simply impossible to square with the predominant economic models, namely agency theory and property rights theory. The legal system does not recognize managers as the agents of the shareholders. Nor does it view the shareholders as the firm's owners. Ownership of a share does not give a shareholder a pro-rata claim to the firm's assets. Those assets are held by a legal form, the corporation, which cannot itself be the direct subject of ownership. Does this imply that the business firm is "ownerless"? Such a conclusion seems at odds with the widely held view that the specification of property rights in productive assets lies at the foundation of a market economy.[82] Less abstractly, it is contradicted by the vocal claims made by contemporary shareholder activists, among others, to be acting as "owners" when they engage with the boards of listed companies.[83]

It is not necessary to go so far as to say that the firm is "ownerless". The firm as such cannot be owned, but in the context of the modern business enterprise, there are multiple, overlapping and often conflicting property rights or property-type claims which the legal system is meant to adjust and reconcile. As we have seen, corporate law is largely concerned

---

82. Perhaps the most influential modern restatement of this view is Douglass C North, *Institutions, Institutional Change and Economic Performance* (Cambridge, UK: Cambridge University Press, 1990) in particular ch 12–14 (exploring the historical role of property rights and other institutions in promoting economic growth).

83. On the ownership claim made for institutional shareholders as myth or "folklore", see Robé, *supra* note 13 at 27.

with one set of such rights, those of shareholders, but this by no means exhausts the set of claims on the firm's assets. Employment law, insolvency law and fiscal law also identify claims of this kind. Each of these areas of law has a dual function: specifying the conditions under which various contributors of inputs (or as they are sometimes called, corporate "constituencies" or "stakeholders"[84]) can draw on the resources of the firm while at the same time, preserving and sustaining the firm's asset pool as a source of productive value. This is the sense in which the business enterprise is a "commons". It is the role of the legal system to maintain this commons where doing so generates a surplus for the parties immediately involved in the productive process and for society at large. The "corporation" and ancillary juridical concepts describing in legal terms the various features of the business firm together have the function of achieving this task.

The economic theory of the commons is in essence a theory about the conditions under which collective action to preserve and sustain resources of value to society becomes possible. The theory has had its main application to natural resources in the form of "common-pool resources" such as collectively managed irrigation, fishery and forest systems. The core insight gained from over two decades of intensive empirical work on the operation of these systems is that over-exploitation of shared resources—the "tragedy of the commons"—can be overcome through forms of collective resource use and management. The conditions needed for the emergence of successful resource management regimes are complex, diverse and often highly localized. Despite this heterogeneity of observed practices, a number of general features of successful common resource pool systems have been identified by scholars in this field, principally in work conducted by Elinor Ostrom and her co-researchers.[85]

---

84. A "stakeholder" can be defined in functional terms as one who makes an input of value to the firm and as a result has an investment which is at risk if the firm fails, along with a claim to exercise voice in the firm's governance. See Thomas A Kochan & Saul A Rubinstein, "Toward a Stakeholder Theory of the Firm: The Saturn Partnership" (2000) 11:4 Organizational Science 367.

85. See especially Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action* (Cambridge, UK: Cambridge University Press, 1990) [Ostrom, *Governing the Commons*]; Elinor Ostrom, *Understanding*

The features of successful resource-use regimes can be understood at two levels. The first level refers to the substantive content of the relevant property rights, and the second to the institutional conditions that are capable of generating those rights. This dual-level analysis is important because specifying the content of effective property rights systems can only take us so far. Collective property rights of the kind that operate in the context of the commons are contingent and contested, and are not self-enforcing. It is therefore necessary to consider the wider framework of governance within which property rights—understood as enduring solutions to the collective action problems associated with shared resources—can emerge and then become stabilized.

At the first level of analysis, what emerges from the now very extensive empirical literature on common resource pools is the complexity of the property rights involved in resource use regimes. The commons is not defined by "open access" or the absence of a right to exclude. On the contrary, the commons is identified by the presence of collectively held rights of access, withdrawal, management and exclusion, and sometimes (but with less salience) the presence of alienation (see Table 1). Case study research suggests that while in practice, property rights of these kinds are combined or bundled together in many varied and different ways, "the right of alienation is not the key defining right for those who have been responsible for designing and adapting common property systems in the field", and that "many users of common-pool resources have effective property rights even though their bundles of rights may not include the right of alienation".[86]

Institutional Diversity (Princeton: Princeton University Press, 2005) [Ostrom, *Institutional Diversity*]; Edella Schlager & Elinor Ostrom, "Property Rights Regimes and Natural Resources: A Conceptual Analysis" (1992) 68:3 Land Economics 249; Amy R Poteete, Marco A Janssen & Elinor Ostrom, *Working Together: Collective Action, the Commons, and Multiple Methods in Practice* (Princeton: Princeton University Press, 2010).

86. *Ibid* at 96.

Table 1: Property Rights in Common-Pool Resources[87]

Property Right	Description
Access	A right to enter a defined physical property
Withdrawal	A right to harvest the products of a resource such as timber, water or food for pastoral animals
Management	A right to regulate the use patterns of other harvesters and to transform a resource system by making improvements
Exclusion	A right to determine who will have the right of access to a resource and whether that right can be transferred
Alienation	A right to sell or lease any of the above rights

At the second level of analysis, the effectiveness of common-pool resource regimes can be seen to turn on the presence or otherwise of enduring institutions capable of generating the relevant substantive norms. These "institutional regularities" or "design principles" are themselves the results of long-run evolutionary processes, and can therefore be thought of in terms of the emergence of enduring structures that have stood the test of time. Poteete et al.,[88] summarizing earlier work by Ostrom,[89] identify the eight principles set out in Table 2 below. The broad message of empirical research on common-pool resources is that where these conditions are present, collective resource-management regimes are more likely than not to be stable, helping to ensure the sustainability of the natural resources in question for present and future generations. An earlier generation of studies had stressed, from a largely theoretical perspective, the unsustainability of the commons in the face of free-rider problems.[90] Two solutions were suggested: state control to enforce the rules of common resource use, on the one hand, and the institution of private property rights, with the emphasis on

87. See Schlager & Ostrom, *supra* note 85; Poteete, Janssen & Ostrom, *supra* note 85 at 95.
88. *Ibid* at 100–01.
89. Ostrom, *Governing the Commons*, *supra* note 85.
90. See Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, Mass: Harvard University Press, 1965).

alienable claims in a market setting, on the other.[91] Combining these suggested solutions, influential strands in the law and economics and new institutional economics literatures argued that private property rights supported by the state through the legal system would provide the basis for ensuring that returns from investments could be adequately captured and externalities reduced.[92] By contrast, the more recent body of work on the commons sees both the state and the market as having the potential to undermine emergent, norm-based systems for collective resource management: "market pressures and government interventions pose threats to common property institutions".[93]

91. See Garrett Hardin, "The Tragedy of the Commons" (1968) 162:3859 Science 1243.
92. See Harold Demsetz, "Toward a Theory of Property Rights" (1967) 57:2 American Economic Review 347; Douglass C North & Robert P Thomas, *The Rise of the Western World: A New Economic History* (London, UK: Cambridge University Press, 1973).
93. Poteete, Janssen & Ostrom, *supra* note 85 at 112.

Table 2: Design Principles for Common-Pool Resources[94]

Design Principle	Description
Well-defined boundaries	Rules defining the boundaries of a resource system and the set of users with rights over it facilitate cooperation and rule enforcement
Proportionality between benefits and costs	Equivalence between inputs and returns enhances the legitimacy of rule systems and assists observance and enforcement
Collective choice arrangements	Where all or most users participate in rule formation, rules are more likely to fit local contexts and be adaptable to changing circumstances
Monitoring	Monitoring should be conducted by individuals or officials who are accountable to users
Graduated sanctions	Graduation of sanctions allows for infractions to be recognized while acknowledging the possibility of misunderstandings, mistakes and exceptional circumstances
Conflict resolution mechanisms	Localized, low-cost dispute resolution mechanisms allow for conflicts in the interpretation and application of rules to be settled in such a way as to maintain trust
Minimal recognition of rights	Rights of local users to make their own rules should be recognized by higher-level entities
Nested enterprises	Where common-pool resources are part of a wider system, local units should be allowed to match rules to local conditions, within a wider framework of institutions designed to govern interdependencies among smaller units

In considering the relevance of research on the commons to issues of corporate law and corporate governance, three questions arise. First, is the model of the commons a good descriptive fit with the modern business enterprise? Second, is the theory of the commons capable of generating a meaningful empirical research agenda for corporate governance? Third, what are the normative

94. *Ibid* at 100–01.

implications of viewing the corporation as a commons? These questions will be addressed in turn.

A. Is the Model of the Commons a Good Descriptive Fit for the Modern Business Enterprise?

The answer to this should be a qualified yes. Naturally occurring resource systems have physical manifestations, while the resources tied up in the organizational structures and routines of a business firm often (indeed, increasingly) take a non-physical form. Analytically, however, there is a high degree of continuity between the business firm and the commons. As we have seen, it is descriptively false to analyze the business enterprise in terms of shareholders' ownership of the firm or its assets. At the same time, the business firm is not "ownerless": the firm is a resource which is subject to multiple, overlapping and sometimes conflicting claims on its use.[95] Different stakeholder groups have claims or rights of various kinds to use the resources produced in and by the firm, in return for the inputs they make into the creation and maintenance of those resources. These claims are defined in a residual or default sense by the different components of the legal framework of the firm (corporate law, insolvency law, employment law and fiscal law, among others), and in a more complete sense by the sum total of explicit and implicit contracts and social norms present within a given enterprise. Many of the social norms governing the position of the different stakeholders with regard to the resources of the firm will be tacit and implicit, and so may operate in tension with the more explicit rules set out in articles of association, loan covenants, collective bargaining agreements and so on. These rules and norms together serve to

95. On a point of clarification, to say that the firm is a "resource" in this sense is not the same as saying that the "corporation" is a thing or *res* (a proposition for which there is little authority; see Part II.B above). The firm is a resource in an economic or functional sense. The legal system supports the notion of the firm as a resource not by characterizing the corporation as a *res* (and hence owned by the shareholders) but, as explained in the text, by juxtaposing and reconciling the various competing and overlapping claims of the different corporate constituencies or stakeholders (shareholders, creditors, workers, fiscal authorities and so on).

define the rights of access, withdrawal, management, exclusion and alienation identified by Ostrom and her colleagues. Some examples are given in Table 3 below.

Table 3: Property Rights in the Business Enterprise

Property Right	Description
Access	Entry conditions for participation in the firm as a shareholder, employee, creditor, etc
Withdrawal	Rules on distribution of capital (dividends, share buy-backs), employee remuneration and benefits, rights of secured and unsecured lenders, claims of fiscal authorities, etc
Management	Rules concerning the division of powers between the board and different constituencies on matters of corporate decision making (shareholders' rights to vote on major transactions, employees' rights to be consulted on restructurings, creditors' rights in insolvency, etc)
Exclusion	Rules determining the scope of voice, participation and income rights of different constituencies (e.g. distinctions between holders of common and preferred stock, "core" employees and others, and different categories of creditors)
Alienation	Rules governing alienability of shares, securitization of financial claims on the firm, etc

The literature on the commons stresses the sense in which rights of alienation are often the least salient, in practice, of the property rights present in a common resource pool. This idea is highly relevant to the analysis of the business enterprise. Historically, corporate law has placed at least as much stress on the idea of shareholder lock-in, or limited alienation rights, as it has on shareholders' rights to sell their claims to third parties. The joint stock company form, in which shareholders' alienation rights are most clearly expressed, is only one variant of the basic corporate structure. It may be contrasted with other forms, such as closed or privately-held companies, in which alienation rights are constrained as a matter of law, contract or practice. Even in the case of the joint stock company, the shareholders' right of alienation consists of a right to sell their continuing voice and income claims to a third party, and does not take the form of a right to the return of the capital originally invested.[96]

If we consider the case of employees, it is clear again that rights of alienation are highly restricted. Only very rarely do employees have job rights that can be treated as the basis of an alienable claim. In a free labour market they can remove their labour power or capacity from the firm, but when they do so, they generally cannot take with them complementary physical assets or intellectual property belonging to the employer, which remain in the firm's asset pool. Yet employees, like shareholders, have a range of access and withdrawal rights, and in many national systems they have voice rights which can be analogized to property-like claims to participate in the management of the firm.[97]

Restrictions on alienation of assets in the context of a common-pool resource are a widely employed means of preserving interdependencies between the assets in the pool, and thereby sustaining the resource over time. In this respect, natural resources such as irrigation or forest systems are no different from the resources tied up within the organizational structures of business firms. In a natural commons, the lifting of restraints on alienation for one or more of the user groups can lead to the depletion of the resource, both directly when assets are removed from the common pool, and more generally through a loss of legitimacy for rules aimed at ensuring the participation of all users in the maintenance of the resource. In the context of company law and corporate governance, the power of certain actors (shareholders and the board) to remove and redeploy the assets of the firm against the wishes of others (employees), through the

96. See Blair, *supra* note 28, and see generally Part II.B, above.

97. See Wanjiru Njoya, *Property in Work: The Employment Relationship in the Anglo-American Firm* (Aldershot, UK: Ashgate, 2007) in particular ch 4.

mechanisms of takeover bids and corporate merger and acquisition activities, poses a set of fundamental questions for courts and policy makers. Different systems currently provide a wide range of answers to those questions.[98]

B. Is the Theory of the Commons Capable of Generating a Meaningful Empirical Research Agenda for Corporate Governance?

The research question addressed by the commons literature concerns the feasibility of institutional solutions to the collective action problems posed by the use of shared resources. Rephrasing this question in the context of corporate law and corporate governance, the issue becomes one of understanding the conditions under which legal and other normative structures can contribute to the sustainability of corporate enterprise—both at the level of individual firms and more generally in terms of the relationship between business firms and the wider societal and natural environments in which they operate. The implication is that viewing the corporation itself as a collectively managed resource can aid understanding of the role the corporate form can play in generating the conditions for social and environmental sustainability. This research agenda is likely to have growing relevance as research in the fields of corporate governance and corporate social responsibility converges, as it is increasingly doing.[99] The multi-methods approaches pioneered by common resource pool researchers, which combine quantitative and qualitative research methods and stress the gains from working within multi-disciplinary teams,[100] highlight wider methodological benefits of applying the commons approach in the corporate governance field.

98. See the comparative overview in Deakin & Singh, *supra* note 53.
99. See generally Lorenzo Sacconi et al, eds, *Corporate Social Responsibility and Corporate Governance: The Contribution of Economic Theory and Related Disciplines* (Basingstoke, UK: Palgrave Macmillan, 2011).
100. Poteete, Janssen & Ostrom, *supra* note 85 at ch 10.

C. What Are the Normative Implications of Viewing the Corporation as a Commons?

For legal scholars, as well as for judges, regulators and policy-makers, models of the business enterprise have never been seen simply as aids to understanding social phenomena; they have also been deployed to justify and critique legal and policy developments. The claims that directors are the shareholders' agents and that the sole purpose of the corporation is the maximization of shareholder wealth (claims which have done much to shape the recent evolution of corporate law and corporate governance not just in the Anglo-American world but on a global basis), owe much to the intellectual revolution in law and economics, specifically the institutional economics which began in the 1970s and came to fruition in succeeding decades. In this context, the normative implications of seeing the corporation as a commons may well be as far-reaching as the methodological implications.

Commons research stresses, as we have seen, the complexity and heterogeneity of property rights regimes and the relatively subordinate role played by alienation rights, particularly in comparison to access and management rights. From this perspective, the emphasis on the importance of shareholders' alienation rights in current corporate governance theory and practice looks misplaced. Shareholders' alienation rights are at the core of the operation of the market for corporate control and the functioning of a liquid capital market in which claims on the corporation's assets are transparently priced and corporate performance is efficiently evaluated. The exclusion of other stakeholder groups, especially employees, from participation in managing the firm is frequently justified by reference to agency-cost considerations, or more simply, by appeals to the importance of shareholders' property rights.[101] We saw above that normative claims for shareholder primacy are based on a misdescription of the legal structure of the firm; the theory of the commons helps us to see that their application in practice may be destructive of long-term value in the corporate economy. Viewing one user

101 See Jensen, *supra* note 22.

group as having priority over the others in the use it can make of common resources and in its power to hold the managers of the resource to account is not compatible with the maintenance of the resource over time.

Table 4 sets out in synoptic form some ways in which the "design principles" identified by commons research could be used to inform the institutional design of corporate law and other aspects of the law governing the business enterprise.

Table 4: Design Principles for the Law of the Business Enterprise

Design Principle	Description
Well-defined boundaries	Rules defining the boundaries of the firm and the set of stakeholders are needed to facilitate cooperation and rule enforcement
Proportionality between benefits and costs	The principle of equivalence between inputs and returns should apply to all stakeholders making a valued input to the firm and not just to shareholders
Collective choice arrangements	All stakeholders should participate in rule formation at the level of the firm, to ensure that the rules are more likely to fit local contexts and be adaptable to changing circumstances
Monitoring	Monitoring of the internal rules and norms of the firm should be conducted by individuals or officials ("management") who are accountable to all stakeholder groups, and not simply to the shareholders
Graduated sanctions	The principle of graduated sanctions should be applied so as to limit the power of management to exclude any one individual or group from access to the resources of the firm, or the power of a dominant group to exclude others (as, most typically, shareholders exclude employees in the context of takeover bids and corporate restructuring)
Conflict-resolution mechanisms	Where possible, localized, low-cost dispute resolution mechanisms should operate at the level of the firm, to facilitate trust-building in stakeholder relations
Minimal	The principle according to which the rights of local

recognition of rights	users to make their own rules should be recognized by higher-level entities implies that the firm's internal governance mechanisms should be given due weight by the legal system
Nested enterprises	The principle that local units should be allowed to match rules to local conditions (within a wider framework of institutions designed to govern interdependencies among smaller units) implies that federal and transnational legal structures should reflect the rights of states and nations to frame rules of fair conduct for the business enterprise which match local conditions

In short, the design principles emerging from commons research imply a model of corporate law based on these considerations: multi-stakeholder governance in preference to shareholder primacy; autonomy for rule-making processes at the level of internal enterprise relations in the face of external capital market pressures; and respect for local and national democratic choices on how to regulate the business firm in the face of pressures to condone or encourage transnational regulatory arbitrage and avoidance. This is, self-evidently, a program of reform of the law of the business enterprise that is radically at odds with the shareholder-oriented, market-focused and globally-driven model of corporate law that was the norm from the early 1980s to the onset of the global financial crisis. The shortcomings of that model are now being laid bare by the growing evidence of a correlation between shareholder-oriented corporate governance laws and practices and the destruction of corporate value during the crisis.[102] Whether the model of the corporation as commons can provide a normative basis for reversing this trend will be a major focus for corporate governance research as the crisis unravels in the coming years. The argument presented here will no doubt raise many objections from law and economics scholars who will see it as incentive-incompatible, and likely to produce distortions and inefficiencies of various kinds. For the reasons set out above, answers to these objections are likely to be found in

102. See the works cited at *supra* note 5.

the re-theorization of corporate law that is needed to bring our working models into line with what we know of the empirical reality of the business firm. Developing this theory more fully and applying its insights to further empirical work will hardly be a trivial task. However, the start has been made.

Conclusion

This paper has argued for a conceptual and methodological repositioning of corporate governance research, and more specifically of research in the economics of corporate law. A repositioning of this kind is needed if corporate governance scholarship is to respond to the challenge of understanding the functions and consequences of the modern business enterprise, particularly in the light of the global financial crisis. The starting point of the analysis was a claim that models matter, not only for the analysis and understanding of social phenomena but also for normative purposes. Corporate law scholarship for the past thirty years has been dominated by a model of shareholder primacy which fits well with certain developments in economic theory, and in the theory and practice of financial markets, but is at odds with what we know of the legal structure of the business enterprise. Using a model which is based on a misdescription of empirical phenomena has the potential not just to warp our understanding of the social world but to tilt policy in a direction that is at odds with society's needs. The role of the shareholder primacy model in creating the intellectual conditions for the global financial crisis is a case in point.

Models should be judged not just by how well they generate hypotheses for empirical testing but also by how well they represent the salient features of the phenomena they describe. On this basis, the shareholder primacy model falls short at the outset, as it fails to describe core aspects of the legal model of the business enterprise, in particular the underpinning provided by law for managerial autonomy, the organizational continuity of the firm and the multi-stakeholder nature of firm-level governance. At the core of the legal model of the firm is the apparent paradox of the ownerless corporation: the firm's productive assets are held through a legal form—the corporation—which cannot be the subject of an ownership claim. The paradox, however, is, more apparent than real. The firm is best seen as a collectively managed resource or "commons" which is subject to a number of multiple, overlapping and potentially conflicting property-type claims on the part of the different constituencies or stakeholders that provide value to the firm. Drawing on the theory of the commons, this paper has argued that the sustainability of the corporation depends on ensuring proportionality of benefits and costs with respect to the inputs made to corporate resources, and on the participation of the different stakeholder groups in the formulation of the rules governing the management and use of those resources. Viewing the corporation as a commons in this sense is the first step toward a better understanding of the role that the corporate form can play in ensuring wider economic and social sustainability.