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Hidden Fallacies in the Agency Theory of the Corporation

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I would like to thank my colleagues in this project for helpful comments at our Workshop on 'Hidden Fallacies in Corporate Law and Financial Regulation: Reframing the Mainstream Narratives. Thanks also go to Miriam Baer, Tim Bowley, Anna Christie, Cristie Ford, Jill Fisch, Brent Fisse, David Frydrych, Talia Gillis, Jonathan Hardman, Claire Hill, Steve Kourabas, Lev Menand, Vice Chancellor Travis Laster, Eva Micheler, Mariana Pargendler, Elizabeth Pollman, Felix Steffen, Bob Thompson and Susan Watson, as well as to participants at the Women in Law and Finance Conference and Newnham College, Cambridge. I am grateful to Darsh Chauhan for excellent research and editorial assistance and to Monash University for providing funding for this project under a Networks of Excellence (NoE) Research Grant on the topic, 'Enhancing Corporate Accountability'.

Abstract

The agency or 'nexus of contracts' model of the firm has been the dominant corporate theory for more than four decades. The classical agency theory of the firm treats the corporation as a fictitious – and purely financial – vehicle, devoid of social connection or responsibilities. The theory also adopts a single-minded focus on one particular agency problem, namely, that which exists between shareholders and managers. This paper argues that, by amplifying a single agency problem, specifically managerial opportunism, the agency theory of the firm potentially blinds us to several other important problems associated with corporations, including the economic power of some corporations and harm caused by negative externalities. Also, by treating the corporation as outside society, and by elevating the role of private ordering between firm participants, agency theory discounts the importance of corporate regulation as an accountability mechanism. The paper critically explores aspects of the reasoning that underpins the agency theory of the firm. Some of the assumptions associated with agency theory, examined in the paper, include the following:- that agency theory constituted a 'revolution' in corporate law; that the corporation can be reduced to a network of private contractual exchanges between natural persons; that these exchanges are necessarily voluntary; that doctrines such as agency and trusts can be deconstructed into mere contracts; that the relationship between shareholders and corporate managers is one of 'pure agency'; that corporations belong for all purposes in the private, rather than the public, realm; that private ordering is an effective legitimising device; that the role of corporate regulation is restricted to creating malleable default rules; that the market is an effective managerial constraint; and that the agency theory of the firm is necessarily linked to a strong form of shareholder primacy. The paper examines these assumptions in the context of contemporary developments in several key corporate governance areas, namely the relationship between managers and investors in start-ups, venture capital and LLCs (which, as discussed in the 2023 Delaware Court of Chancery decision, New Enterprise Associates 14 v Rich, are often viewed as purely a 'creature of contract'); shareholder activism and ESG; executive compensation; and corporate criminal liability. This paper suggests that various assumptions underpinning the agency theory of the firm are now outdated and sit uncomfortably with contemporary 'on the ground' corporate law and governance developments. This dissonance between the dominant theory of modern corporate law and the real world suggests that the time may have come to re-evaluate the assumptions that support the use of agency theory as the only comprehensive analytical tool for understanding the corporation and to introduce a broader conception of the public corporation and its relationship with society in the modern world.

Keywords: Corporation; agency theory; contract; shareholders; managers; activism; executive pay; corporate criminal liability

JEL Classifications: D21 : D 23, D70; G23, G30, K10; K20; K22, L21, L 22, N20, 016

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1. Introduction

> 'Logic is not concerned with the false opinions which people happen to entertain, but with the manner in which they come to entertain them'.
>
> John Stuart Mill[1]

Since Aristotle identified his 13 fallacies in *Sophistical Refutations*,[2] the study of logical fallacies has ebbed and flowed across time and jurisdictions.[3] So, too, has the number of possible logical fallacies in existence – it has been reported, for example, that one seventh-century Indian logician succeeded in identifying 2,032 types of fallacy.[4] Logical fallacies have particular resonance in the areas of law and politics, given Jeremy Bentham's seminal 1809

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1 John Stuart Mill, *A System of Logic, Ratiocinative and Inductive*, 8th edn (Franklin Square, Harper & Brothers, 1882) book 5, ch 2, §1.

2 See Aristotle, *Sophistical Refutations* (Hawthorne, Aeterna Press, 2015).

3 See generally CL Hamblin, *Fallacies* (London, Methuen & Co Ltd, 1970).

4 See generally ibid, ch 5.

work, *The Book of Fallacies*,[5] that sought to expose fallacious political arguments used to frustrate legal reform.[6]

Although there is disagreement as to the precise meaning of the term 'fallacy',[7] it is generally accepted that the concept involves flawed or erroneous reasoning.[8] From this perspective, a fallacious argument is said to be one that '*seems* to be valid but is not'.[9]

The purpose of this chapter is to explore some aspects of the reasoning that underpins the agency theory of the firm (otherwise known as the 'contractual' or 'nexus of contracts' model). The classical agency theory of the firm treats the corporation as a fictitious – and purely financial – vehicle, devoid of social connection or responsibilities. The theory applies a single-minded focus on one particular agency problem, namely, that which exists between shareholders and managers.[10]

This chapter argues that, by amplifying a single agency problem, namely that of managerial opportunism, the agency theory of the firm potentially blinds us to several different problems, including the economic power of some corporations[11] and harm caused by negative externalities.[12] And, by elevating the role of private ordering between firm participants, the agency theory discounts the importance of corporate regulation as an accountability mechanism.

The chapter suggests that some of the assumptions underpinning the agency theory of the firm are now outdated and sit uncomfortably with contemporary 'on the ground' corporate law and governance developments. This dissonance between the dominant theory of modern corporate

5 Philip Schofield (ed), *The Book of Fallacies* (Oxford, Oxford University Press, 2015).

6 Peter Singer, *Ethics in the Real World* (Princeton, Princeton University Press, 2016) 211.

7 See Maurice A Finocchiaro, 'Fallacies and the Evaluation of Reasoning' (1981) 18 *American Philosophical Quarterly* 13, 13.

8 ibid, 14–15.

9 Hamblin, *Fallacies* (n 3) 194.

10 Donald C Langevoort, 'The Effects of Shareholder Primacy, Publicness, and "Privateness" on Corporate Cultures' (2020) 43 *Seattle University Law Review* 377, 378.

11 See, eg, Milan Babic, Eelke Heemskerk an Jan Fichtner, 'Who is More Powerful – States or Corporations?, *The Conversation*, 10 July 2018.

12 See, eg, Claire Hill and Yaron Nili, 'Independence Reconceived' (*Columbia Business Law Review*, forthcoming); Richard M Buxbaum, 'Corporate Legitimacy, Economic Theory, and Legal Doctrine' (1984) 45 *Ohio State Law Journal* 515, 517-520.

law and the real world suggests that the time may have come to re-evaluate the assumptions that support the use of agency theory as the only comprehensive analytical tool for understanding the corporation[13] and to introduce a broader conception of the public corporation and its role in modern society.

2. The Rise to Dominance of the Agency Theory of the Corporation and Some of the Assumptions Embedded in It

> 'The publicly held business corporation is an awesome social invention'.
>
> Michael C Jensen and William H Meckling[14]

> 'Small shifts in your thinking … can lead to massive changes in end results'.
>
> Kevin L Michel[15]

The agency theory of the corporation has now been the dominant paradigm for over four decades.[16] Its emergence in the 1970s–1980s broke new ground in a variety of ways, not least of which was its resurrection of theoretical debate about the nature of the corporation – a debate that had undergone a long hiatus in US corporate law.[17] By reviving legal theory, contractarian scholars succeeded in redirecting public discourse about corporations, including the relationship of corporations with society and how corporations should be regulated.[18]

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13 See generally Eva Micheler, *Company Law: A Real Entity Theory* (Oxford, Oxford University Press, 2021) ch 1; Edward L Rubin, 'Images of Organizations and Consequences of Regulation' (2005) *Theoretical Inquiries in Law* 347.

14 Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305, 357.

15 Kevin L Michel, *Moving through Parallel Worlds to Achieve Your Dreams: The Epic Guide to Unlimited Power* (Michel Leadership Ebook, 2013) 73.

16 See, eg Michael Klausner, 'Fact and Fiction in Corporate Law and Governance' (2013) 65 *Stanford Law Review* 1325, 1326–29.

17 The decline of theoretical debate in the 1920s is often attributed to an influential article by John Dewey: John Dewey, 'The Historic Background of Corporate Legal Personality' (1926) 35 *Yale Law Journal* 655, 666–68. Prior to that, the theoretical nature of the corporation had been a 'virtual obsession' in the US for several decades: Morton J Horwitz, *The Transformation of American Law, 1870–1960: The Crisis of Legal Orthodoxy* (Oxford, Oxford University Press, 1992) 101.

18 See, eg Roberta Romano, 'Metapolitics and Corporate Law Reform' (1984) 36 *Stanford Law Review* 923.

The rise of the agency theory of the corporation represented a 'radical rejection'[19] of the earlier managerialist image of the corporation, which focused on questions relating to the hierarchical power of corporate management and whether or not such power was legitimate.[20] Pro-managerialists had previously viewed the corporation as a 'social institution',[21] where managers act as 'corporate statesmen'[22] with broad discretionary powers enabling them to perform a public role,[23] and to 'consciously direct economic forces for the common good'.[24] Anti-managerialist scholars, on the other hand, had argued that corporate managers held power without accountability, leaving shareholders vulnerable and unprotected. These scholars tended to regard Delaware as the prime villain in this narrative, arguing that the State had 'watered the rights of shareholders vis-à-vis management down to a thin gruel'.[25]

The subsequent emergence of the agency theory of the corporation subverted both sides of this earlier debate. Contractarian scholars rejected the managerialist perception of the corporation as a social institution, while at the same time criticising the anti-managerialist assumption that shareholders were defenceless and unprotected by US corporate law.[26] Rather, contractarians considered that shareholders were adequately protected by the market and that their alleged abuse was therefore 'largely mythical'.[27]

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19 William W Bratton, 'The New Economic Theory of the Firm: Critical Perspectives from History' (1989) 41 *Stanford Law Review* 1471, 1477.

20 ibid 1475–76.

21 Harwell Wells, '"Corporation Law is Dead": Heroic Managerialism, Legal Change, and the Puzzle of Corporation Law at the Height of the American Century' (2013) 15 *University of Pennsylvania Journal of Business Law* 305, 331.

22 ibid 353.

23 See, eg ibid 326–31; Lynne L Dallas, 'The New Managerialism and Diversity on Corporate Boards of Directors' (2002) 76 *Tulane Law Review* 1363, 1366–73.

24 Francis X Sutton et al, *The American Business Creed* (Cambridge, Mass., Harvard University Press, 1956) 34.

25 William L Cary, 'Federalism and Corporate Law: Reflections upon Delaware' (1974) 83 *Yale Law Journal* 663, 666.

26 See, eg ibid.

27 Gregory A Mark, 'Some Observations on Writing the Legal History of the Corporation in the Age of Theory' in Lawrence E Mitchell (ed), *Progressive Corporate Law* (Oxfordshire and New York, Taylor & Francis, 2020) 71.

The genesis of the agency theory of the corporation in Jensen and Meckling's classic 1976 article reframed corporate law in terms of agency relationships.[28] The theory is undeniably elegant. It encompasses a 'single, universal, organising principle',[29] which treats a particular agency problem – namely, the misalignment of interests between corporate managers and providers of capital – as the key problem of corporate law.[30]

A central aspect of Jensen and Meckling's agency theory of the firm was that most organisations, including corporations, are 'simply *legal fictions*' (emphasis in original).[31] In reaching this conclusion, Jensen and Meckling adopted an aggregate theory of the corporation, deconstructing it into a 'nexus of contracting relationships'[32] (a phrase that later morphed into the more familiar term, 'nexus of contracts').[33] They interpreted 'legal fiction' to mean 'the artificial construct under the law which allows certain organizations to be treated as individuals'.[34]

The idea that a corporation is a legal fiction (or a '*persona ficta*') accords with legal history. However, the fact that Jensen and Meckling added the word 'simply' before the reference to 'legal fictions' is revealing. It demoted the concept of legal personality,[35] and indeed, in later interpretations of agency theory, there is a transformation from understanding the corporation as

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28 Jensen and Meckling, 'Theory of the Firm' (n 14). Earlier work in this area represented important antecedents: see, eg Melvin A Eisenberg, 'The Conception That the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm' (1999) 24 *The Journal of Corporation Law* 819, 820–22, discussing the intellectual transition from RH Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386, to Jensen and Meckling.

29 Isaiah Berlin, *The Hedgehog and the Fox: An Essay on Tolstoy's View of History*, 2nd edn (Henry Hardy (ed), Princeton, Princeton University Press, 2013) 2.

30 This misalignment in interests is sometimes viewed more broadly as applying, not merely to shareholders, but to 'suppliers of finance', which also includes creditors: see Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) 52 *The Journal of Finance* 737, 737–38.

31 Jensen and Meckling, 'Theory of the Firm' (n 14) 310.

32 ibid 311.

33 See Marc T Moore, *Corporate Governance in the Shadow of the State* (Oxford, Hart Publishing, 2013) 72 fn 50, attributing the first use of the phrase 'nexus of contracts' to Eugene Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 288, 290.

34 Jensen and Meckling, 'Theory of the Firm' (n 14) 310 fn 12. They also considered that this legal fiction was itself a party to the nexus of contracts: at 311.

35 See Jonathan Hardman, 'Fixing the Misalignment of the Concession of Corporate Legal Personality' (2023) *Legal Studies* 1, 2, describing transaction cost economics as reducing the role of separate legal personality by rendering it 'merely a cheaper mechanism to achieve private ordering'.

a 'legal fiction' (ie artificial, but real)[36] to viewing it as 'fictitious' (ie non-existent).[37] These later interpretations of Jensen and Meckling's agency paradigm dissolved the corporation into nothing more than a 'complex set of explicit and implicit contracts'[38] between various self-interested resource holders.[39] The corporation effectively became 'a matter of convenience rather than reality'.[40]

This shift in the depiction of the corporation had important implications, generating a range of assumptions that subsequently became bedrock principles of modern US corporate law. First, the methodological individualism of this approach offered little scope for recognition of the corporation as an autonomous actor,[41] or for intrinsically organisational accountability.[42]

Second, the agency theory's emphasis on free contractual choice resulted in an assumption that the various contractual exchanges between stakeholders were voluntary. This focus on contract relied on a sharp divide between the public and private spheres,[43] while at the same time placing that the corporation firmly within the latter realm.[44]

Third, the theory interpreted the relationship between shareholders and corporate managers as one of 'pure agency'.[45] Jensen and Meckling treated outside equity and debt holders as 'principals' in

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36 ibid 5, where Hardman argues that separate legal personality 'is a state concession to a real entity'. See also Ngaire Naffine, 'Who Are Law's Persons? From Cheshire Cats to Responsible Subjects' (2003) 66 *Modern Law Review* 346, 347, stating that '[p]erhaps the greatest political act of law is the making of a legal person'.

37 See Arthur W Machen, 'Corporate Personality' (1911) 24 *Harvard Law Review* 253, 257, in relation to this distinction. See also See Hardman, 'Fixing the Misalignment' (n 35) 6-7.

38 Frank H Easterbrook and Daniel R Fischel, 'The Corporate Contract' (1989) 89 *Columbia Law Review* 1416, 1418.

39 See Fama, 'Agency Problems' (n 33) 289.

40 Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Cambridge, London, Harvard University Press, 1991) 12.

41 See, eg Paul Eddy Wilson, 'Barring Corporations from the Moral Community: The Concept and the Cost' (1992) 23 *Journal of Social Philosophy* 74; Richard B Stewart, 'Book Review: Organizational Jurisprudence' (1987) 101 *Harvard Law Review* 371.

42 *cf* Bratton, 'The New Economic Theory' (n 19) 1480, discussing the institutional version of the agency model of the corporation.

43 Rutger Claassen, 'Political Theories of the Business Corporation' (2023) 18 *Philosophy Compass* 1, 5.

44 See, eg Moore, *Corporate Governance* (n 33) 71.

45 Jensen and Meckling, 'Theory of the Firm' (n 14) 309.

this relationship, with corporate managers acting as their agents.[46] Their analysis interpreted agency as a very narrow economic concept, thereby creating a limited viewpoint, which focused on a single relationship and did not purport to comprehend the larger picture.

Fourth, by interpreting contracts as the 'essence' of the firm,[47] the paradigm enhanced the significance of private ordering over mandatory rules and emphasised the 'enabling structure of US corporate law'.[48] This suggested that corporate law's role as a regulatory mechanism is extremely limited,[49] effectively restricted to providing malleable default rules,[50] and enforcing the voluntary bargains created under the nexus of contracts.[51] Under the agency theory of the corporation, mandatory legal rules and doctrines, such as fiduciary duties, designed to control managerial conduct, were largely unnecessary. Instead, the theory optimistically assumed that market forces[52] would do the heavy regulatory lifting as an economic constraint which forced managers to promote shareholder interests.[53]

Fifth, the paradigm dissolved any presumed boundaries around the firm.[54] Jensen and Meckling perceived themselves as cracking open the prior economic 'black box' of the firm and peering inside it to discern the conflicting objectives of its various stakeholders.[55] They treated the earlier 'black box' approach to the corporation as not a theory of the firm at all, but 'actually a theory of

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46 ibid 310.

47 Jensen and Meckling, 'Theory of the Firm' (n 14) 310, stating that '[c]ontractual relations are the essence of the firm, not only with employees but with suppliers, customers, creditors, etc'.

48 Michal Barzuza, 'Inefficient Tailoring: The Private Ordering Paradox in Corporate Law' (2018) 8 *Harvard Business Law Review* 131, 133.

49 See Henry N Butler, 'The Contractual Theory of the Corporation' (1989) 11 *George Mason University Law Review* 99, 100.

50 See Easterbrook and Fischel, *Economic Structure* (n 40) 34.

51 Jensen and Meckling, 'Theory of the Firm' (n 14) 311 fn 14, stating that '[t]he police powers of the state are available and used to enforce performance of contracts or to enforce the collection of damages for non-performance'.

52 See Eisenberg, 'The Conception' (n 28) 823; David Campbell, 'The Role of Monitoring and Morality in Company Law: A Criticism of the Direction of Present Regulation' (1997) 7 *Australian Journal of Corporate Law* 343, 361.

53 See Klausner, 'Fact and Fiction' (n 16) 1327.

54 See Hardman, 'Fixing the Misalignment' (n 35) 9–12 (on the meaning of 'the firm').

55 Jensen and Meckling, 'Theory of the Firm' (n 14) 306–07.

markets in which firms are important actors'.[56] Under Jensen and Meckling's paradigm, however, the image of public corporations as important actors (either in markets or society as a whole) disintegrated. Indeed, the paradigm's deconstruction of the corporation into a network of contracts rendered meaningless any attempt to define what lay inside or outside the firm.[57]

Sixth, the agency theory became commingled with the shareholder primacy movement.[58] Jensen and Meckling's multi-stakeholder contractual approach did not necessarily compel a shareholder-centred view of the corporation.[59] In fact, Blair and Stout would subsequently employ a similar aggregate economic theory of the firm to argue against the pre-eminence of shareholder interests.[60] Nonetheless, there is little doubt that Jensen and Meckling's article provided the springboard for the shareholder primacy movement.[61] This is not on the basis that shareholders are 'owners' of the firm (ownership essentially being an 'irrelevant concept' under the agency theory of the firm),[62] but rather on the basis that shareholders are 'residual' claimants,[63] who, unlike other stakeholders, cannot sufficiently limit their risk by contract.[64]

Finally, the agency theory's relentless private law focus and reliance on stakeholder contracts explicitly banished corporate social responsibility (CSR) from the realm of corporate law. After all, why would CSR be required vis-à-vis employees, if employees could be 'guardians of their

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56 ibid 306.

57 ibid 311; Rubin, 'Images' (n 13) 351. *cf* Fama, 'Agency Problems' (n 33) 289, stating that corporate managers are subject to discipline 'by the markets for their services, *both within and outside of the firm*' (emphasis added).

58 Claassen, 'Political Theories' (n 43) 4–5.

59 See, eg Eisenberg, 'The Conception' (n 28) 833, stating '[i]t is commonly thought that the nexus-of-contracts conception is connected in some fundamental way to the concept of shareholder primacy. It isn't'.

60 Margaret M Blair and Lynn A Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247, 253–54.

61 See Brian R Cheffins, 'What Jensen and Meckling Really Said about the Public Company' in Elizabeth Pollman and Robert B Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* (Cheltenham, Edward Elgar Publishing, 2021) 12–13, 16–17.

62 Fama, 'Agency Problems' (n 33) 290.

63 Moore, *Corporate Governance* (n 33) 76. See also at 74–78, where Moore discusses the link between the contractual theory of the firm and 'shareholder exclusivity in corporate governance law': at 78.

64 See generally Brian R Cheffins, 'The Team Production Model as a Paradigm' (2015) 38 *Seattle University Law Review* 397, 408–09.

own interests' and self-protect via their contracts with the company?[65] According to Jensen and Meckling, questions such as 'what should be the objective function of the firm' or 'does the firm have a social responsibility' were logically inconsistent with their agency theory of the firm as a fiction.[66] As they stated, '*[t]he firm is not an individual*' (emphasis in original).[67]

The narrowness and descriptive inadequacies of this approach morphed into normative inadequacies. Milton Friedman's famous 1970 pronouncement that '[t]he social responsibility of business is to increase its profits' is emblematic of this deficiency.[68] The so-called Friedman doctrine encompassed all the assumptions that Jensen and Meckling would subsequently weave into scholarly economic arguments in their 1976 article. Friedman held very clear views on corporate managers who take seriously CSR/Environment, Social and Governance (ESG) issues, such as employment, anti-discrimination and environmental protection[69] – he accused them of 'preaching pure and unadulterated socialism'.[70] Friedman also stated that '[o]nly people can have responsibilities'[71] and that the responsibility of corporate managers, as agents of the shareholders, is to comply with their principals' desires, 'which generally will be to make as much money as possible'.[72] Under this approach, shareholders and their desires are viewed as relatively homogeneous, with monetary gain[73] or 'shareholder value maximization' becoming the corporate lodestar.[74]

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65 See *BTI 2014 LLC v Sequana SA & Ors* [2022] UKSC 25, (2023) All ER 303, 315–16 [27]–[28] (Lord Reed P). See also at 322–23 [52]–[54] (Lord Reed P), noting that this was the traditional approach in relation to corporate creditors.

66 Jensen and Meckling, 'Theory of the Firm' (n 14) 311.

67 ibid.

68 Milton Friedman, 'A Friedman Doctrine – The Social Responsibility of Business Is to Increase Its Profits' *The New York Times* (New York, 13 September 1970).

69 ibid.

70 ibid 32: Friedman also accused such business leaders as being 'unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades'.

71 ibid.

72 ibid. Milton Friedman's famous quote continued with the following qualification: 'while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom'.

73 ibid.

74 See generally Oliver Hart and Luigi Zingales, 'The New Corporate Governance' (2022) 1 *The University of Chicago Business Law Review* 195, 196.

Of course, it might be argued that my description of early agency theory constitutes a fallacy in its own right, namely, the fallacy of inaccurate or uncharitable reconstruction, by failing to take sufficient account of the theory's subsequent evolution.[75] It is certainly true that the agency theory has not remained static, with some legal scholars pushing back against a purely contractual portrayal of the corporation to include property elements.[76] Nonetheless, it is fair to say that, despite attempted fine-tuning, the central tenets of original agency theory (including assumptions about the fictitious nature of the corporation, the hegemony of contract law[77] and the centrality of the shareholder value maximisation norm) have proven to be remarkably resilient and continue to hold a powerful sway today in both law[78] and finance.[79]

3. Questionable Assumptions Underpinning the Agency Theory of the Corporation

> 'I had fallen victim to the fallacy of the "growing edge"; the belief that only the very frontier of scientific advance counted; that everything that had been left behind by that advance was faded and dead'.
>
> Isaac Asimov[80]

The agency theory of the corporation contains several assumptions that are questionable from an historical and legal perspective. For example, although many commentators assumed that the agency theory of the corporation amounted to a 'revolution',[81] from an historical perspective, the theory was, in fact, less radical than it first appeared. Similar aggregate/contractual theories

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75 Finocchiaro, 'Fallacies' (n 7) 18, 22.

76 See eg Henry Hansmann and Reinier Kraakman, 'The Essential Role of Organizational Law' (2000) 110 *Yale Law Journal* 387, 406.

77 See Eisenberg, 'The Conception' (n 28) 836.

78 See generally Dorothy S Lund and Elizabeth Pollman, 'The Corporate Governance Machine' (2021) 121 *Columbia Law Review* 2563.

79 See Hart and Zingales, 'The New Corporate Governance' (n 74) 204–07, discussing why shareholder value maximisation became, and stayed, the business norm.

80 Isaac Asimov, *Adding a Dimension: Seventeen Essays on the History of Science* (Garden City, Doubleday, 1964).

81 See, eg Roberta Romano, 'After the Revolution in Corporate Law' (2005) 55 *Journal of Legal Education* 342, 342; Michael C Jensen, 'Organization Theory and Methodology' (1983) 58 *The Accounting Review* 319, 324.

of the corporation flourished in the US during the nineteenth century[82] (albeit in competition with entity theories of the corporation),[83] before waning at the turn of the twentieth century.[84] Writing in the late 1980s, Bratton described the supposedly new agency theory of the firm as ‘merely the latest in a long series of attempts to describe and justify the phenomenon of collective production in individualist terms’.[85] The theory has also been labelled ‘contractualism with economic foundations’.[86]

Nor was the use of contractual language new. The famous 1819 US Supreme Court decision, *Trustees of Dartmouth College v. Woodward*,[87] interpreted a corporation’s charter as a contract between its original parties, namely ‘the donors, the trustees, and the crown’.[88] This approach became legal orthodoxy in the US, with an 1865 US federal court case brief stating that:

> ‘[a] charter of a corporation is a contract of a two-fold character; it is, 1st, a contract between the State and the corporation; and 2dly, between the corporation and the stockholders’.[89]

By the late nineteenth century, however, the first of these two types of contract (which would certainly attract the censure of agency theorists) was headed for extinction in the US. In the era of

82 See Morton J Horwitz, ‘*Santa Clara* Revisited: The Development of Corporate Law Theory’ (1985) 88 *West Virginia Law Review* 173, 182, noting that ‘through the 1880s, there was a strong tendency to analyze corporation law not very differently from the law of partnership’.

83 See Bratton, ‘The New Economic Theory’ (n 19) 1490–91; Horwitz, ‘*Santa Clara* Revisited’ (n 82) 176, arguing that the ‘“natural entity”’ theory of the corporation was instrumental in ‘legitimating big business’.

84 See Bratton, ‘The New Economic Theory’ (n 19) 1490.

85 ibid 1472–73.

86 Claassen, ‘Political Theories’ (n 43) 4.

87 *Trustees of Dartmouth College v Woodward*, 17 US 518 (1819).

88 ibid 643.

89 Elliott Anthony, *A Treatise on the Law of Consolidation of Railroad Companies* (Chicago, Brach & Barnard, 1865) v.

competition for corporate charters,[90] the state receded, in favour of the corporation itself, as primary 'law-maker'.[91]

In the UK, nineteenth- and early-twentieth-century case law also used the terminology of 'contract' to describe the effect of the constitutional document, the articles of association.[92] These cases treated the articles of association as a 'contract' between the shareholders *inter se*,[93] but it was also accepted that a binding contract existed between the shareholders and the company itself.[94] The state was not considered to be a contracting party under early UK company law.[95]

Yet, although historically, the language of contract was a significant and familiar aspect of UK company law, contract was certainly not all that mattered. Trust law played an equally important role in the development of unincorporated joint stock ('deed of settlement') companies,[96] which ultimately provided the blueprint for modern UK company law.[97] These companies, which have been described as 'an inferior substitute' for chartered corporations,[98] nonetheless made the best of the legal tools at hand. They used contract law to operate as large partnerships, but they also employed the trust concept as a means of holding property.[99] In both the US and the UK, directors

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90 See generally Charles M Yablon, 'The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910' (2007) 32 *The Journal of Corporation Law* 323.

91 Joel Seligman, 'A Brief History of Delaware's General Corporation Law of 1899' (1976) 1 *Delaware Journal of Corporate Law* 249, 273.

92 See, eg *Pritchard's Case* (1873) 8 Ch App 956, 960 (Mellish LJ), 961 (James LJ); *Eley v Positive Government Security Life Assurance Co Ltd* (1875) 1 Ex D 20, 26 (Amphlett B).

93 *Pritchard's Case* (n 92) 960 (Mellish LJ, James LJ agreeing at 961); *Eley* (n 92) 26 (Amphlett B, Cleasby B agreeing at 29–30).

94 See *Hickman v Kent or Romney Marsh Sheepbreeders' Association* [1915] 1 Ch 881, [1914–15] All ER Rep 900 (Astbury J).

95 This was due to the different organisational origins of UK and US corporate law: see Jennifer G Hill, 'The Trajectory of American Corporate Governance: Shareholder Empowerment and Private Ordering Combat' [2019] *University of Illinois Law Review* 507, 540–47.

96 ibid 544–47.

97 A legislative attempt to outlaw deed of settlement companies via the famous UK Bubble Act of 1720 was a regulatory failure: see LCB Gower, 'Some Contrasts between British and American Corporation Law' (1956) 69 *Harvard Law Review* 1369, 1370. US corporate law, by way of contrast, derived from royal chartered corporations: see Hill, 'Trajectory' (n 95) 541–44.

98 Timothy W Guinnane, Ron Harris and Naomi R Lamoreaux, 'Contractual Freedom and Corporate Governance in Britain in the Late Nineteenth and Early Twentieth Centuries' (2017) 91 *Business History Review* 227, 231.

99 See LCB Gower, 'The English Private Company' (1953) 18 *Law and Contemporary Problems* 535, 535. On the importance of the trust concept for deed of settlement companies, see John Morley, 'The Common

and officers were regarded as fiduciaries and their corresponding duties provided a constraint on managerial discretion.[100]

Since Jensen and Meckling's agency theory of the corporation rose to prominence, some US scholars have also sought to deconstruct trusts[101] and fiduciary duties[102] into mere contracts. However, these reductionist attempts mischaracterise aspects of both trust law and fiduciary duties, undermining their rich and complex historical foundations.[103] The conflation of contract and fiduciary duties, for example, overlooks their 'profound dissimilarity' in terms of origin and scope.[104] Whereas contract law is a common law doctrine, fiduciary duties and trust law originated in equity.[105] Whereas contract law is firmly based on the parties' intention, fiduciary obligation often subverts the parties' intention.[106] Furthermore, some aspects of trust law, such as a prohibition on exculpatory provisions in trust instruments, are incompatible with contractual principles.[107]

Agency theory places the corporation firmly in the private realm, yet it is by no means obvious that it belongs there for all purposes and at all times. Berle and Means in their seminal 1932

Law Corporation: The Power of the Trust in Anglo-American Business History' (2016) 116 *Columbia Law Review* 2145, 2157-59, 2161.

100 Gower, 'Some Contrasts' (n 97) 1383.

101 See, eg John H Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105 *Yale Law Journal* 625. Although Langbein states that it is 'not my wish to fold the law of trusts into the law of contracts': at 671, his claim that '[t]rusts are contracts': at 627 arguably does precisely that. It has therefore been said that Langbein 'kick-started the obligational approach to trusts'. Ming Wai Lau, *The Economic Structure of Trusts: Towards a Property-based Approach* (Oxford, Oxford University Press, 2011) 21 fn1.

102 See Frank H Easterbrook and Daniel R Fischel, 'Corporate Control Transactions' (1982) 91 *Yale Law Journal* 698, 702; Frank H Easterbrook and Daniel R Fischel, 'Contract and Fiduciary Duty' (1993) 36 *The Journal of Law and Economics* 425.

103 See, eg Deborah A DeMott, 'Beyond Metaphor: An Analysis of Fiduciary Obligation' (1988) *Duke Law Journal* 879, 923–24. See also at 889 fn 45.

104 ibid 888.

105 ibid 881–82 fn 10, stating that '[f]ew areas of the law are as distinctively equitable in character as fiduciary obligation'.

106 ibid 887.

107 ibid 923.

text, *The Modern Corporation and Private Property*, viewed the public corporation as a deeply ambiguous entity, straddling both public and private law.[108]

This public-private divide created ongoing tension in corporate law history and practice,[109] as conceptions of the corporation shifted between these 'different visions of corporatism'.[110] Yet, various other theories have viewed the corporation through a more public lens. According to some of these theories, the corporation is an entity in its own right, akin to a political body.[111] Other contemporary theories of the firm have criticised the common use of human metaphors and personification to describe the corporation, while stressing its unity and autonomy as a distinctive legal person.[112]

Corporate history highlights this public-private duality. The early period of special charters, for example, combined public and private goals.[113] Yet, over time a schism developed between some corporations, such as municipal corporations, which were treated as public bodies, in contrast to business corporations, which tended to be classified as private entities.[114] Nonetheless, Berle and Means were arguably correct in their view that public corporations encompass elements of both. Eisenberg captures this duality in his statement that '[c]orporation law is private law, but the public has an interest in it'.[115] This duality is also evident in current academic debate about corporate purpose, which, it has been argued, can include both the idea

108 Adolf A Berle and Gardiner C Means, *The Modern Corporation & Private Property*, 2nd edn (Oxford, Routledge, 2017).

109 See generally William T Allen, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 *Cardozo Law Review* 261.

110 William W Bratton and Michael L Wachter, 'Shareholder Primacy's Corporatist Origins: Adolf Berle and *The Modern Corporation*' (2008) 34 *The Journal of Corporation Law* 99, 124.

111 See generally Jennifer Hill, 'Visions and Revisions of the Shareholder' (2000) 48 *The American Journal of Comparative Law* 39, 51-57.

112 See, eg Meir Dan-Cohen, *Rights, Persons, and Organizations: A Legal Theory for Bureaucratic Society* 2nd edn (New Orleans, Quid Pro, LLC, 2016); Stewart, 'Book Review' (n 41).

113 Mark, 'Some Observations' (n 27) 68–69; Hill, 'Visions' (n 111) 51–52.

114 See generally Gerald E Frug, 'The City as a Legal Concept' (1980) 93 *Harvard Law Review* 1057.

115 Melvin Aron Eisenberg, 'New Modes of Discourse in the Corporate Law Literature' (1984) 52 *George Washington Law Review* 582, 588.

of private ordering in an individual corporation and a broader notion about the role of the public corporations generally vis-à-vis society.[116]

In the quest to position the corporation in the purely private realm, Jensen and Meckling's view of agency ignored, and failed to correspond with, legal theory. Specifically, Jensen and Meckling interpreted agency as a purely economic concept and thereby jettisoned fiduciary law from its ambit. Furthermore, their treatment of corporate managers and directors as agents *of the shareholders* does not accord with modern legal theory or practice in common law jurisdictions. A central feature of the law of agency is that the agent is subject to the ongoing control of the principal,[117] and this concept of agency accords with Friedman's view that corporate managers, as agents, must comply with the shareholders' wishes. Yet, this approach is not consistent with modern UK or US corporate law. Although during the nineteenth century, UK courts accepted that shareholders had ultimate control and could therefore override decisions of the board of directors,[118] by the early twentieth century, this approach was decisively rejected by the judiciary.[119] The modern UK approach is that a company's directors are not the agents of the shareholders, and that the latter have no legal right to give directions or override board decisions, absent an explicit provision in the company's constitution.[120] In the US context, the formidable protection given to board decisions by the business judgement rule, combined with the precatory nature of many shareholder resolutions, provides further evidence that the relationship between shareholders and directors does not satisfy the legal test for agency. US rules relating to charter alteration and shareholder voting suggest that the relationship between directors and shareholders

116 See, eg Dorothy S Lund and Elizabeth Pollman, 'Corporate Purpose' in Jeffrey N. Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* 2nd edn (Oxford, Oxford University Press, forthcoming); Colin Mayer, 'What is Wrong with Corporate Law? The Purpose of Law and the Law of Purpose' (2022) *Annual Review of Law and Science* 283.

117 See, eg American Law Institute, *Restatement (Third) of Agency* (2006) § 1.01.

118 See, eg *Isle of Wight Railway Co v Tahourdin* (1883) 25 Ch D 320.

119 *Automatic Self Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34, 45–46 (Cozens-Hardy LJ); Hill, 'Visions' (n 111) 42-44, 48.

120 It appears, however, that this was commonly the case in the UK: see Paul L Davies and Sarah Worthington, *Gower: Principles of Modern Company Law*, 11th edn (London, Sweet and Maxwell, 2021) 360 [14-7]–[14-8]. Shareholders also had ultimate control over the allocation of power in UK companies through their ability to alter the companies' articles of association: at [3-31]–[3-32].

under traditional US corporate law is not a principal-agent relationship – rather, directors act as 'gatekeepers',[121] and shareholders occupy the role of 'supplicants'.[122]

One problem with agency theory's contractual rhetoric and image of directors as agents of the shareholders is that it conceals both corporate power and managerial power. The private focus of agency theory, for example, masks the fact that many multinational corporations now rival nation states in terms of revenue and influence.[123] Also, by employing the concept of contract as a 'vehicle for voluntary exchange',[124] agency theory introduced an assumption of equality of bargaining power between various stakeholders. No legal doctrine captures the ideal of decisional autonomy and entrepreneurial freedom as effectively as contract law.[125] This theoretical lens, together with the concept of private ordering, minimised the perception of managerial power and disguised management's positional conflict of interest (even as the theory presented itself as an antidote to rampant managerial conflicts of interest).[126] These features of agency theory also had a legitimising effect, suggesting that shareholders, and private ordering by shareholders, could provide an effective constraint on corporate managers.[127]

Jensen and Meckling's agency theory placed considerable faith in the ability of the market to operate as a regulatory substitute.[128] Yet, doubts have also grown over time about the effectiveness

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121 See, eg Stephen M Bainbridge, '*UNOCAL* at 20: Director Primacy in Corporate Takeovers' (2006) 31 *Delaware Journal of Corporate Law* 769, 771.

122 See, eg *Continental Securities Co v Belmont* 99 NE 138 (1912) 141, stating that any action by shareholders is 'necessarily in the form of an assent, request, or recommendation'.

123 See Babic, Heemskerk and Fichtner, 'Who is More Powerful?' (n 11).

124 Jensen and Meckling, 'Theory of the Firm' (n 14) 310, citing Armen A Alchian and Harold Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62 *The American Economic Review* 777 for this point.

125 See Edward B Rock and Michael L Wachter, 'Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation' (2001) 149 *University of Pennsylvania Law Review* 1619, 1628, describing the nexus of contracts as a 'powerful metaphor' in this regard.

126 See Melvin Aron Eisenberg, 'The Structure of Corporation Law' (1989) 89 *Columbia Law Review* 1461, 1471–72; Rubin, 'Images' (n 13) 350–51.

127 Gerald E Frug, 'The Ideology of Bureaucracy in American Law' (1984) 97 *Harvard Law Review* 1276, 1305. *cf* political theories of the corporation that treat the corporate power as legitimate only to the extent that it aligns with purposes that society accepts as legitimate: see Claassen, 'Political Theories' (n 43) 2–3.

128 See Buxbaum, 'Corporate Legitimacy' (n 12) 516, arguing that agency theory focuses too much on the effect of markets on firms and insufficiently on the effect of large enterprises on social institutions, including markets.

of the market as a managerial constraint.[129] In the aftermath of global financial crisis, the UK Turner Review stated that the crisis challenged a central assumption concerning the market's efficiency, rationality and ability to self-regulate that had previously underpinned financial law.[130] If the agency theory of the firm encompasses an assumption that there are clear costs to over-regulation, the global financial crisis showed that the opposite is also true and there are also serious 'costs to under-regulation'.[131]

4. Growing Dissonance between the Contractual Theory of the Firm and Contemporary Corporate Governance Developments

> '**Geronte**: It seems to me you are locating them wrongly: the heart is on the left and the liver is on the right.
>
> **Sganarelle**: Yes, in the old days that was so, but we have changed all that, and we now practise medicine by a completely new method'.
>
> Molière[132]

In his 1937 article on 'The Nature of the Firm',[133] Ronald Coase accepted that one of the key questions to be asked in relation to economic assumptions is '[d]o they correspond with the real world?'.[134] Over the last few decades, many of the assumptions underpinning the agency theory of the corporation have acquired the status of axiomatic and unassailable truths, yet they fit uncomfortably with a variety of recent corporate governance developments.[135]

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129 See, eg William W Bratton and Simone M Sepe, 'Corporate Law and the Myth of Efficient Market Control' (2020) 105 *Cornell Law Review* 675; Barzuza, 'Inefficient Tailoring' (n 48) 134.

130 Financial Services Authority, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (March 2009) 39 ff.

131 John C Coffee, 'Financial Crises 101: What Can We Learn from Scandals and Meltdowns – from Enron to Subprime?' in RP Austin (ed), *The Credit Crunch and the Law* (Sydney, The Ron Parsons Centre of Commercial, Corporate and Taxation Law, 2008) 37.

132 Molière, *Le Médecin Malgré Lui*, Act II.

133 Coase, 'The Nature' (n 28).

134 ibid 386, quoting Joan Robinson, *Economics is a Serious Subject: The Apologia of an Economist to the Mathematician, the Scientist and the Plain Man* (Cambridge, Heffer & Sons, 1932) 12.

135 See Deirdre N McCloskey, *The Rhetoric of Economics* 2nd edn (Madison, University of Wisconsin Press, 1998), 23–8, discussing how some economic 'truths', such as the law of demand, rest on rhetorical, rather than purely scientific, foundations.

These developments suggest that there is now far greater attention paid to the role of the corporation in society and to issues of corporate accountability. The next section considers developments in the following areas – the relationship between corporate managers and shareholders and private ordering; shareholder activism and ESG; executive compensation; and corporate criminal liability.

4.1 Contemporary Developments Concerning the Relationship Between Corporate Managers and Shareholders and Private Ordering

Contemporary developments concerning the relationship between corporate managers and shareholders provide an uneasy fit with Jensen and Meckling's paradigmatic agency relationship, which assumes that corporate managers must comply with the shareholders' wishes. As noted previously, this presumed relationship does not satisfy the legal test for agency. Nonetheless, even if it did, governance patterns in some contemporary corporations, such as startups, deviate substantially from this blueprint.

Jensen and Meckling's theory envisaged a corporate world in which outside shareholders have only a vertical agency relationship with corporate managers.[136] Yet, as Pollman has demonstrated, the governance structure of startups is typically at odds with this paradigm. Startups include not only vertical tensions between shareholders and managers, but also major horizontal conflicts between investors with divergent interests.[137] Also, whereas Jensen and Meckling's paradigm is relatively static, startup governance structures are dynamic; they evolve over time and encompass overlapping and shifting roles for participants.[138] Furthermore, although fissures can undoubtedly develop, the relationship between various startup participants is often highly collaborative. Rather than conforming to a fixed vertical relationship, the interactions between venture capitalists and startup entrepreneurs are more complex, exhibiting partnership-like qualities of 'give-and-take'[139] and 'shared decisionmaking power'.[140]

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136 Elizabeth Pollman, 'Startup Governance' (2019) 168 *University of Pennsylvania Law Review* 155, 177.

137 ibid 178; Robert P Bartlett, 'Venture Capital, Agency Costs, and the False Dichotomy of the Corporation' (2006) 54 *University of California Law Review* 37, 61–4.

138 Pollman, 'Startup' (n 136) 160.

139 D Gordon Smith, 'Venture Capital Contracting in the Information Age' (1998) 2 *Journal of Small and Emerging Business Law* 133, 139.

140 Jill E Fisch and Simone M Sepe, 'Shareholder Collaboration' (2020) 98 *Texas Law Review* 863, 874.

Nor is this this pattern necessarily restricted to startups. As Fisch and Sepe show, such collaboration is also increasingly evident in modern public companies with high levels of institutional investor shareholding.[141] Two other assumptions in Jensen and Meckling's agency paradigm fail to reflect contemporary corporate governance developments. The first is that shareholders have homogenous interests.[142] The second is that directors and executives constitute a unified managerial group,[143] an assumption that no longer holds true since the rise of independent directors[144] as a check on managerial shortcomings or overconfidence.[145]

As noted previously, agency theory also suggests that private ordering by shareholders is an effective constraint on corporate managers and therefore has a has a legitimising impact.[146] Yet the concept of private ordering, which is so deeply embedded in US corporate law, itself contains some potentially flawed assumptions that fail to correspond with the real world. For example, the widely accepted view that private ordering is an efficient corporate governance tailoring mechanism (and that the market provides incentives for corporations voluntarily to adopt pro-shareholder governance provisions) has been challenged in recent times.[147] Another matter of concern is that some organisations, such as VC-funded startups, commonly effect private ordering not via changes to the charter or bylaws, but rather by means of opaque shareholder agreements[148] – a development that has been described as 'stealth governance'.[149] Even in the context of alternative entities, such as LLCs, commentators have suggested that the goal of private ordering is often not to promote economic efficiency but instead as a means of legitimising opportunism.[150]

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141 Fisch and Sepe, 'Collaboration' (n 140).

142 Pollman, 'Startup' (n 136) 177.

143 ibid.

144 Jeffrey N Gordon, 'The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices' (2007) 59 *Stanford Law Review* 1465.

145 See Hill and Nili, 'Independence' (n 12).

146 Frug, 'Ideology' (n 127) 1305. *Cf* political theories of the corporation that treat the corporate power as legitimate only to the extent that it aligns with purposes that society accepts as legitimate. See Claassen, 'Political Theories' (n 43) 2, 3.

147 Barzuza, 'Inefficient Tailoring' (n 48) 132-34; Jill E Fisch, 'Stealth Governance: Shareholder Agreements and Private Ordering' (2021) 99 *Washington University Law Review* 913.

148 Fisch, 'Stealth Governance" (n 147).

149 ibid.

150 See, eg Peter Molk, 'How Do LLC Owners Contract Around Default Statutory Protections' (2017) 42 *The Journal of Corporation Law* 503; Leo E Strine, Jr and J Travis Laster, 'The Siren Song of Unlimited

In a recent Delaware Court of Chancery decision, *New Enterprise Associates 14 v Rich*,[151] Vice-Chancellor Laster rejected an assumption, accepted in many prior Delaware cases,[152] that corporations and LLCs are purely 'creatures of contract'.[153] Although acknowledging that contract law has an important role to play, he stated that:

> '[j]ural entities are thus never wholly creatures of contract. Nor are they a nexus of contracts. However attractive that metaphor might be for economic modeling, entities are reified constructs'.[154]

The approach adopted in *New Enterprise Associates 14 v Rich* introduces the state, together with a public policy vision, into the corporate law arena.[155] It also provides limits on the scope of private ordering and reasserts the significance of fiduciary duty law in relation to corporations and even LLCs, which have often been regarded as quintessentially contractual.[156]

Traditional assumptions concerning the power of private ordering are also associated with the idea that US corporate law is highly protective of shareholder rights, a narrative embedded in La Porta et al's famous 'law matters' hypothesis.[157] In fact, however, US shareholders possess far fewer corporate governance rights than shareholders in other common law jurisdictions, where such rights are often guaranteed by mandatory laws.[158] The 2006 Paulson Committee, which noted

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Contractual Freedom' in Robert W Hillman and Mark J Loewenstein (eds), *Research Handbook on Partnerships, LLCs and Alternative Forms of Business Organizations* (Cheltenham, Edward Elgar Publishing, 2015) 11.

151 *New Enterprise Associates 14 v Rich* CA No. 2022-0406-JTL (Del Ch 2 May 2023).

152 See Mohsen Manesh, 'Creatures of Contract: A Half-Truth About LLCs' (2018) 42 *Delaware Journal of Corporate Law* 391, 458–66.

153 *New Enterprise* (n 151) fn 159.

154 *New Enterprise* (n 151).

155 ibid. See also Vice Chancellor Laster's decision in *Obeid v Hogan*, 2016 WL3356851 (Del Ch 2016), fn 2, where he states that 'an LLC agreement is not an exclusively private contract among its members precisely because the LLC has powers that only the State of Delaware can confer'.

156 ibid.

157 Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Corporate Ownership around the World' (1999) 54 *The Journal of Finance* 471.

158 See generally Jennifer G Hill, 'Subverting Shareholder Rights: Lessons from News Corp's Migration to Delaware' (2010) 63 *Vanderbilt Law Review* 1.

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that '[o]verall, shareholders of US companies have fewer rights … than do their foreign competitors'.[159]

An important aspect of private ordering is 'who is doing the ordering?' and this can differ across time and jurisdictions. In contrast to the United Kingdom, where the 'free contracting' aspect of the articles of association was viewed as one of the cornerstones of shareholder rights,[160] private ordering in the US was traditionally the domain of the board of directors. Nonetheless, in recent times, this has shifted, with institutional investors using private ordering to adopt bylaw amendments on a company-by-company basis. These bylaw amendments have resulted in the transplantation in some US corporations of certain pro-shareholder protections that are mandatory in other common law jurisdictions.[161] Whereas the United States was traditionally viewed as the dominant exporter of corporate law,[162] this development has rendered it a corporate importer. The development also challenges the assumption that global corporate law transmission is in one direction only.[163] Rather than driving global convergence, as predicted by La Porta et al and others,[164] Cabrelli and Siems have argued that the US is increasingly an 'outlier' in international corporate governance.[165]

Although agency theory assumes that the board's role is to carry out the wishes of shareholders, the recent appropriation of private ordering by shareholders has led many US boards of directors to engage in a form of 'private ordering combat',[166] where their aim is to subvert, rather than implement, investors' wishes. Boards have, for example, used their own bylaw amendment

159 Committee on Capital Markets Regulation, *Interim Report* (30 November 2006) 16.

160 Richard C Nolan, 'Shareholder Rights in Britain' (2006) 7 *European Business Organization Law Review* 549, 554–56.

161 Jennifer G Hill, 'Transnational Migration of Laws and Norms in Corporate Governance: Fiduciary Duties and Corporate Codes' in Seth Davis, Thilo Kuntz and Greg Shaffer (eds), *Transnational Fiduciary Law* (Cambridge, Cambridge University Press, 2023) 227.

162 David Cabrelli and Mathias Siems, 'Convergence, Legal Origins, and Transplants in Comparative Corporate Law: A Case-Based and Quantitative Analysis' (2015) 63 *The American Journal of Comparative Law* 109, 127.

163 Hill, 'Transnational Migration' (n 161) 227.

164 See, eg Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439, 468.

165 Cabrelli and Siems, 'Convergence' (n 162) 152.

166 Hill, 'Trajectory' (n 95).

powers to reduce the efficacy of shareholder proposals,[167] and to exert control over the forums in which investors can bring litigation.[168] These developments rest heavily on the assumption that bylaw provisions are contractually binding on shareholders, even though the provisions were drafted and adopted by the board of directors,[169] leading one scholar to ask 'whose law is it?'.[170]

4.2 Shareholder Activism and ESG

Problem-framing is all-important in corporate law and theory.[171] Corporate financial performance, which takes centre stage as the key problem to be solved under the agency theory of the firm, is undoubtedly a legitimate concern. It was viewed as such in the 1970s, when financial economists sought an antidote to the problem of managerial opportunism, entrenchment and empire-building.[172] Shareholding was traditionally assumed to be a voluntary act, according with Stout's claim that 'investors are not forced to purchase shares in public corporations at gunpoint'.[173] Today, however, members of the public in many jurisdictions are, in fact, involuntary investors via mandatory retirement saving schemes.[174] In an environment of 'forced capitalism',[175] corporate financial performance matters more than ever.

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167 ibid 534–35.

168 See, eg *Boilermakers Local 154 Retirement Fund v Chevron Co* 73 A 3d 934 (2013). See also *Salzberg v Sciabacucchi* 227 A 3d 102 (Del 2020); Alison Frankel, 'Dela. Supreme Court: Companies Can Pick Forum for Shareholders' Section 11 Claims', *Reuters* (London, 18 March 2020).

169 See Fisch (n 147), 921-23.

170 James D Cox, 'Whose Law Is It? Battling over Turf in Shareholder Litigation' in Jennifer G Hill and Randall S Thomas (eds) *Research Handbook on Shareholder Power* (Cheltenham, Edward Elgar Publishing, 2015).

171 See generally Tim Bowley and Jennifer G Hill, 'Stewardship Codes, ESG Activism and Transnational Ordering' in Thilo Kuntz (ed), *Research Handbook on Environmental, Social, and Corporate Governance* (Cheltenham, Edward Elgar Publishing, forthcoming).

172 See Michael C Jensen, 'Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers' (1986) 76 *The American Economic Review* 323, 323.

173 Lynn A Stout, 'The Mythical Benefits of Shareholder Control' (2007) 93 *Virginia Law Review* 789, 801.

174 See Leo E Strine, 'Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance' (2007) 33 *The Journal of Corporation Law* 1, 4.

175 ibid.

However, the manager-shareholder agency problem is not the only problem to which corporate law needs to respond. In many jurisdictions, the parties to agency problems concerning financial performance will be different. In parts of Asia and Europe, for example, where concentrated ownership structures are the norm,[176] and institutional investment is minimal, the key agency problem will be between controlling and minority shareholders (or 'principal-principal' agency problems).[177] Historically, similar problems existed in US public corporations between wealthy elites with large shareholdings on the one hand, and small shareholders and corporate managers, on the other.[178]

In recent years, financial scandals, such as the Wells Fargo fraudulent accounts scandal, emphasised that there are multiple substantive problems in corporate law.[179] These include a the danger of defective corporate cultures[180] that can result in negative externalities.[181] The scandals also demonstrated that classic alignment of interest techniques under agency theory, such as performance-based pay, can exacerbate negative externalities, by creating perverse incentives for corporate misconduct that can harm various stakeholders (including shareholders) and society as a whole.[182] These developments show that an undiluted version of the nexus of contracts model of the corporation can be normatively unappealing.

There is also increasing recognition of a new, and unprecedented set of risks concerning the environment, particularly in relation to climate change, which have helped ESG go

176 OECD, *OECD Corporate Governance Factbook 2023* (2023) 17ff.

177 See Gregorio Sánchez-Marin et al, 'Excess Executive Compensation and Corporate Governance in the United Kingdom and Spain: A Comparative Analysis' (2022) 43 *Managerial and Decision Economics* 2817, 2818.

178 At least before corporate managers became powerful and prosperous. See generally Sarah C Haan, 'The Pathology of Passivity: Shareholder Passivity as a False Narrative in Law' in Alexandra Andhov, Claire Hill and Saule Omarova (eds), *Hidden Fallacies in Corporate and Financial Regulation: Reframing the Mainstream Narratives* (Oxford, Hart Publishing, forthcoming).

179 Jennifer G Hill, 'Corporations, Directors' Duties, and the Public/Private Divide' in Arthur B Laby and Jacob Hale Russell (eds) *Fiduciary Obligations in Business* (Cambridge, Cambridge University Press, 2021) 286.

180 ibid 292–93.

181 See, eg Buxbaum, 'Corporate Legitimacy' (n 12) 517–18.

182 See generally Jennifer G Hill, 'Deconstructing Sunbeam — Contemporary Issues in Corporate Governance' (1999) 67 *University of Cincinnati Law Review* 1099, 1120-25.

'mainstream'.[183] These risks are now treated as key financial risks for corporations; BlackRock, for instance, has estimated that climate change poses a US $8.2 billion risk to its portfolio.[184]

Issues involving negative externalities, including environmental harm, go to the heart of corporate legitimacy.[185] Growing concern about these issues has led to greater regulatory focus on issues of corporate culture,[186] negative externalities and misconduct risk, in addition to a more public conception of the corporation.[187] These developments are manifested at an aspirational level and in 'on the ground' ESG shareholder activism. At the aspirational level, shareholder stewardship codes, which have proliferated around the world since their introduction in the UK in 2010 following the global financial crisis,[188] now pay greater attention to sustainability and ESG issues.[189] The 2020 version of the UK Stewardship Code exemplifies this trend, leading one commentator to ask whether, in the space of a decade, the UK Stewardship Code has gone from 'saving the company to saving the planet'.[190]

Activist campaigns, such as that at ExxonMobil in 2020, reflect a dramatic increase in 'on the ground' activism by institutional investors[191] in areas like climate change risk, board and workforce diversity, and human capital management.[192] There has been escalating institutional

183 See Alex Edmans, 'The End of ESG' (2023) 52 *Financial Management* 3, 4, describing 'ESG's evolution from a niche subfield into a mainstream practice'.

184 See Felix Jaeger, 'Say No to Climate Change, Say Yes to "Say on Climate"' (Oxford Business Law Blog, 13 July 2021).

185 See eg Langevoort, 'The Effects' (n 10).

186 ibid.

187 See eg Hilary A Sale, 'Fiduciary Law, Good Faith, and Publicness' in Evan J Criddle, Paul B Miller and Robert H Sitkoff (eds) *The Oxford Handbook of Fiduciary Law* (Oxford, Oxford University Press, 2019).

188 Financial Reporting Council, *The UK Stewardship Code* (July 2010).

189 See Dionysia Katelouzou and Alice Klettner, 'Sustainable Finance and Stewardship: Unlocking Stewardship's Sustainability Potential' in Dionysia Katelouzou and Dan W Puchniak (eds) *Global Shareholder Stewardship* (Cambridge, Cambridge University Press, 2022).

190 Paul Davies, 'The UK Stewardship Code 2010–2020: From Saving the Company to Saving the Planet?' in Dionysia Katelouzou and Dan W Puchniak (eds) *Global Shareholder Stewardship* (Cambridge, Cambridge University Press, 2022).

191 See generally Bowley and Hill, 'Stewardship Codes' (n 171).

192 David M Silk, Sebastian V Niles and Carmen XW Lu, 'ESG and Sustainability: Key Considerations for 2021' (Harvard Law School Forum on Corporate Governance, 30 January 2021).

support for shareholder resolutions involving social and environmental issues.[193] For example, annual 'say on climate' votes have now become a global phenomenon.[194] ESG pressures are, moreover, being generated at an international level,[195] rather than through horizontal adoption of national laws, which La Porta et al assumed would constitute the main method of legal transplantation.[196]

Reductionist theories that portray the corporation as fictitious have led to a vigorous debate between shareholder-centred and stakeholder-centred theories of the corporation.[197] There is no doubt that 'stakeholderism' is on the rise. For example, in his 2018 Annual Letter to CEOs, Larry Fink of BlackRock stated that companies 'must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate',[198] and his 2022 letter continued to extol the benefits of 'stakeholder capitalism'.[199] In 2019, the US Business Roundtable announced that it, too, would embrace stakeholderism.[200] However, the binary approach, in which the interests of shareholders and stakeholders is treated as irreconcilable, is ultimately unhelpful and disguises the fact that such opposition can disappear when a longer term view of the corporation and corporate performance is taken.[201]

The British Academy's *Future of the Corporation* project and the concept of corporate purpose are premised on a more holistic depiction of the corporation than stakeholderism. They also envisage a distinctly public role for the corporation, together with a concern about negative externalities. For example, the mantra of the *Future of the Corporation* project is that 'the

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193 ibid.

194 See generally Bowley and Hill, 'Stewardship Codes' (n 171).

195 Tim Bowley and Jennifer G Hill, 'The Global ESG Stewardship Ecosystem' (*European Business Organization Law Review*, forthcoming): Mariana Pargendler, 'The Rise of International Corporate Law' (2021) 98 *Washington University Law Review* 1765.

196 La Porta, Lopez-de-Silanes and Shleifer, 'Finance' (n 157); La Porta, Lopez-de-Silanes and Shleifer, 'Ownership' (n 157).

197 Klaus J Hopt, 'Corporate Purpose and Stakeholder Value – Historical, Economic and Comparative Law Remarks on the Current Debate, Legislative Options and Enforcement Problems', European Corporate Governance Institute – Law Working Paper No 690, 2023 (16 March 2023).

198 Letter from Larry Fink to CEOs (January 2018).

199 Letter from Larry Fink to CEOs (January 2022).

200 Business Roundtable, 'Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy That Serves All Americans"' (19 August 2019).

201 Hill, 'Public/Private Divide' (n 179) 289, 292.

purpose of business is creating profitable solutions for problems of people and planet, and not profiting from creating problems'.[202] Consistent with this approach, the 2018 UK Corporate Governance Code now includes references to corporate culture and the responsibility of public companies, not only to create value for shareholders, but also to contribute to 'wider society'.[203]

None of these developments sits comfortably with traditional assumptions that underpin the agency theory of the firm. This is indicated by the recent attempt by Hart and Zingales to argue that these developments reflect a paradigm shift from a shareholder value maximisation norm to one of shareholder welfare maximisation.[204] In their reinterpretation of agency theory, Hart and Zingales have, to be sure, tweaked the agency theory, but they have tweaked it only in terms of shareholder preferences, not in terms of the corporation as a social actor.

4.2 Executive Compensation

Jensen and Meckling's 1976 article did not discuss the full implications of theory for specific areas of corporation governance, including executive compensation.[205] Yet the article provided the basis for such later elaboration of the original thesis. This elaboration would have significant implications for the development of executive pay.

In 1990, Jensen and Murphy adopted an agency theory of the firm to transform executive pay in their famous article, 'CEO Incentives – It's Not How Much You Pay, But How'.[206] The article re-examined executive pay, which had traditionally been treated as fiduciary duty issue, [207] exclusively through the lens of misaligned interests between managers and shareholders. They presented the use of incentives in executive compensation contracts as a corporate governance solution to the agency problem of corporate underperformance and paved the way for the era of performance-based pay.[208]

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[202] The British Academy, *Policy & Practice for Purposeful Business* (September 2021) 6.

[203] Financial Reporting Council, *The UK Corporate Governance Code* (July 2018) 4.

[204] Hart and Zingales, 'The New Corporate Governance' (n 74).

[205] See generally Cheffins, 'What Jensen and Meckling' (n 61), arguing that there is a wide gap between what Jensen and Meckling actually said, and what they were perceived to have said, in their 1976 article.

[206] Michael C Jensen and Kevin J Murphy, 'CEO Incentives – It's Not How Much You Pay, But How' (1990) 68 *Harvard Business Review* 138.

[207] Charles M Yablon, 'Bonus Questions – Executive Compensation in the Era of Pay for Performance' (1999) 75 *Notre Dame Law Review* 271, 279–80.

[208] ibid. See also Frank Dobbin and Dirk Zorn, 'Corporate Malfeasance and the Myth of Shareholder Value' in Diane E Davis (ed), *Political Power and Social Theory* vol 17 (Leeds, Emerald Group Publishing Ltd, 2005).

Performance-based pay functioned as a self-regulatory device to deal with the problem of corporate underperformance, offering the promise of higher compensation for superior corporate performance and reduced pay for sub-standard performance.[209] Within this economic framework, quantum of pay was rendered irrelevant, provided that the compensated performance increased shareholder wealth.[210]

The 1990s was a decade of spiralling executive pay,[211] fuelled by the widespread adoption of performance-based pay in combination with huge stock option awards.[212] It is worth noting that, although stock option awards declined over the next decade,[213] they are by no means a thing of the past. In 2018, for example, Tesla CEO, Elon Musk, received a performance-based stock option grant that was potentially worth US $55 billion, the largest executive compensation deal in US history.[214]

The rapid escalation of executive pay led to academic debate between two different schools of thought: optimal contracting and managerial power theory.[215] Optimal contracting scholars, relying on the agency theory of the firm, argued that executive compensation contracts operated as an efficient means of maximising net shareholder value of contracting costs and transactions costs, thereby aligning the interests of shareholders and managers. Managerial power scholars, on the other hand, claimed that this analysis was defective in disguising and failing to recognise a power imbalance that effectively allowed US executives to set their own pay.[216]

Further concerns about design and operation of executive pay contracts emerged following the Enron and WorldCom scandals at the turn of the century and the 2007–09 global financial crisis. The dual collapses of Enron and WorldCom (and several other companies around the world) showed that attempting to solve the problem of misaligned incentives between

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209 See Jensen and Murphy, 'CEO Incentives' (n 206); Carola Frydman and Raven E Saks, 'Executive Compensation: A New View from a Long-Term Perspective, 1936–2005' (2010) 23 *The Review of Financial Studies* 2099.

210 See Mark J Loewenstein, 'Reflections on Executive Compensation and a Modest Proposal for (Further) Reform' (1996) 50 *SMU Law Review* 201, 206–07.

211 See, eg Alex Edmans, Xavier Gabaix and Dirk Jenter, 'Executive Compensation: A Survey of Theory and Evidence' in Benjamin E Hermalin and Michael S Weisbach (eds), *The Economics of Corporate Governance* (Amsterdam, North-Holland, 2017) vol I, 388–95.

212 See generally ibid 398–404.

213 ibid.

214 Jef Feeley and Scott Carpenter, 'How Elon Musk Scored a $55 Billion Pay Package That's Now Under Fire' *Bloomberg* (New York, 14 November 2022).

215 See Jennifer Hill and Randall Thomas, 'Introduction' in Randall S Thomas and Jennifer G Hill (eds), *Research Handbook on Executive Pay* (Cheltenham, Edward Elgar Publishing, 2012) 1–2.

216 ibid.

managers and shareholders could, when taken to extremes, create a different set of problems. Specifically, the scandals showed that high-powered incentive pay contracts could create perverse incentives to engage in misconduct, including earnings management, in order to meet profit targets.[217]

The global financial crisis brought a new set of problems into the mix, namely the danger that flawed executive compensation structures could create perverse incentives that encouraged short-termism, over-leveraging and excessive risk-taking.[218] The crisis also led to recognition that misalignment of interests between management and shareholders was not the only problem that the executive pay design needed to address. Equally important was the need to align the interests of management with the interests of society as a whole.[219]

Enron, WorldCom and the global financial crisis demonstrated that, although corporate financial success matters, an exclusive focus on wealth maximisation can create perverse incentives for corporate misconduct and negative externalities and has sometimes 'dulled the senses' of institutions, boards of directors and managers to other kinds of risk.[220]

A burgeoning development in executive pay relates to a new set of risks, particularly those involving the environment and climate change. As noted previously, these risks constitute negative externalities that are now treated by investors and regulators as key long-term financial risks,[221] and as a result, a growing number of listed firms include drivers related to sustainable performance in their executive remuneration packages.[222] However, at this point in time, ESG-linked pay tends to represent only a relatively small proportion of total executive

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217 See generally Roberto Barontini and Jennifer G Hill, 'Sustainability and Executive Compensation' in Michele Siri, Kern Alexander and Matteo Gargantini (eds), *Handbook of EU Sustainable Finance: Regulation, Supervision and Governance* (Cambridge, Cambridge University Press, forthcoming); Dobbin and Zorn, 'Corporate Malfeasance' (n 208).

218 See Lucian A Bebchuk and Holger Spamann, 'Regulating Bankers' Pay' (2010) 98 *Georgetown Law Journal* 247, 255–68.

219 See Jennifer G Hill, 'Regulating Executive Remuneration After the Global Financial Crisis: Common Law Perspectives' in Randall S Thomas and Jennifer G Hill (eds), *Research Handbook on Executive Pay* (Cheltenham, Edward Elgar Publishing, 2012) 233–34.

220 Australian Prudential Regulation Authority, *Prudential Inquiry into the Commonwealth Bank of Australia* (April 2018) 3.

221 See Jaeger, 'Say No' (n 184).

222 See, eg Stavros Gadinis and Amelia Miazad, 'Corporate Law and Social Risk' (2020) 73 *Vanderbilt Law Review* 1401, 1407, 1419, and the examples cited therein.

pay packages,[223] and it is not surprising that there are conflicting studies as to its effectiveness as an antidote to short-term shareholder profit maximisation.[224]

4.3 Corporate Criminal Liability

'Corporations don't commit offences; people do'.

E. Bodenheimer[225]

Nowhere is the 'schizophrenic'[226] nature of the corporation in legal theory more evident than in the context of corporate crime. Modern developments in corporate criminal liability also sit uncomfortably with the individualism that underpins the agency theory of the firm.

The historical notion of the corporation as a *persona ficta* recognised the corporation as an artificial legal person, but one that was not identical to a human being.[227] As Watson notes, this reasoning provided certain benefits to early ecclesiastical bodies or '*universitas*'.[228] Although these bodies were regarded as separate legal entities for certain purposes, such as holding property, they were also protected from excommunication and liability for some types of wrongdoing on the basis that they were incapable of possessing a *mens rea*.[229] The notion that only natural, and not juridical, persons, can be subject to criminal liability still operates in parts of continental

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223 See Caroline Flammer, Bryan Hong and Dylan Minor, 'Corporate Governance and the Rise of Integrating Corporate Social Responsibility Criteria in Executive Compensation: Effectiveness and Implications for Firm Outcomes' (2019) 40 *Strategic Management Journal* 1097, 1101.

224 ibid. *cf* Karen Maas, 'Do Corporate Social Performance Targets in Executive Compensation Contribute to Corporate Social Performance?' (2018) 148 *Journal of Business Ethics* 573.

225 Edgar Bodenheimer, *Philosophy of Responsibility* (Littleton, Colorado, FB Rothman, 1980) 117.

226 Allen, 'Our Schizophrenic Conception' (n 109).

227 See Nicola Lacey, 'Philosophical Foundations of the Common Law: Social Not Metaphysical' in Jeremy Horder (ed), *Oxford Essays in Jurisprudence: Fourth Series* (Oxford, Oxford University Press, 2000), 25, noting that the history of debate about corporate liability has been riddled with 'analogies and disanalogies' between corporate persons and human beings.

228 Susan Watson, *The Making of the Modern Company* (Oxford, Hart Publishing, 2022) 15.

229 See, eg Christopher D Stone, 'The Place of Enterprise Liability in the Control of Corporate Conduct' (1980) 90 *Yale Law Journal* 1, 3, 70.

Europe, on the basis that 'a legal entity cannot be blameworthy', although this assumption weakened in the late twentieth century.[230]

The reasoning underpinning aggregate theories of the corporation, including the agency theory as it is widely understood, provides even stronger support for focusing on human, as opposed to organisational misconduct. According to these theories, corporate personhood is 'a matter of convenience rather than reality',[231] or a mere 'verbal symbol' or 'mathematical expression' to describe its human components.[232] Such models effectively treat the corporation as fictitious, leading to the conclusion that there 'no such thing as the company'.[233]

Paradoxically, this method of 'privatising' the corporation has sometimes proven advantageous to corporations in the context of rights conferral. Indeed, US courts granted corporations rights before recognising the existence of corporate criminal liability.[234] For example, US Supreme Court case law has employed this reasoning to justify granting constitutional rights to the corporation,[235] on the basis that, as an assemblage of natural persons, it deserves the same protection as its human members.[236] It has also been argued that treating the corporation as an aggregation of individuals, rather than an organisation in its own right, has the effect of humanising, and inviting greater empathy for, the corporation.[237]

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230 See Edward B Diskant, 'Comparative Corporate Criminal Liability: Exploring the Uniquely American Doctrine through Comparative Criminal Procedure' (2008) 118 *Yale Law Journal* 126, 129.

231 Easterbrook and Fischel, 'The Corporate Contract' (n 38) 1426.

232 Max Radin, 'The Endless Problem of Corporate Personality' (1932) 32 *Columbia Law Review* 643, 658.

233 *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, [1995] 3 All ER 918, 923 (Lord Hoffman for the Court).

234 See generally Miriam H Baer, 'Personhood, Procedure and the Endurance of Corporate Compliance' in Elizabeth Pollman and Robert B Thompson, *Research Handbook on Corporate Purpose and Personhood* (Cheltenham, Edward Elgar Publishing, 2021).

235 *First National Bank of Boston v Bellotti* 435 US 765 (1978) 794–95. See generally Baer (n 234) 335-38, discussing recent case law based on the US Supreme Court's contemporary 'decisive embrace of the aggregate theory': ibid 336.

236 Nikolas Bowie, 'Corporate Personhood v. Corporate Statehood' (2019) 132 *Harvard Law Review* 2009, 2012, 2025.

237 See Simone Tang et al, 'The Morality of Organization Versus Organized Members: Organizations Are Attributed More Control and Responsibility for Negative Outcomes Than Are Equivalent Members' (2020)119 *Journal of Personality and Social Psychology* 901.

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The assumption that the corporation is fictitious embedded in contractual theories, including agency theory, also has implications for accountability. These theories sit most comfortably with the view propounded almost a century ago by Radin, who posited that all legal wrongs are committed by 'flesh and blood' persons,[238] and the goal of the law should be to identify those individuals and bring them to justice.[239]

However, this is not the way contemporary US criminal law has played out. In fact, for several decades prior to the global financial crisis, US prosecutors regularly targeted corporations, rather than senior managers, for liability.[240] In the aftermath of the crisis, Judge Jed Rakoff employed the rhetoric of methodological individualism[241] (albeit to highlight the lack of accountability for senior managers after the global financial crisis) when he criticised this trend in strong terms, describing it as 'technically and morally suspect'[242] because '[c]ompanies do not commit crimes; only their agents do'.[243] An extreme version of this position is to treat entity liability as encompassing 'fictitious offenses perpetrated by fictitious persons'.[244]

This deconstructionist approach is not consistent with contemporary criminal law in common law jurisdictions, such as the US, the UK and Australia, whose legal regimes now assume that corporations can be blameworthy and subject to criminal liability.[245] Entity criminal liability is an important modern legal device, which can enhance accountability in a range of situations, particularly where misconduct occurs due to a defective corporate culture.[246] Recognising the

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238 Radin, 'The Endless Problem' (n 232) 663.

239 ibid 661. *cf*, however, the institutional version of the nexus of contracts model of the corporation, where the firm exists 'as a single maximizing unit, not simply as an artifact of transactions among maximizing individuals': see Bratton, 'The New Economic Theory' (n 19) 1480.

240 This trend was accompanied by increasing use of deferred prosecution agreements and non-prosecution agreements: see generally Jed S Rakoff, 'The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?' in Robin Hui Huang and Nicholas Calcina Howson (eds), *Enforcement of Corporate and Securities Law* (Cambridge, Cambridge University Press, 2017) 11–12.

241 See Brent Fisse and John Braithwaite, 'The Allocation of Responsibility for Corporate Crime: Individualism, Collectivism and Accountability' (1988) 11 *Sydney Law Review* 468, 473–75.

242 Rakoff, 'The Financial Crisis' (n 240) 12.

243 ibid 11.

244 Fisse and Braithwaite, 'The Allocation' (n 241) 475.

245 See generally Micheler (n 13) ch 5.3, noting, however, that the courts in various jurisdictions adopt different tests for when wrongful acts will be attributed to the corporate entity.

246 See Samuel W Buell, 'The Blaming Function of Entity Criminal Liability' (2006) 81 *Indiana Law Journal* 473, 477–78; Samuel W Buell, 'The Responsibility Gap in Corporate Crime' (2018) 12 *Criminal*

corporation as an entity[247] and an autonomous actor in society enables us to see corporations not only as rights holders, but also as subject to certain responsibilities vis-à-vis society.[248] Lacey argues, for instance, that the emergence of liability for corporate manslaughter in the UK during the twentieth century was emblematic of the ability of societal norms and expectations to affect legal interpretation and doctrine.[249] Entity criminal liability is likely to increase in an era of growing public concern about corporate power, such as that wielded by Big Tech companies, and negative externalities in relation to ESG and climate change.[250]

5. Conclusion

> '[T]he corporation is (forgive this compound adjective) a right-and-duty-bearing unit'.
>
> Frederic William Maitland[251]

> 'I'm now a critic of where we got to'.
>
> Michael Jensen[252]

This chapter argues that, although the economic model has provided valuable insights into the role of incentives within the corporation, its reductionist approach has ultimately provided a myopic, under-inclusive and insufficiently nuanced perspective. The theory, as it has been interpreted (and sometimes misinterpreted) over the ensuing decades, operates as a form of instrumental reasoning designed to address a particular problem, namely the danger of corporate managers preferring their own interests to those of shareholders. When framed as a

Law and Philosophy 471, 473.

247 See, eg Susan Watson, 'How the Company Became an Entity: A New Understanding of Corporate Law' [2015] *Journal of Business Law* 120.

248 See Phillip I Blumberg, 'The Corporate Entity in an Era of Multinational Corporations' (1990) 15 *Delaware Journal of Corporate Law* 283, 285; Wilson, 'Barring Corporations' (n 41)

249 Lacey, 'Philosophical Foundations' (n 227).

250 Claassen, 'Political Theories' (n 43).

251 Herbert Albert Laurens Fisher (ed), *The Collected Papers of Frederic William Maitland* (Cambridge, Cambridge University Press, 1911) vol III, 307.

252 Jensen was so quoted in John Cassidy, 'The Greed Cycle' *The New Yorker* (New York, 23 September 2002) 75.

comprehensive and all-encompassing theory, however, the relatively narrow lens of the agency model creates a form of tunnel vision that obscures other important problems in corporate law and is inconsistent with legal, historical and sociological understandings of the corporation.[253] Agency theory fails to recognise the complexity, distinctive features and diversity of organisations. And, by banishing the state, the theory ultimately fails to recognise 'the importance of intermediating institutions in a pluralist democracy'[254] and to provide a holistic picture of the relationship between government, corporations and individuals.[255]

The chapter argues that are multiple problems in corporate law and different problems may come to the forefront at different times and for different purposes, creating a tension between public and private law. Ultimately, when treated as an all-encompassing paradigm, the agency theory of the firm provides an overly simplified and an impoverished depiction of the corporation, which sits uncomfortably with numerous contemporary corporate law and governance developments.

253 See generally Claasen, 'Political Theories' (n 43); Rubin, 'Images' (n 13). See also Eric W Orts, *Business Persons: A Legal Theory of the Firm* (Oxford, Oxford University Press, 2013), 27–28, stating that agency theory 'flies in the face of a blizzard of perspectives from other disciplines, including law, which reveal and explain the social reality of firms'.

254 Stewart, 'Book Review' (n 41) 371.

255 ibid, 386–87; Buxbaum, 'Corporate Legitimacy' (n 12) 516, 519–520.

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