

The theory of enterprise law, and the eclipse of corporate law

LSE, An Institutional Theory of the Firm

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Four main points

- 1. Much **corporate law** and firm **theory is contradictory**, crossing every element of Roman law taxonomy ('nexus of contracts', property/entity shielding, person, emanation of the state), without consensus.
- 2. **Enterprise law theory** says corporations and enterprises are **social institutions**, to '**serve... all society**'. Enterprise law **eclipses legal form**: labour, tax, antitrust, tort, GDPR...
- 3. The **functions of enterprise** are accumulating **finance**, coordinating **governance**, and distributing **rights**.
- 4. The **principles of enterprise law**, what it should do, must derive from empirical research and leading theories: realise human **rights, democracy in the economy, justice**.

1. Corporate law/firm theory contradictory

• There is no consensus in major parts of standard corporate law/firm theory on what a corporation is:

– ‘**person**’, *Salomon v A Salomon & Co Ltd* [1896] UKHL 1.

– ‘nexus of **contracts**’, M. Jensen and T. Meckling, ‘Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (1976) 3 J Financial Economics 305, 330 F. Kessler (1934) 83 U Penn L Rev 393, 394.

– entity with ‘**proprietary** foundations’, J Armour and MJ Whincop, ‘The Proprietary Foundations of Corporate Law’ (2007) 27(3) OJLS 429 and H Hansmann and R Kraakman, ‘The Essential Role of Organizational Law’ (2000) 110 YLJ 387.

– ‘concession of the **state**’, *Trustees of Dartmouth College v Woodward*, 17 US 518, 636-638 (1819)

1. Corporations are social institutions

- Corporate law theory's incoherence – crossing all Roman law taxonomy – comes from Roman law taxonomy's incoherence: **all legal rights/duties express social relations among people** (not people and 'things', legal 'persons', the 'state'). **Abstractions obscure this**: O Kahn-Freund, 'Hugo Sinzheimer 1875–1945' in *Labour Law and Politics in the Weimar Republic* (1981) 102. Also Hohfeld (1913) 23 Yale LJ 16, 42, rights+correlative duty.
- The better view is that a **corporation is a 'social institution'. It is instituted by the people who contribute to it**. This is + remains the dominant view behind modern corporate law: Berle and Means (1932) 114. More in E McGaughey, 'The codetermination bargains' (2016) 143-6; (2015) 78 MLR 10 57.
- The corporate institution is just one part of enterprise theory.

1. Normative corporate law theory incoherent

- The 'social institution' concept leads to the view that all **corporations/enterprises should 'serve... all society'** (not directors or shareholders): Berle and Means (1932) 356.
- But the rival theory, most strident in the US, is that corporations should serve '**shareholder value**' since:
 - shareholders are '**owners**' (Friedman) - but they're not
 - shareholders bear **risk** (Easterbrook, etc) - but they don't
- It was **missed that shareholders are** mostly asset manager + banks, **investing 'other people's money'**. They bear no risk, and take fees.
- It **ignores publicly owned corporations** (so do almost all corporate law texts) even though universities, NHS, etc use corporations too.
- It **ignores the sector-specific regulation** that changes firm behaviour.

2. An 'enterprise' is the major concept

•AA Berle, legal forms such as **corporations take their 'being from the reality of the underlying enterprise'**. More 'often than not, a single large-scale business is conducted, not by a single corporation, but by a constellation of corporations controlled by a central holding': 'The Theory of Enterprise Entity' (1947) 47(3) Columbia L Rev 343, 344

•T Raiser, 'the **social purpose** of [**constitutional**] **rights** and the principle of the **social state** are of **utmost importance in enterprise law**': 'The Theory of Enterprise Law in the Federal Republic of Germany' (1988) 36(1) Am J Comp L 111, 113–14

•S Deakin, **to understand 'business enterprise** or firm' behaviour, company law explains just a 'fraction' of reality, so **we must 'bring in insolvency law, employment law, tort law and, arguably competition and tax law, to get the full picture'**: 'The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise' (2012) 37(2) Queen's LJ 339, 365.

2. How enterprise law can look

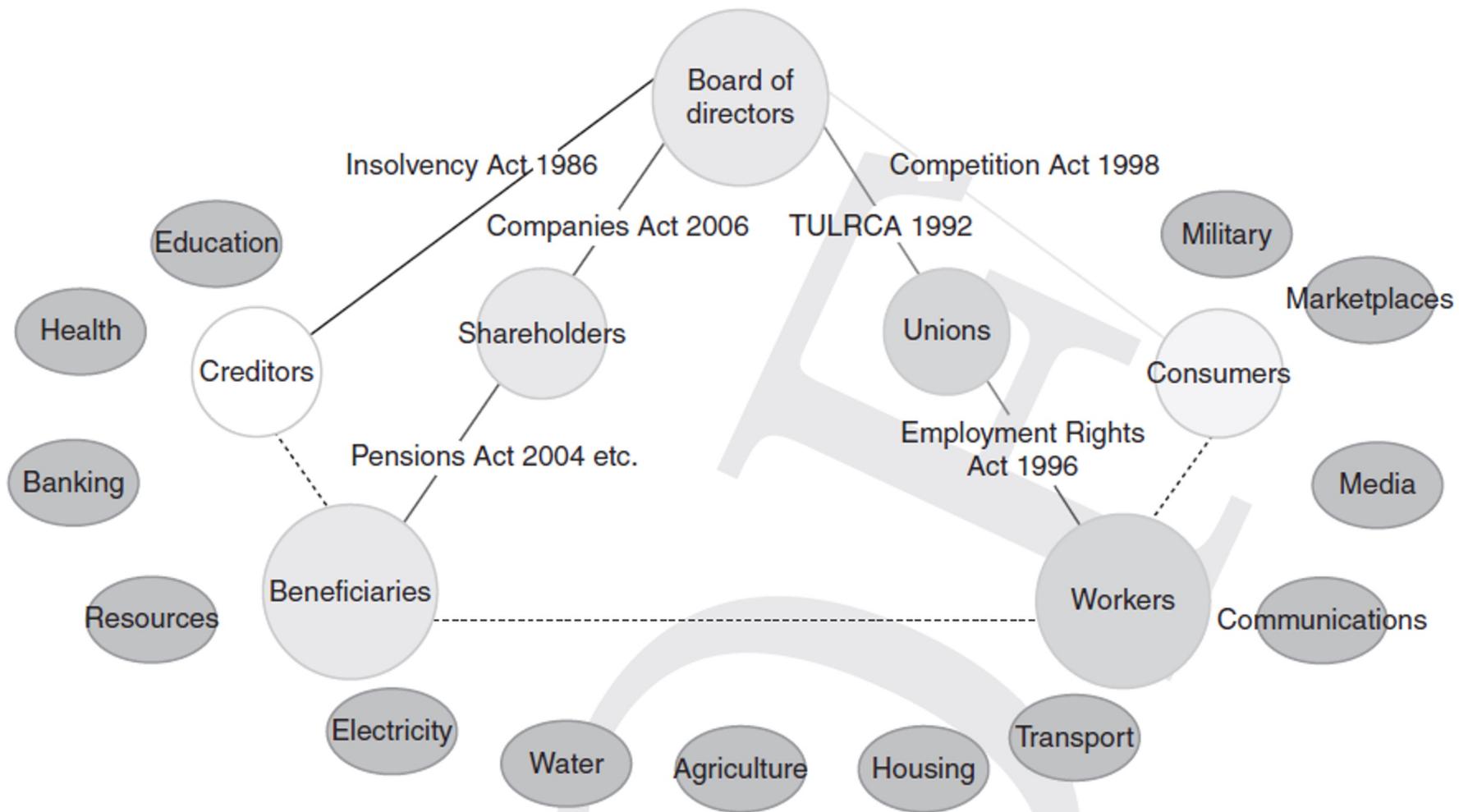


Figure 0.1 The pyramid of general enterprise law and specific enterprise law in the UK

2. Enterprise law eclipses corporate law

- In law, the ‘enterprise’ concept is increasingly used, and appears likely to eclipse corporate law in most fields. The ‘enterprise’ or corporate group matters:
 - in **labour** law, Fair Labor Standards Act of 1938 s 203(r)
 - in **accounting**, e.g. Companies Act 2006 ss 393–407
 - in **tax**, e.g. Corporation Tax Act 2010 ss 93 and 152
 - in **competition** law, CA 1998; *Viho* [1996] ECR I-5457
 - in **torts**, *Catholic Child WS v IBCS* [2012] UKSC 56, [65]
 - in **public regulation**, HRs, e.g. GDPR 2016 art 4(18)

3. Functions of enterprise

• More important than just what an enterprise 'is' is what it 'does' - its functions. It's very similar to the functions of the employer - coordination and distribution: S Deakin, 'The Changing Concept of the "Employer" in Labour Law' (2001) 30 ILJ 72 - but we can usefully add one on finance:

-accumulating resources: **finance** (capital, being property for production, not consumed, A Smith (1776) Bk II, ch 1)

-coordinating production: **governance**

-distributing resources: **rights**

• Through these 3 functions, all enterprises public or private can be understood, to give coherence to disparate laws.

4. Principles of enterprise

•Chicago School corporate law theory says “shareholder value” is the single goal. This game is played everywhere:

–bankruptcy/insolvency law is *only* for **creditor wealth-maximisation**: DG Baird and TH Jackson (1984) 51 U Chic LR 97

–antitrust/competition law is *only* for **consumer welfare**, R. Bork, *The Antitrust Paradox: A Policy at War with Itself* (1978) 426–9

–labour law for the **individual employee** (if at all), Friedman, etc

•In these single-value theories, any sense of the public interest is lost. People are divided against themselves. Evidence-free reasoning.

•But enterprise principles, which seek to ‘serve... all society’ must view the law as a coherent whole. A starting point in enterprise is the Universal Declaration of Human Rights...

Theories that drive enterprise law

•UDHR 1948 + ICESCR 1966 or ICCPR 1966, rights to education, health, social security, fair pay, property, natural resources, food and water, housing, the ‘benefits of science’, expression, privacy, ‘free and full development of [one’s] personality’. These **rights are at the foundation of our ‘economic constitution’**.

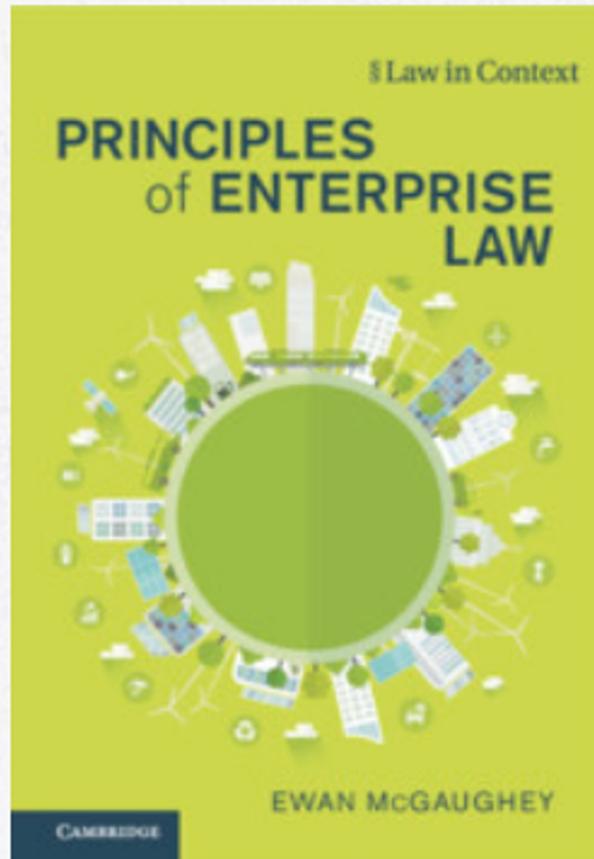
•We may draw on major theories + legal trends, for principles of stakeholder **governance**: investors, workers, and in specific enterprises the consumer (Webb & Webb, Kautsky, Deakin).

•And what should be public or privately owned? In fact there’s no binary divide but a range of **financing** options. Yet it appears that private enterprise works best *if* productive property is broadly distributed: Berle, ‘Property, Production and Revolution’

Principles of enterprise law

- (1) The **finance** of enterprise should **realise human rights** as expediently as possible.
- (2) **Governance** power should **mirror people's investments of labour, savings and custom**.
- (3) **Human rights** should be made **effective** in legislation, courts and all social institutions.
- (4) **Private enterprise should follow broad distribution of productive property and finance**.
- (5) An enterprise state upholds **social security**, placing risks onto the broadest shoulders.
- (6) An enterprise state **educates**, and **distributes the benefits of science** rapidly and equally.
- (7) **Environmental and human health** should be improved, and no harm allowed.
- (8) **Communication privacy and deliberative media** should strengthen democratic politics.
- (9) **Prices and taxes should be charged transparently**, efficiently and by the ability to pay.
- (10) **Enterprise law should enable every member of society to realise their full potential**.

And for how that works...



Principles of Enterprise Law

The Economic Constitution and Human Rights

TEXTBOOK

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