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A Response to Stephen Bainbridge and Susan Watson

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Real Entity Theory Without Metaphysics: How Organizations Shape Corporate Law A Response to Stephen Bainbridge and Susan Watson

Eva Micheler[1] and Jenkin Chim[2]

Abstract: This paper defends real entity theory against critiques by Bainbridge and Watson. Drawing on organizational behavior scholarship, it distinguishes organizations/firms as social entities with autonomous structures from corporations/companies as legal vehicles. The theory explains corporate law doctrine without metaphysical claims, acknowledging that corporations act through humans and require statutory incorporation.

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1. INTRODUCTION

In 2021, Professor Eva Micheler published a book advancing a modern version of real entity theory that explaining corporate law.[3] In a 2024 article, jointly written with David Gindis, she built on that real entity model of the corporation and invited legal scholars to engage with ideas about organisations and institutions expressed by Oliver Williamson and Elinor Ostrom, who were jointly awarded the Nobel Prize in Economics.[4]

The aim of this paper is to respond, with profound respect, to points made by Professor Stephen Bainbridge and Professor Susan Watson, who each offered a critique of real entity theory. Professor Bainbridge writes that real entity theory advances inappropriate metaphysical arguments and that corporations do not themselves act but require human actors to take and execute decisions. Professor Watson accepts that organisations can have a 'sociological personality' but rejects real entity theory because the corporation or company, as an artificial legal person, is only created through a process of incorporation upon compliance with the general incorporation statutes, rather than by recognition of a pre-existing entity. She further suggests that the corporate fund, rather than the association of members historically, has been and continues to be the defining characteristic of the corporate form. Their respective arguments will be set out in more detail in section 2.

In the sections that follow we explain the model of real entity theory, as advanced in the 2021 book, in two parts. We distinguish *organisations* or *firms* from *corporations* or *companies*. In sections 0 to 0 we explain in what sense and why organisations or firms are to be characterised as real entities. We explain that this modern version of real entity theory does not advance empty metaphysical arguments (section 0). It also fully accepts that corporations can only act through human actors and that they are established on a statutory basis through a process of incorporation (section 0).

In section 9 we draw the connection between organisations or firms and corporate law. In section 0 we explain that and how the scholarship on organisations informs our positive understanding of corporate or company law. We support this argument with select examples from the 2021 book, focusing on English law. Section 0 is concerned with a narrative model of the corporation or company that builds on real entity theory and takes advantages of the scholarship of Oliver Williamson and Elinor Ostrom. This model has been set out in an article that Eva Micheler wrote with David Gindis.

Sections 10 - 12 clarify and respond to related arguments. We make clear that the real entity model advanced here does not inform the decision on how the influence of shareholders or other constituencies of the corporation is or should be

[3] Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021).
[4] David Gindis and Eva Micheler, 'Institutional Theory for Corporate Law: An Invitation' (2024) 24 Journal of Corporate Law Studies 399.

calibrated (section 10). We give our view on the significance of the corporate fund (section 0), and we explain the relationship between our perspective and the perspective advanced by the economic discipline of legal institutionalism (section 0).

Section 0 concludes and summaries the central thesis set out in the paper.

2. THE CRITIQUE

2.1. PROFESSOR STEPHEN BAINBRIDGE

In a blogpost Professor Stephen Bainbridge discusses the introduction to Professor Eva Micheler's 2021 book. He follows the orthodox nexus for contracts model where corporations are aggregates of the contributions of individuals. He rejects real entity theory on the basis that it relies on empty metaphysical arguments.[5] Professor Bainbridge's main concern is to justify the profit motive and advance the American director-primacy model of the corporation. In his view real entity theory, which has been advanced by Professor Padfield to support a director-primacy approach, is nevertheless as at odds with a practical approach to corporate law. Professor Bainbridge supports this conclusion with a reference to Felix Cohen's famous article on 'transcendental nonsense' in law, where the latter criticises the court in New York for deciding a jurisdictional question by asking, 'Where is a corporation [physically located]?'. Cohen observes that the question of jurisdiction should be answered by reference to economic, social, political, or ethical considerations rather than 'abstract' or 'metaphysical' ideas of the corporation. The court should consider, for example, the difficulties of injured plaintiffs to sue in a different state or the possible hardship to the corporation defending actions in many states. Cohen further writes that 'nobody has seen a corporation' and that we must not assume that it 'travels as mortal men do'. Professor Bainbridge endorses this perspective and rejects real entity theory as a metaphysical abstraction with no practical significance.

In his 2023 book, entitled *The Profit Motive*, Professor Bainbridge returns to his critique of real entity theory. He writes that '[t]hose who view the corporation as a real entity are engaged in a form of reification… treating an abstraction – in this case, a legal fiction – as if it has material existence. […] Unfortunately, reification can be misleading, because it allows one to lose sight of the fact that corporations do not do things, people do.'[6]

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[5] Stephen Bainbridge, 'The Corporation Is Not a Real Entity and to Argue to the Contrary Is "Transcendental Nonsense"' (*ProfessorBainbridge.com*, 5 April 2021) <www.professorbainbridge.com/professorbainbridgecom/2021/04/the-corporation-is-not-a-real-entity-and-to-argue-to-the-contrary-is-transcendental-nonsense.html> accessed 17 August 2025.

[6] Stephen M. Bainbridge, *The Profit Motive: Defending Shareholder Value Maximization* (CUP 2023) ch 10, 126.

2.2. PROFESSOR SUSAN WATSON

Professor Susan Watson accepts that a corporation or company, once incorporated, can acquire a type of sociological personality.[7] For instance, there will be a corporate *persona*, which 'relates to the external perception of the company; its reputation and brand derived from how it interacts externally and also from the human beings who work for it and interact on its behalf in various capacities'.[8] It is also sociological in the sense that members of a corporation have their own perspectives of how the corporation operates, the rules they are bound by, or how they see themselves acting within it. This concept is reminiscent of HLA Hart's distinction between the external and internal points of view towards rules. Professor Watson accepts that this internal perspective, originating from 'the entity itself rather than its shareholders', is key to conceiving the modern company.[9] She nevertheless rejects real entity theory and characterises modern companies as concessions of the state because they only come into existence after they have been incorporated following a statutory process. On this view real entity theory is unconvincing because legal personality is not the 'consequence of [a sociological] … real personality'.[10] The theory is wrong because it does not 'accurately identify the source of the legal personality of the company'.[11] A company does not derive its legal personality from the recognition of a pre-existing state of its members acting collectively.[12] Real entity theories 'do not recognise the inconvenient truth that the inception of a modern company is brought about through the process of incorporation, not through recognition by the law of an existing company'.[13] Moreover, a company that never operates in the world, such as a shelf company, is still fully recognised.[14] Professor Watson further points out that real entity theories do not have much to say about what distinguishes the legal personality of companies from other types of institutions or organisations.[15]

With a view to critiquing shareholder-focused models of the corporation, Professor Watson writes that the corporate form is not 'made up of human beings but has at its core a (joint stock) fund'.[16] In contrast to Bainbridge, who stresses that corporations are aggregates of people, she believes that the corporation exists 'separately from human beings as a type of fund consisting of rights'.[17] As a result,

[7] Susan Mary Watson, 'The Corporate Legal Person' (2019) 19 Journal of Corporate Law Studies 137, 161.
[8] Ibid 140.
[9] Ibid 161.
[10] Ibid 145.
[11] Ibid 147; see also Jonathan Hardman, 'The Making of the Corporate Legal Concession Theory' (2024) 44 OJLS 181, 194 and Jonathan Hardman, 'Fixing the Misalignment of the Concession of Corporate Legal Personality' (2023) 43 Legal Studies 443.
[12] Susan Mary Watson, 'The Corporate Legal Person' (2019) 19 Journal of Corporate Law Studies 137, 147 and 150-151.
[13] Ibid 162.
[14] Ibid 147.
[15] Ibid 140 and 147.
[16] Ibid 162.
[17] Ibid.

the corporate form is 'impacted by the actions of human beings associated with [the fund]'.[18] It is through these interactions and decisions that 'the corporate legal person develops a persona in the world'.[19] The corporate fund, as separated through the corporate form or other legal devices before incorporation became generally available, is the defining and constituting feature of shareholder capitalism. It has been 'hiding in plain sight', 'obscured by contemporary theoretical conceptions that marginalise its 'significance'.[20]

In summary, for Professor Watson, corporate legal personhood is derived from the general incorporation statutes. Incorporation has 'shifted from being a concession to being a right' in that a corporation comes to exist upon the satisfaction of certain 'process requirements'.[21] The essence of the company, as an artificial legal person, is its corporate fund. As far as any idea of real entity is concerned, it is only after a corporation's legal inception that it becomes a dynamic entity operating in the real world capable of developing a persona, 'contracts and transacts for value', etc.[22]

2.3. A RESPONSE

In what follows, we will argue that a modern version of real entity theory does not advance empty metaphysical arguments. It also fully accepts that corporations can only act through human actors, that they are created by incorporation, and are sometimes used for purposes that do not support the operation of an organisation or firm. We make this argument by drawing a distinction between organisations or firms on the one hand and corporations or companies on the other. Organisations and firms and their characteristics will be examined first.

3. ORGANISATIONAL BEHAVIOUR

Our analysis of organisations and firms begins with human behaviour. The first step in the argument is that social context causes human beings to adapt their behaviour. Organisations or firms provide a particular social context and thus cause a shift in individual human behaviour that is empirically observable. The behaviour of an academic is different depending on whether they act in a private or professional capacity. Even as an academic, their behaviour varies according to whether they speak to students, to colleagues, or to individuals unfamiliar with the sector or the law. Moreover, their professional conduct changes in line with whichever university

[18] ibid.
[19] ibid.
[20] Susan Mary Watson, 'The Foundations of Shareholder Capitalism' (2025) European Corporate Governance Institute - Law Working Paper No. 863/2025, 2 <https://ssrn.com/abstract=5367660> accessed 21 August 2025.
[21] Susan Watson, *The Making of the Modern Company* (Hart Publishing 2022) ch 13, 214.
[22] ibid ch 14, 230 and 233.

or department they act for. Individual action is informed by the processes, procedures, and policies adopted by the organisation an individual is acting for. Beyond these explicit rules, human conduct is further influenced by the informal cues and norms an individual has become aware of through interactions with other members of the same social environment.

The effect of social interactions with other people on individual human behaviour is supported by long-standing and eminent academic scholarship. At the onset of the twentieth century, Thorstein Veblen, for example, wrote that the individual's conduct is 'hedged about and directed by his habitual relations to his fellows in the group', that these relations are 'of an institutional character', and 'vary as the institutional scheme varies'.[23]

There is also empirical scholarship confirming the effect of social context. 'Group think' can induce individuals to disengage from their own judgement. Similarly, 'group loyalty' can cause members to continue with practices that have proven to be ineffective. By virtue of being in an organisation, individual judgement and attitudes can be overridden.[24] In an experiment, Lynne Zucker demonstrated that individuals act differently when they see themselves as a part of an organisation. The perceived presence of an organisational context causes individuals to adjust their cognitive perception of the real-world physical facts. The organisational context brings about human behaviour that would otherwise not exist.[25] Diane Vaughan has shown that the Space Shuttle Challenger disaster was the result of NASA's organisational culture, which was characterised by an acceptance of high-risk technology based on normalised deviance from evidence of dangers. The disaster could not technically be attributed to any single individual. The cause of the disaster was the 'banality of organisational life', rather than breaches of certain safety rules.[26] Michel Ehrenhard and Timo Fiorito examined the behaviour of employees of twenty-five banks involved in corporate scandals. They found that much of such behaviour was attributable to systemic issues, of which multiple segments of the bank, often including the board, were knowledgeable.[27] The cause of corporate scandals was a particular organisational culture, rather than rogue individuals. It is

[23] Thorstein Veblen, 'The Limitations of Marginal Utility' (1909) 17(9) Journal of Political Economy 620, 629; see also Andrew Van de Ven, 'The Institutional Theory of John R Commons: A Review and Commentary' (1993) 18(1) Academy of Management Review 139.

[24] See further Christian List and Philip Pettit, *Group Agency: The Possibility, Design, and Status of Corporate Agents* (OUP 2011); Susanna K Ripken, 'Corporations are People Too: A Multi-Dimensional Approach to the Corporate Personhood Puzzle' (2009) 15 Fordham Journal of Corporate and Financial Law 98, 131–33 and also Christian Witting, *Liability of Corporate Groups and Networks* (CUP 2018) 49.

[25] Lynne G Zucker, 'The Role of Institutionalization in Cultural Persistence' (1977) 42 American Sociological Review 726.

[26] Dianne Vaughan, *The Challenger Launch Decision* (University of Chicago Press 1996); see also David Welsh and others, 'The Slippery Slope: How Small Ethical Transgressions Pave the Way for Larger Future Transgressions' (2015) 100 Journal of Applied Psychology 114.

[27] Michel Ehrenhard and Timo Fiorito, 'Corporate Values of the 25 Largest European Banks: Exploring the Ambiguous Link with Corporate Scandals' (2018) 18 Journal of Public Affairs 1, 4 and 7; see also Henrich Greve, Donald Palmer, and Jo-Ellen Pozner, 'Organizations Gone Wild: The Causes, Processes, and Consequences of Organizational Misconduct' (2010) 4(1) The Academy of Management Annals 53.

also worth noting that these scandals occurred despite the banks adopting corporate values such as integrity, professionalism, and fairness.[28]

4. ORGANISATIONS OR FIRMS ARE SOCIAL ENTITIES

4.1. INTRODUCTION

Having accepted that human behaviour is shaped by social context and that organisations are an example of such a context, we move on to the second step of the argument. For this step, we accept that human beings adopt habits. After an initial learning process, human decision-making and behaviour is to some extent automated. Human beings develop heuristics, evolving into habits and routines.[29] When we work together with others, we adopt shared routines, processes, procedures, and create a shared culture. Together these elements can be referred to as 'organisational structure'. Organisational structure is persistent. New participants join an organisation and are absorbed into the structure they find. They conform to the incumbent structured patterns of behaviour. They adopt these patterns and teach them to those who join after them. There is a sense in which organisational structure operates independently of who the respective participants are at any one time. It is to a certain extent autonomous irrespective of a changing body of shareholders, directors, employees and other participants in a firm or organisation. Firms or organisations are social entities in the sense that

4.2. THEORY

The characterisation of organisations and firms as entities with a structure that is autonomous of their participants is supported by an eminent body of theoretical contributions to the literature.

4.2.1. Herbert Simon

Herbert Simon, Nobel Laureate in Economics, stressed the significance of routines, processes, and procedures in the initiation of human action and development of organisational behaviour. He is well known for the concept of 'bounded rationality'. Simon was sceptical of the perfect rationality of the economic man and believed

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[28] Michel Ehrenhard and Timo Fiorito, 'Corporate Values of the 25 Largest European Banks: Exploring the Ambiguous Link with Corporate Scandals' (2018) 18 Journal of Public Affairs 1, 7–8.

[29] Roger C Shank and Robert P Abelson, *Script, Plans, Goals and Understanding: An Inquiry into Human Knowledge Structures* (Hillsdale 1997) who argue that human action operates on the basis of pattern recognition. When new situations display similarities with previous experience, they trigger pre-existing scripts and lead to sequences of action borrowed from a well-known situation. More generally: Daniel Kahneman, *Thinking, Fast and Slow* (Penguin 2011) 21–38; Gerd Gigerenzer, 'Fast and Frugal Heuristics: The Tools of Bounded Rationality' in Derek J Köhler and Nigel Harvey (eds), *Blackwell Handbook of Judgement and Decision-Making* (Blackwell 2004).

that 'the choices people make are determined not only by some consistent overall goal and the properties of the external world, but also by the knowledge that decision makers do and don't have of the world, their ability or inability to evoke that knowledge when it is relevant, to work out the consequences of their actions, to conjure up possible courses of action, to cope with uncertainty…, and to adjudicate among their many competing wants.'[30] Rationality is bounded because human cognitive abilities are constrained. Moreover, to operate on perfect rationality would be costly both in terms of time and effort.[31] This view led Simon to developing a decision criterion known as satisficing: 'the strategy of considering the options available to you for choice until you find one that meets or exceeds a predefined threshold… for a minimally acceptable outcome.'[32] The assumption is that there is always a 'trade-off between effort and accuracy'.[33]

On this view, organisations assist individuals in rational action by developing processes.[34] They supply performance programmes that guide human action, pre-packaged with a pre-defined objective and approximate expectations of what the 'minimally acceptable outcome' is. Processes are a form of heuristics. For instance, adhering to a company policy or process can reduce an individual's time needed to make a decision afresh at every juncture. It may even eliminate the need to thoroughly consider the consequences of one's actions, relying on a perception (whether misguided or not) that the outcome will generally be satisfactory (otherwise the very process would not be initially adopted by the organisation). Routines are ways that the organisation balances the need for efficiency and accuracy in corporate action. For our purposes, it is important to stress that Herbert Simon's contribution emphasises the influence of organisations on individual action. It conceives of organisations as processes, rather than as aggregators of individual contributions.

4.2.2. Michael Hannan and John Freeman

For Michael Hannan and John Freeman, the enduring organisational structure is the defining characteristic of organisations.[35] At the same time, organisations need to adapt to changes in their environment to succeed. These two ideas may be at odds with each other: processes generate structural inertia, limiting the ability of

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[30] Herbert A. Simon, 'Bounded Rationality in Social Science: Today and Tomorrow' (2000) 1(1) Mind & Society 25.
[31] Irving J Good, 'Rational Decisions' (1952) 14(1) Journal of the Royal Statistical Society Series B (Methodological), 107.
[32] Gregory Wheeler, 'Bounded Rationality' (*The Stanford Encyclopedia of Philosophy,* 13 December 2024) <https://plato.stanford.edu/entries/bounded-rationality/> accessed 21 August 2025.
[33] ibid.
[34] Michael Mintrom, 'Herbert A Simon, Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations' in Martin Lodge and others (eds), *The Oxford Handbook of Classics in Public Policy and Administration* (OUP 2015).
[35] Michael T Hannan and John Freeman, 'The Population Ecology of Organizations' (1977) 82(5) American Journal of Sociology 929; Michael T Hannan and John Freeman, 'Structural Inertia and Organizational Change' (1984) 49(2) American Sociological Review 149.

organisations to adapt.[36] For example, internal structural arrangements like plants, equipment, and specialised personnel limit an organisation's agility to change business plans. Another example would be the endemic inability of organisations to supply decision-makers with full information. Internal political constraints also act as a powerful organisational structure. Change often requires power to be re-allocated between organisational sub-units which, in turn, generates resistance to such change. Lastly, organisations are also constrained by their past decisions. Once standards and procedures on the allocation of tasks and authority have become subject to normative agreement, path-dependencies are etched and the cost of change is greatly increased.[37] At this juncture, organisational structures appear to be a negative force. However, their existence is a key ingredient to an organisation's survival. For example, internal political constraints provide for a system of checks and balances in an organisation. Putting in place structures also allows organisations to reliably reproduce and store knowledge and information. In addition, despite producing structural inertia, organisational structures do not fully eliminate the room for change.[38] From our perspective this contribution conceives of organisations as entities that are characterised by their social structure.

4.2.3. Richard R. Nelson and Sidney G. Winter

Richard R. Nelson and Sidney G. Winter use evolutionary theory to explain patterns of economic change. Routines are a central idea in their theory. To succeed in competitive markets, firms adopt routines. Firms are also historical entities. As such, routines adopted by firms represent their organisational 'genes'.[39] They allow a firm to 'reproduce or replicate its practices and activities across different areas and to confront new problems'.[40] Routines are the result of an endogenous and experience-based learning process.[41] Successful firms will continue to use and optimise their routines to 'renew and reproduce'.[42] Routines consist of conscious and tacit knowledge, and this type of information is 'socially held'.[43] These routines also shape organisational behaviour, possibly both enabling or inhibiting the organisation's ability to change and adapt.[44] Nelson and Winter's framework of

[36] Michael T Hannan and John Freeman, 'The Population Ecology of Organizations' (1977) 82(5) American Journal of Sociology 929, 930.
[37] ibid 931.
[38] Michael T Hannan and John Freeman, 'Structural Inertia and Organizational Change' (1984) 49(2) American Sociological Review 149.
[39] Ammon J. Salter and Maureen McKelvey, 'Evolutionary Analysis of Innovation and Entrepreneurship: Sidney G. Winter – Recipient of the 2015 *Global Award for Entrepreneurship Research*' 47(1) Small Business Economics 1.
[40] ibid 10.
[41] W. Richard Scott, *Institutions and Organizations* (4th edn, Sage 2014) 36.
[42] Ammon J. Salter and Maureen McKelvey, 'Evolutionary Analysis of Innovation and Entrepreneurship: Sidney G. Winter – Recipient of the 2015 *Global Award for Entrepreneurship Research*' 47(1) Small Business Economics 1, 10.
[43] Nicolai J. Foss, 'Bounded Rationality and Tacit Knowledge in the Organizational Capabilities Approach: An Assessment and a Re-evaluation' (2003) 12(2) Industrial and Corporate Change 185, 186.
[44] Richard R. Nelson and Sidney G. Winter, *An Evolutionary Theory of Economic Change* (Harvard University Press 1982).

organisational life goes beyond Herbert Simon's 'bounded rationality'. It has been characterised as introducing a concept of 'organic rationality', perhaps due to the semi-automatic nature of organisational life that is the result of embedding routines in the operations of the organisation.[45] Nonetheless, the theory has also suffered criticism for insufficient explanation on the connection between individual action and tacit knowledge/organisational behaviour.[46] However, for current purposes, there is clearly an established school of thought in the economics literature that conceives of firms as entities capable of their own distinct and self-directed behaviour.

4.2.4. Edith Penrose

The concepts of tacit knowledge and routines also feature in the field of resource-based economics.[47] Edith Penrose stressed that a firm's most important asset is its specialised use of resources, including skilled labour.[48] This asset develops over time and is difficult to reproduce by outside actors since it is predicated on tacit knowledge.[49] On this view, the firm is modelled as the holder of knowledge, which allows the firm to put specific resources to use. This constellation-like model is to be contrasted with a mere nexus aggregating contributions from individuals with particular incentives. There is a type of institutional knowledge that permeates through the organisation.

4.3. EMPIRICAL SCHOLARSHIP

These eminent theoretical contributions are supported by empirical studies demonstrating the presence and effect of organisational structure. For example, Warren Boecker showed that the strategy initially adopted by the founder of an organisation will persist throughout the firm's lifecycle. He sampled fifty-three semiconductor firms and observed that firms, founded in the earlier era of the industry, were more likely to continue pursuing a first-mover strategy. Conversely, new firms entering the industry at a more established time of the industry were more likely to develop and carry out a niche strategy.[50] 'Decisions made at the founding stage imprint organisational characteristics that help determine the organisation's future direction.'[51] Boecker points out that imprinting forces are sometimes

[45] Oliver E. Williamson, *The Economic Institutions of Capitalism* (The Free Press 1985).
[46] Nicolai J. Foss, 'Bounded Rationality and Tacit Knowledge in the Organizational Capabilities Approach: An Assessment and a Re-evaluation' (2003) 12(2) Industrial and Corporate Change 185, 198 (with further references).
[47] The importance of tacit knowledge is also sometimes emphasized in legal contributions: see eg. Brian Cheffins, 'Corporations' in Mark Tushnet and Peter Cane (eds), *The Oxford Handbook of Legal Studies* (OUP 2005) 485, 497.
[48] Edith Penrose, *The Theory of Growth of the Firm* (4th edn, OUP 1995); W. Richard Scott, *Institutions and Organizations* (4th edn, Sage 2014) 37–38.
[49] W. Richard Scott, *Institutions and Organizations* (4th edn, Sage 2014) 37.
[50] Warren Boeker, 'The Development and Institutionalization of Subunit Power in Organizations' (1989) 34(3) Administrative Science Quarterly 388.
[51] ibid 408.

overlooked because researchers tend to explain current characteristics based on currently observable phenomena.[52] Similarly, Arthur Stinchcombe examined the characteristics of the new universities that emerged in the United States between 1870 and 1900. Universities were established 'in bursts' during this period. They adopted different forms of governance depending on when they were first established. These forms persisted over long periods of time. Organisations are thus 'imprinted' with the characteristics exhibited at the time of establishment.[53] As more organisations of the same time or type are created, their legitimacy increases such that their structural templates are reinforced.[54]

4.4. SUMMARY

In this section we have argued that organisations or firms are social entities because they are associated with a structure that is independent of their individual participants at any one time. This structure persists over time. It shapes the behaviour of individual participants. Through this structure organisations influence individuals when they take decisions and implement them. Organisations are social entities because they give rise to formal and informal rules that are autonomous of the individual participants whose behaviour they shape and restrict.[55]

5. A SIDE NOTE: ORGANISATIONAL STRUCTURE AND HUMAN AGENCY

Before we go on to examine in what sense organisations or firms are real, we need to clarify the relationship between organisational structure and individual human agency. Human beings do not operate like cogs in a machine. Organisational structure notwithstanding we retain our individual agency. There is a debate about the extent to which human actors are determined by the structure organisations impose on them.

More recent scholarship tends to favour a mediating position that recognises both human agency and organisational structure as determinants of organisational action.[56] W. Richard Scott, for example, characterises organisations as 'figures'.[57] He

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[52] ibid.
[53] W. Richard Scott, *Institutions and Organizations* (4th edn, Sage 2014) 194; Arthur L Stinchcombe, 'Social Structure and Organizations' in James G March (ed), *Handbook of Organizations* (Rand McNally 1965) 142.
[54] W. Richard Scott, *Institutions and Organizations* (4th edn, Sage 2014) 194.
[55] See also David Gindis, 'From Fictions and Aggregates to Real Entities in the Theory of the Firm' (2009) 5(1) Journal of Institutional Economics 25.
[56] See eg. Patricia H Thornton, William Ocasio, and Michael Lounsbury, *The Institutional Logics Perspective: A New Approach to Culture, Structure and Process* (OUP 2012); Thomas B Lawrence, Roy Suddaby, and Bernard Leca (eds), *Institutional Work* (CUP 2009); see also Pursey PMAR Heugens and Michel W Lander, 'Structure! Agency! (And Other Quarrels): A Meta-analysis of the Institutional Theories of Organisation' (2009) 52 Academy of Management Journal 61, 92–95.
[57] W. Richard Scott, *Institutions and Organizations* (4th edn, Sage 2014) 262.

writes that all (even innovative) action is affected by existing contexts and any change must be channelled in light of it.[58] However, the acknowledgement that organisations are characterised by their processes, which constrain human action, should not be seen as an endorsement of a reactionary normative agenda. Processes also operate as avenues for change, facilitating bottom-up action. Imagine, for instance, an individual university employee who is dissatisfied with the way in which student information is recorded and made available in an internal system. He or she believes that outcomes would be improved if this process was simplified. He or she can agitate such that a proposal for a change is added to the agenda of key decision-makers who endorse the proposal. In this way an individual can bring about change by taking advantage of the incumbent organisational structure. The structure restricts individual action but also acts as a channel for individual agency. Processes are a 'two-way street'.[59]

6. ORGANISATIONS OR FIRMS ARE REAL ENTITIES

Having established that organisations are entities in the sense that they are the source of a structure that shapes human behaviour, we proceed to the third step of the argument and explain in what sense they are 'real'.

Stephen Bainbridge is right. We cannot see or touch organisations or firms. There is no physical object or person that is permanently associated with them. They are nevertheless real in their consequences. Through their structure they affect people whose decisions and actions modify the physical tangible world. They are real because they bring about behaviour that would not otherwise exist.

Organisations or firms are social facts. The concept of a 'social fact' largely originated from Emile Durkheim. He observed that modes of behaviour can be generalised from social interactions. These modes are external to individuals and have become the object of study for the discipline of sociology.[60] Richard Adelstein, an institutional economist, draws on a further distinction between 'brute facts' (rocks, trees, dogs, people) and 'social facts'.[61] Brute facts exist regardless of how humans act, intend, or ascribe meaning to phenomena. Social facts exist only

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[58] See also V Lynn Meek, 'Organizational Culture: Origins and Weaknesses' (1988) 9(4) Organizations Studies 453, 462–65.

[59] W. Richard Scott, *Institutions and Organizations* (4th edn, Sage 2014) 272–73; see also Anthony Giddens, *The Constitution of Society* (Berkeley University of California Press 1984) 25–28 and 327 who observes that individuals are simultaneously constrained and empowered social structures; Joanne Martin and Caren Siehl, 'Organizational Culture and Counterculture: An Uneasy Symbiosis' (1983) 12(2) Organizational Dynamics 52.

[60] Emile Durkheim, *The Rules of Sociological Method: And Selected Texts on Sociology and its Method* (Steven Lukes ed, Palgrave Macmillan 2013) 49-71.

[61] Richard Adelstein, 'Firms as Social Actors' (2010) 6(3) Journal of Institutional Economics 329, 344–45 relying on John R Searle, *The Construction of Social Reality* (Free Press, New York 1995) at 2–26; see also Nicholas H. D. Foster, 'Perception, Language and "Reality" in Corporate Law Theory' (2006) 17 KCLJ 299, 304-315.

because there is a collective intention and understanding that they exist. Firms share these characteristics. Firstly, its members intend to act as part of a group or other social unit and not as individuals. Secondly, non-members reinforce this collective intention because they also see the members of the firm as an active unit and thus constitute a social fact.[62] By consensus, the firm is treated by 'everyone' as real.[63] This social reality exists independently of whether a firm or organisation is incorporated as a legal person.

In addition to this consensus, it is also possible to deduce the common characteristics of a social unit such as an organisation or firm. It manifests itself through the visible performance of structured routines by real people in real time.[64] There is also a system of rules and policies that govern internal processes and conduct.[65] These features reify the firm as a unit 'that acquires knowledge, makes decisions and acts in the market through the operation of routines'.[66] Interactions within firms consolidate into a particular set of habits, routines, processes, and procedures. They persist irrespective of changes to the roster of the firms' participants.[67] Routines are social phenomena and firms are not 'living' organisms but nonetheless 'autonomous' as they exist apart from their temporal participants and are thus capable of intentionality and bring about social action in their own right.[68]

The real entity theory advanced in the 2021 book, extended in the 2024 article, and affirmed in this contribution accepts that organisations are real in a social sense. They are not tangible like brute facts, but they affect human behaviour and so are real in their consequences.

7. NO METAPHORS

We can pause here to observe that this perspective on organisations or firms does not involve metaphors. The metaphors critiqued by Professor Stephen Bainbridge date from the late nineteenth and early twentieth century.[69] The jurist Otto von Gierke, for example, characterised the company as a 'living organism' and 'a real

[62] Richard Adelstein, 'Firms as Social Actors' (2010) 6 Journal of Institutional Economics 329, 346.
[63] ibid 345.
[64] ibid 347.
[65] ibid 340.
[66] ibid 341-42.
[67] ibid 342.
[68] ibid 333.
[69] Ron Harris, 'The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business' (2006) 63(4) Washington and Lee L Rev 1421; see generally Joshua Getzler, 'Law, History and the Social Sciences: Intellectual Traditions of Late Nineteenth- and Early Twentieth-Century Europe' in Andrew Lewis and Michael Lobban (eds), *Law and History: Current Legal Issues 2003 Volume 6* (OUP 2004) 215.

person, with body and members and a will of its own'.[70] These statements were based on intuition. They were made at a time when the social sciences were in their infancy and scholars had not yet developed the theoretical understanding and empirical evidence that we now have on how individuals and organisations or firms relate to each other.

Professor Stephen Bainbridge is right that these historic metaphors are wrong. This is because they liken the directors with the brain of a human body and the other participants in organisations or firm with other parts of that body. That suggests that - much like my brain causes my fingers to type this text - the directors take decisions, and the participants execute these. This perspective endorses a model of organisations or firms that does not exist. It assumes that organisational structure has the extreme effect of completely controlling the participants of organisations. It ignores that all participants have agency. Directors can influence participants through routines, processes, procedures, culture and other rules. However, organisational structure is different from biological or mechanical structure. It is malleable and is modified over time through repeat social interactions.

8. ALL ACTORS ARE HUMAN BEINGS

We can further note that in the approach discussed here organisations act through human beings. They are conceived of as a social phenomenon that gives rise to a structure which in turn is real in its consequences.

9. APPLYING REAL ENTITY THEORY TO COMPANY LAW

9.1. INTRODUCTION

To reiterate the position, the literature has established that firms or organisations are social entities. They are not to be characterised as a mere aggregate of individual contributions from their participants. Yet, such a characterisation does not equate the firm to a human person, so it is not an anthropomorphic exercise. To anthropomorphise would invite an extreme (and erroneous) structural model of organisations and firms that has no role for human agency. Human social interactions underlie the habits, routines, processes, procedures, tacit knowledge, and culture that create and maintain organisations. These are not biological or mechanical but social phenomena which can be and are researched and understood

[70] Otto Gierke, *Political Theories of the Middle Age* (Frederic William Maitland tr, CUP 1900, reprinted Thoemmes Press 1996) xxvi; Joshua S Getzler, 'Frederic William Maitland—Trust and Corporation' (2016) 35 University of Queensland Law Journal 171.

by the methods available to the social sciences. Human agency coexists with this social structure to allow for selective conformity or deviation.

To repeat, the metaphorical model of the late nineteenth and early twentieth centuries intuited this phenomenon and expressed it in contestable terms. These contributions were written before psychology, sociology, management and economics became the mature disciplines that we know now. Today the insights that firms and organisations are more than aggregates and real (in their consequences) entities are supported by sound theory and empirical evidence. So far, we have not mentioned the law and its role. We will do so in this section.

The fourth step of my argument addresses the question, 'How does this insight relate to the law?'. Professor Watson is right that the company or corporation is created through a process of incorporation through general incorporation statutes rather than through the recognition of a pre-existing entity. But this observation does not undermine the real entity approach advanced here. The point made here is that the law as it stands reflects the properties of organisational action. This is because it has evolved in response to and with a view to solving the problems that arise from organisations.[71] The essence of the theory advanced here (and in the 2021 book) is that company or corporate law can be better understood at a positive level if we conceive of the corporate form as a legal vehicle that enables organisations or firms, which operate through routines, processes, and procedures, and are thus real in their consequences, to act autonomously. This point will be substantiated further in subsection 0 below.

Before we come to this, we need to acknowledge that Professor Watson is also right when she points out that companies can be used for purposes that have nothing to do with organisations. In the UK, for example, the corporate form is available for all lawful purposes. This, however, does not undermine the point that the corporate form has evolved to support organisational action. It is logically possible for something to be shaped by a core purpose but to nevertheless have other legitimate use cases. A mundane example is a chair, the dimensions of which are determined by reference to a human being in a sitting position. Chairs nevertheless are used as ladders, to store books or papers, as beds for dogs and cats and even for decoration. All of these are legitimate use cases that have, however, not shaped the way the object is designed.[72]

In the book, Professor Eva Micheler writes that real entity theory is useful to develop normative recommendations. This point is explored further in a 2024 article that she wrote together with David Gindis.[73] The essence of this article will be briefly set out in subsection 0.

[71] See also Nicholas H,D, Foster, 'Perception, Language and "Reality" in Corporate Law Theory' (2006) 17 KCLJ 299, 322–23.

[72] See further in Eva Micheler, 'Separate Legal Personality – An Explanation and a Defence" (2024) 24 Journal of Corporate Law Studies 301, 321-23.

[73] David Gindis and Eva Micheler, 'Institutional Theory for Corporate Law: An Invitation' (2024) 24 Journal of Corporate Law Studies 399, 417-435.

9.2. REAL ENTITY THEORY AS A POSITIVE THEORY

The book makes the argument that real entity theory, as advanced above, explains company law as it currently stands. It does so through an examination of UK company law doctrine.[74] For this paper we have selected some examples from the book and will analyse them below in subsections 0 – 0. The analysis will focus on English law with occasional pointers to other legal systems.

9.2.1 Separate legal personality

The law recognises organisations and firms as distinct social phenomena. The English legal system, for example, developed rules that govern commercial organisations through the partnership law. Non-commercial organisations are subject to the rules on unincorporated associations. For partnerships these have been codified in the Partnership Act 1890.[75] Neither form needs registration in the UK. They arise based on the existence of certain facts. Until 1844, joint stock companies were organised in the UK through partnership law. This caused problems that were resolved by requiring them to register.

Professor Watson writes that it is 'at least arguable' that 'a successful form of modern company law could … [exist] without the enactment of a general incorporation statute'.[76] She refers to the deed of settlement companies that pre-dated the corporate form as an example of private parties using partnership and trust law to create such a structure. This may be hypothetically true, but we need to accept that the corporate form has left deed of settlement companies behind.[77] They could still be established today but are not because the corporate form has been better able to support the organisations of the modern economy. The company law regime that we have now is the product of an evolution where we saw company law gradually evolving from partnership law.

Company or corporate law goes further than partnership law in recognising the social reality of organisations or firms.[78] It makes available separate legal personality, which is not available to partnerships in England,[79] and this enables organisations to function better. Their social autonomy is enhanced by legal

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[74] Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021).
[75] 53 & 54 Vict c 39.
[76] Susan Mary Watson, 'The Corporate Legal Person' (2019) 19 Journal of Corporate Law Studies 137, 149.
[77] See further Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 37-38; Eva Micheler, 'Separate Legal Personality – An Explanation and a Defence" (2024) 24 Journal of Corporate Law Studies 301, 316-17.
78 For an explanation of the limitations of partnership law during the time before the first Companies Act came into force see Andreas Televantos, *Capitalism Before Corporations: The Morality of Business Associations and the Roots of Commercial Equity and Law* (OUP 2020) 26-28.
[79] In contrast, partnerships are considered legal persons in Scots Law. There are nevertheless problems with the model of separate legal personality adopted for Scottish partnerships. It is, for example, unclear if the legal personality of a partnerships survives a change in its members. See The Scottish Law Commission and Law Commission for England and Wales, *Partnership Law: A Joint Consultation Paper* (Scot Law Com No 111 / Law Com No 159, 2000) paras 9 to 11.

autonomy.[80] Ronald Gilson writes that corporate law makes it possible for a corporation to become a 'real boy'.[81] We argue that corporate law makes it possible for real social entities to become formal subjects of the law. It enables a social reality, which otherwise might be characterised as a partnership or as an unincorporated association, to be elevated and become formally integrated as an actor into the legal system.[82]

Separate legal personality is useful since it is not possible to always permanently identify any one physical object or person as the organisation. It condones, supports, and enhances the ability of organisations to act autonomously by supplying them with a permanent public manifestation. It also enables the organisation or firm to continue to exist beyond a changing body of members.

Separate legal personality supplies a nexus enabling a company or corporation to contract with its participants and with third parties. The company or corporation serves as a nexus for contracts. The corporate form, however, is more than just a nexus for contracting. The point that companies or corporations are designed for more than contractual purposes draws support from the fact that they themselves, in addition to individual participants, are liable in tort and criminal law.[83] Companies are vicariously liable in tort. Criminal law uses the identification doctrine as a default but has recently developed special attribution rules for corporate criminal conduct.[84] If companies or corporations were no more than aggregates of their participants, it would not be necessary to make them subjects in tort or crime.

The organisational purpose of separate legal personality can finally be seen when separate legal personality comes to an end.[85] Parties in a contract can normally terminate it by agreement. This is not as straight-forward for shareholders or directors of companies, which need to be wound up and removed from the register to end their legal personality. Similarly, a contract based on illegality or fraud is normally considered ineffective and void. However, companies afflicted by such vitiating circumstances continue to exist until they are wound up. The winding up process ensures that any organisational activity of a company is put to an orderly end.

[80] See also David Gindis, 'From Fictions and Aggregates to Real Entities in the Theory of the Firm' (2009) 5 Journal of Institutional Economics 25, 39 and 41; David Gindis, 'Ernst Freund as the Precursor of the Rational Study of Corporate Law' (2020) 16(5) Journal of Institutional Economics 597; David Gindis and Daniel H Cole, 'Toward a Knowledge Commons Perspective on the Corporate Form' in David Gindis (ed), *Governing Corporate Knowledge Commons* (CUP forthcoming).
[81] Ronald Gilson, 'From Corporate Law to Corporate Governance' in Jeffrey N Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP 2015) 7.
[82] See further Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 41-47; Eva Micheler, 'Separate Legal Personality – An Explanation and a Defence' (2024) 24 Journal of Corporate Law Studies 301, 315-21.
[83] Eva Micheler, 'Separate Legal Personality – An Explanation and a Defence' (2024) 24 Journal of Corporate Law Studies 301, 319-320.
[84] For further reference see Martin Petrin and Christian A. Witting, *Research Handbook on Corporate Liability* (E-Elgar 2023) chs 1, 2, 3, 6, and 9; Elise Bant, *The Culpable Corporate Mind* (Bloomsbury 2023); Rachel Leow, *Corporate Attribution in Private Law* (Bloomsbury 2022).
[85] Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 45-46.

9.2.2 On fictions

The separate legal personality of the company or corporation is sometimes referred to as fictitious.[86] There is no room here to discuss the different ways in which the term 'fiction' can be and has been conceived of over time in this context. We respectfully defer to Professor Watson's excellent analysis on this aspect.[87] We only point out that separate legal personality is always rooted in the legal system. Human beings now have legal personality as a matter of right. Historically, however, they did not. Slaves in Roman law and women in Victorian Britain did not have full legal personality.[88] There is also not one absolute concept of legal personhood even for human beings. In the modern world citizenship and requirements for residency permits structure the extent to which human beings are recognised as legal actors in particular jurisdictions. Criminal law can affect the legal status of human beings.[89] The fact that the legal personhood of the corporation derives from a statute does not render it defective.

It also does not matter that there are different models of the corporation in different jurisdictions. Many of these share key characteristics such as separate legal personality or a form of limited liability.[90] The differences between them are the result of the wider institutional environment in which these forms have evolved rather than evidence that a real entity approach is unconvincing.[91]

9.2.3 Unlimited capacity

The capacity of companies used to be limited by the objects stated in their memorandum.[92] A company could only validly enter contracts in furtherance of its objects. Contracts outside of these were void because they were 'beyond the company's powers' or 'ultra vires'. Importantly from our perspective, the ultra vires doctrine was abolished because it did not suit the requirements of commercial organisations. At first, shareholders contracted out of the doctrine by causing companies to adopt long object clauses pre-empting all sorts of potential objects

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[86] ibid 10, 82 and 101.

[87] For this see Susan Mary Watson, 'The Corporate Legal Person' (2019) 19 Journal of Corporate Law Studies 137, 156-161.

[88] Richard Gamauf, 'Slavery and Roman Law' in Stephen Hodkinson et al. (eds), *The Oxford Handbook of Greek and Roman Slavery* (OUP 2021) <https://doi.org/10.1093/oxfordhb/9780199575251.013.11> accessed 24 August 2025; Richard Gamauf, 'Social Position and Legal Capacity' in Paul J du Pessis (ed) *The Oxford Handbook of Roman Law and Society*; Jean-Jacques Albert, 'The Legal Capacity of Public Slaves in the Roman Empire' (2021) 64 Bulletin of the Institute of Classical Studies 21; Tim Stretton and Krista J Kesselring, *Married Women and the Law: Coverture in England and the Common Law World* (McGill-Queen's University Press, Montreal 2013); Mary Shanley, *Feminism, Marriage, and the Law in Victorian England (1850-1895)* (Princeton University Press, Princeton 1989).

[89] Colin Dayan, *The Law Is a White Dog: How Legal Rituals Make and Unmake Persons* (OUP 2011).

[90] Islamic law appears to be an exception: Timur Kuran, 'The Absence of the Corporation in Islamic Law: Origins and Persistence' (2005) 53 The American Journal of Comparative Law 785; Nicholas H.D. Foster, 'Islamic Perspectives on the Law of Business Organizations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-style Law' (2010) 11 EBOR 3.

[91] Nicholas H.D. Foster, 'Company Law Theory in Comparative Perspective: England and France' (2000) 48 The American Journal of Comparative Law 573, 611 referencing Gunther Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences' (1998) 61 MLR 11.

[92] See further Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 48-55.

that might become relevant in the future. With time the legislature reacted and removed the vitiating effect of object clauses altogether.[93] At the same time, organisational action was further facilitated by Companies Act 2006, s 40, which, in relation to third parties acting in good faith, endows the directors with authority to bind the company in contract irrespective of any limitations in the corporate constitution. This enables companies to transact in an efficient manner. Their contractual partners can rely on the directors having the power to represent the company.

9.2.4 Limited liability

Limited liability further enhances the autonomy of organisations or firms.[94] It enables asset partitioning between the company, its shareholders and directors.[95] This provides individuals with the opportunity to set up a business or other organisation without putting all their personal assets at risk. It also enables an organisation or firm to continue to thrive when the fortunes of its individual participants falter.[96]

9.2.5 Defining the roles of corporate participants

In addition to supplying separate legal personality, the Companies Act 2006 sets out a high-level procedural framework for the operation of the company.[97] The statute is supplemented by soft law instruments such as the UK Corporate Governance Code, which advances generally-accepted recommendations on how management should be structured and how directors should make decisions.[98]

The statute delineates the specific roles to be held by individual participants. All companies are required to have at least one shareholder and one director. These roles may be occupied by the same person but are nevertheless treated as distinct. Even the smallest companies are treated as 'organised' in terms of the law.[99] Large companies have a company secretary and auditors. In addition to constituting the roles, the statute sets out the fundamental responsibilities for each of them. Constitutional matters are to be decided by the shareholders, and they also participate in certain management decisions. The Act also imposes mandatory procedures for shareholder meetings to guarantee the procedural integrity of their decisions. Directors have general statutory duties, need to ensure that the company's

[93] Companies Act 2006, s 39.
[94] See generally Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) ch 4.
[95] Henry Hansmann and Reinier Kraakman, 'The Essential Role of Organizational Law' (2000) 110 The Yale Law Journal 387.
[96] See for example Mariana Pargendler, 'Veil Peeking: The Corporation as a Nexus for Regulation' (2021) 169 University of Pennsylvania Law Review 717.
[97] See also Edward B. Rock and Michael L. Wachter, 'Islands of Conscious Power: Law, Norms and the Self-Governing Corporation' (2001) 149 University of Pennsylvania L Rev 1619; see also Ronald J. Gilson, 'From Corporate Law to Corporate Governance' in Jeffrey N. Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP 2018) 3, 7-8.
[98] For a critique of the Code see Brian R. Cheffins and Bobby V. Reddy, 'Thirty Years and Done – Time to Abolish the UK Corporate Governance Code' (2022) 22 Journal of Corporate Law Studies 709.
[99] *Lee v Lee's Air Farming Ltd* [1960] UKPC 33, [1961] AC 12.

entry with Companies House is up to date, maintain financial records, and produce financial reports. The company secretary and auditors play supporting roles. The UK Corporate Governance Code suggests ways for employee interests to be represented in board decision-making.

All of this is evidence that corporate law is designed to support organisations.[100] None of these roles would be required if the company or corporation was designed to just hold an asset or a fund. For this it would be sufficient to set up a trust by appointing a trustee and appropriating assets to him or her.

9.2.6 The corporate constitution

The constitution is adopted by those setting up a company. It contains more detailed rules on how companies take decisions. Those setting up a company can either adopt their own bespoke articles or rely on the Model Articles, which have been set out in a statutory instrument.[101] The content of the constitution is a further example supporting the conclusion that corporate law has been designed to support organisational decision-making and action.[102] The constitution is a product of private action but derives its force from the statute. Standard contract law does not apply to the constitution. Instead, the unfair prejudice remedy and the rules on just and equitable winding up serve as mechanisms for resolving situations where the mutual understanding of a quasi-partnership is not reflected in the constitution. The constitution is best characterised as the foundational document for the operation of an organisation or firm, and it has more in common with secondary legislation adopted by private action on a statutory basis than with a contract. The common law nevertheless permits these procedures to be overridden by an informal unanimous decision (the *Duomatic* principle).[103] This example illustrates that company law is alive to organisational reality and can prioritise this over formal legal processes.

9.2.7 Directors' duties and their enforcement

Directors' duties are owed to the company itself rather than the shareholders or any other stakeholders. In the book, Professor Micheler argues that the law is primarily concerned with ensuring a certain degree of compliance from directors with the Companies Act and the constitution, rather than with the enhancement of economic interests.[104] If organisations are defined by their routines, processes, habits, and procedures, the law is interested in setting minimum standards or guaranteeing a level of integrity in these forms of 'procedural rationality'.

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[100] See generally Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 103-112.
[101] The Companies (Model Articles) Regulations 2008, SI 2008/3229.
[102] Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 112-123.
[103] *Re Duomatic Ltd* [1969] 2 Ch 365.
[104] Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 125-194.

For example, Companies Act 2006, section 171 is concerned with the company constitution and that constitutional powers are properly exercised.[105] The law does not instruct directors to maximise shareholder return (however defined) either, rather it instructs directors to promote the 'success of the company' for the 'benefit of the shareholders as a whole' (Companies Act 2006, s 172). In doing so, the board must have regard to the interests of wider constituents. It is, however, up to the directors' subjective 'good faith' judgement to define what success is.[106] This puts the company itself at the centre of the directors' responsibilities and further defers to their good faith judgement to determine what is required for the company to succeed.[107] The standard required under the duty of skill and care (Companies Act 2006, s 174) is determined by the court assessing what a reasonably diligent person would do in the organisational role performed by the director in question.[108] It can be elevated by the particular expertise a particular director is found to possess. When they apply this standard, the courts require directors to put in place appropriate internal control and risk management systems.[109] This is evidence that corporate law has evolved to reflect the characteristics of organisations. It acknowledges the existence and relevance of organisational structure.

This perspective is reinforced by the rules governing derivative actions. The default position is that the board decides on whether to sue directors who have breached their duties.[110] If the whole board is in breach, it is for the shareholders to take the litigation decision. An individual shareholder, who wishes to bring a claim against a director or the entire board, requires the permission of the court. Under the statutory regime, the courts grant permission only if the shareholder can show that a hypothetical director, promoting the success of the company, would pursue this claim (Companies Act 2006, s 263). Derivative claims are most likely to succeed if the claiming shareholder can show, on the facts, that the corporate decision-making process on whether a claim should be brought cannot be made to work independently of the wrong-doing directors.[111] The law is deliberately designed with a view to preventing individual shareholders from circumventing the corporate decision-making process.[112]

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[105] ibid 128-130.
[106] ibid 131-137.
[107] See also Asaf Raz, 'Taking Personhood Seriously', Columbia Business Law Review 2023 Colum. Bus. L. Rev. (2023).
[108] See Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 138-142.
[109] *Re Barings plc (No 5)* [2000] 1 BCLC 523.
[110] ibid 237-256.
[111] See, for example, *Cullen Investments Ltd v Brown* [2015] EWHC 473 (Ch), [2016] 1 BCLC 491. Cullen (claimant) and Mr Brown (defendant) were shareholders of a joint venture company set up to make property investments. Mr Brown and his brother were directors in the company. Brown had breached his duties, namely to avoid a conflict of interest, when he concealed and took an investment opportunity in Germany for himself. The corporate decision-making process could not be made to work independently of the wrongdoing directors since the defendant directors constituted the majority of the company. Permission to continue the claim was granted and ultimately largely successful in [2017] EWHC 1586 (Ch).
[112] John Armour, 'Derivative Actions: A Framework for Decision' (2019) 135 LQR 412; Jonathan Hardman, 'An institutional analysis of UK ostensible minority shareholder protection mechanisms' (2023) 23 JCLS 397.

The reluctance of the UK law to enable individual shareholders to enforce claims against directors through derivative actions is to some extent compensated by the unfair prejudice remedy.[113] Under Companies Act 2006, s 994, shareholders can petition to the court for a remedy when they have been treated in an unfair *and* prejudicial manner.[114] An example would be when a majority shareholder takes excessive remuneration – a problem since the minority shareholder cannot remove this director nor cause the articles to be changed.[115] This tool has the benefit that under Companies Act 2006, s 996 the court has flexibility as to what remedy to award. The most common of these is an order that the majority buy out the minority. The courts have been more comfortable with intervening in this way. A buy-out order delivers accountability without requiring the court to interfere with the autonomy of the corporate decision-making process.[116]

9.2.8 Conflicts of Interest

Company law recognises that individual agency coexists with organisational structure. It specifically addresses the problem of conflicts of interest affecting individual directors. Under Companies Act 2006, s 175, directors must seek permission to pursue corporate opportunities for their own benefit. Under Companies Act 2006, s 177, a director must disclose his or her personal interest in a corporate transaction. Interested transactions are not illegal per se but subject to disclosure and approval. A declaration procedure is put in place by the Companies Act to authorise them and even if a director failed to declare, it is always open to the shareholders to ratify the transaction afterwards.[117]

9.3. NORMATIVE PERSPECTIVES

In an article published in 2024, David Gindis and Eva Micheler build on real entity theory and propose a narrative model of the company or corporation. They rely on the work of Oliver Williamson and Elinor Ostrom and set out the company or corporation as an entity embedded in and characterised by levels of governance. Corporate law as the source of the corporate form is at the heart of this model. There are four levels, the meta-constitutional level, the constitutional level, the policy level, and the operational level. At the meta-constitutional level there is the Companies Act, together with other statutory requirements, which frame the ability of those setting up a company and governing it at the constitutional level. That level complies with the meta-constitutional rules and consists of the corporate constitution but also soft law mechanisms such as the UK Stewardship Code. Below and embedded in the constitutional level there is the policy level, where the directors take decisions. These decisions are implemented at operational level.

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[113] See eg. Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 248-9.
[114] *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14 (CA).
[115] *Re Cumana Ltd* [1986] BCLC 430 (CA).
[116] Eva Micheler, *Company Law: A Real Entity Theory* (OUP 2021) 252-56.
[117] Companies Act 2006, ss 177, 182, and 239.

The benefit of this narrative model is that it comes closer to the reality of organisational action than a nexus of contracts model. At each level human actors are shaped by the prevailing formal and informal norms but also interpret these through their own preferences. The latter may give rise to conflicts of interest but also different perspectives on what is a desirable outcome. A policy decision by the board, for example, does not automatically execute at operational level. This may be because operational actors are shirking but could also be because they adopt different opinions as what leads to and constitutes a successful result.

Further, information does not flow automatically from the operational to the policy or constitutional level. Each actor reports in compliance with the formal and informal rules they are bound by but also shaped by their own opinions, preferences and values.

David Gindis and Eva Micheler suggest that this narrative way of conceptualising the corporate form enables those seeking to suggest improvements to develop specific recommendations that better reflect the reality of how organisations or firms work and how corporate law interacts with other institutional forces.

9.4. SUMMARY

In this section we have shown that a model that conceives of companies or corporations as legal tools that are designed to support organisational action can help to explain the law at a positive level. It also forms a basis on which normative recommendations can be developed.

10. APPLYING REAL ENTITY THEORY TO COMPANY LAW

It is not my intention to use real entity theory to advance support for either greater shareholder or stakeholder influence. Conceiving the company as a real entity is logically prior to any legal system deciding the extent to which shareholders or other constituencies should have influence. It also does not determine if and to what extent corporations pursue or should pursue a profit motive. Admittedly, real entity theory was originally conceived against the background of a system where shareholders had more influence than other constituencies. The early German theorist Walter von Rathenau was a proponent of real entity theory and was critical of the level of shareholder influence that existed before the 1930 reforms. German law has since introduced its current dual board model, giving the board a comparatively higher level of independence from the shareholders. However, this history does not logically associate real entity theory with any level of shareholder influence. Real entity theory does not seek to explain the balance of power between constituencies at a positive level nor how such power should be allocated at a normative level. It focuses on the characteristics of organisational action and how these are reflected in the law.

11. THE SIGNIFICANCE OF THE CORPORATE FUND

Professor Watson writes that the corporate fund rather than the association of members historically has been and continues to be the defining characteristic of the corporate form. For the modern law we would argue that the possibility of a corporate fund is an important aspect of company law. But it is not a legal requirement and not always present in practice either. In the UK, companies can be incorporated without any capital as companies limited by guarantee. Companies limited by a share capital can be set up with a capital of one pound sterling or less. There is no requirement for companies to hold assets of any value. A shelf company would be an example. All modern companies, however, must comply with statutory organisational norms. Even a shelf company must have one shareholder and one director. These roles can be held by the same individual but are nevertheless separate in law.[118]

12. ANOTHER SIDE NOTE: THE PERSPECTIVE OF LEGAL INSTITUTIONALISM

The real entity theory advanced here relies on a distinction between organisations or firms and corporations or companies. We contribute to the field of corporate law and observe that the law is designed in a way that supports organisations and firms, which are conceived of as real social entities.

In the field of institutional economics, a recent debate centres on the same distinction that we draw. That debate is conducted between Professor Jean-Philippe Robé on one side and Professors Simon Deakin, David Gindis and Geoffrey Hodgson on the other side. These two sides disagree over the role of the law in defining the firm as a unit of economic rather than legal analysis. Robé believes firms are an economic concept that is independent of the law. Deakin et al. consider law as a constituting factor of the economic concept of the firm.

In *Property, Power and Politics*, Robé presents the view that these two terms are 'radically different notions' and conflating the two has resulted in mis-shaping the company as a nexus for contracting relationships.[119] He considers a firm to be 'an

[118] *Lee v Lee's Air Farming Ltd* [1960] UKPC 33, [1961] AC 12.
[119] Jean-Philippe Robé, *Property, Power and Politics: Why We Need to Rethink the World Power System* (Bristol University Press 2020) 195.

organization performing an economic activity'.[120] Conversely, the term 'corporation' only refers to a 'specific legal device' exhibiting 'peculiar characteristics', such as a 'potentially eternal legal personality, an asset partitioning effect, and several layers of separations of ownership and control.'[121] Robé believes in separating these two concepts practically and conceptually in order to gain a better understanding of the constitutive role of law in the modern economy. He argues that a 'corporation' is a legal fiction, whereas a 'firm' is not a legal fiction: the 'firm' is a 'creature of business practice'. The "granting of legal personality does not make of a 'corporation' a 'firm'".[122] For Robé, by nature, a firm is like an army in that both are organisations. An organisation's 'members have an activity in common', 'use assets to conduct their activity', and their activities are 'structured, organized, with internal rules, hierarchies, orders'.[123] The distinction is that a firm's 'organised activity' is economic in nature.

Deakin et al. disagree and define 'the term firm to apply to individuals or organisations with the legally recognised capacity to produce goods or services for sale'.[124] For them, the law is 'so deeply imbricated with the operation of firms in the economy that it makes no sense for the economist's conception of the firm to ignore the role of the law.'[125] On this view, the term firm does not identify an economic phenomenon that exists independently of the law. The law affects the value of ownership claims in the company. For example, the law recognises certain categories of shares such as ordinary shares and preference shares. Each class confers different legal rights on its holder. The law shapes commercial expectations and behaviour in significant ways.[126]

This paper contributes to the field of corporate law. From this perspective a conceptual distinction between organisations or firms and corporations or companies is useful. Corporate forms differ from one jurisdiction to another. Some jurisdictions have more than one corporate form.

As corporate lawyers we see many of the insights on organisations and firms from the wider social sciences reflected in the doctrinal legal rules. This is why we favour a real entity model that explains the law at a positive level as supporting organisations or firms as real social entities. This perspective, however, does not preclude an economist from taking the view that economic phenomena are influenced and shaped by legal rules. Historically, organisations and firms predate corporate law as we see it now. Until the mid-nineteenth century UK firms did not have easy access to the corporate form. The deed of settlement companies that

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[120] Jean-Philippe Robé, 'Firms *Versus* Corporations: A Rebuttal of Simon Deakin, David Gindis, and Geoffrey M. Hodgson' (2022) 18 Journal of Institutional Economics 693, 693.
[121] ibid.
[122] ibid 696.
[123] ibid 697.
[124] Simon Deakin and others, 'Legal Institutionalism: Capitalism and the Constitutive Role of Law' (2017) 45(1) Journal of Comparative Economics 188, 194.
[125] Simon Deakin, David Gindis and Geoffrey M. Hodgson, 'What Is a Firm? A Reply to Jean-Philippe Robé' (2021) 17 Journal of Institutional Economics 861, 867.
[126] ibid 866.

prevailed at the time did not provide separate legal personality or limited liability in the way we know them now. Modern firms would not exist in the way they are if it was not for corporate law.[127] Economic scholarship does well in appreciating that law is one of the factors that constitute economic activity.

The academic fields of corporate law and economics are communicating but separate disciplines. Corporate lawyers have greatly benefitted from the insights produced by agency theory and more generally economics analysis. In the paper Eva Micheler wrote together with David Gindis, they invite legal scholars to take advantage of sources beyond the familiar neoclassical approaches.[128] The legal institutionalism, promoted by Katharina Pistor,[129] Eric Orts,[130] Simon Deakin, Geoffrey Hodgson,[131] and David Gindis,[132] encourages economists to take an interest in law as a factor that shapes economic reality.[133]

13. SUMMARY

What is the company or corporation? Is there a theoretical model that enables us to better understand corporate law?

We maintain the view that a real entity theory of company law is the most suitable explanation for these foundational questions. The company is a legal entity, which is designed to enable an organisation to act autonomously, independently of its individual participants. Company law establishes procedures and rules that enable and secure the integrity of this form of collective decision-making.

Real entity theory builds on the idea that the corporation is built on pre-legal or extra-legal foundations. A modern version of the theory recognises organisations or firms as a social phenomenon independent of the law, and they are autonomous actors in and of themselves. Thus, they are not mere aggregates of their individual participants' contributions. They are manifestations of distinct views and interests being pursued beyond their participants' idiosyncrasies. There is empirical evidence that human beings adapt their behaviour when acting as a member of a group. Groups develop shared standards. Over time, organisational habits, routines, processes, and procedures take on a life of their own, establishing an organisation

[127] Eric W. Orts, *Business Persons: A Legal Theory of the Firm* (OUP 2013).
[128] David Gindis and Eva Micheler, 'Institutional Theory for Corporate Law: An Invitation' (2024) 24 Journal of Corporate Law Studies 399.
[129] Katharina Pistor, *The Code of Capital: How the Law Creates Wealth and Inequality* (Princeton University Press 2019).
[130] Eric W. Orts, *Business Persons: A Legal Theory of the Firm* (OUP 2013).
[131] Geoffrey M. Hodgson, *The Wealth of a Nation: Institutional Foundations of English Capitalism* (Princeton University Press 2023); Geoffrey M. Hodgson, *Conceptualizing Capitalism: Institutions, Evolution, Future* (University of Chicago Press 2015).
[132] David Gindis and Geoffrey M. Hodgson, 'The Legal Nature of the Firm' in Josef Windsperger and Aveed Raha (eds), *Research Handbook on the Theory of the Firm* (Edward Elgar forthcoming).
[133] Simon Deakin et al., 'Legal Institutionalism: Capitalism and the Constitutive Role of Law' (2017) 45 Journal of Comparative Economics 188.

as a source of rules that shape individual behaviour. This process is self-reinforcing: standards are created, individuals conform to them, and the organisational apparatus detects and deters deviance. Thus, participants' behaviours are deeply affected by the organisation. Of course, participants can also influence organizational behaviour. Habits, routines, procedures, and culture can be modified but would likely require significant time, motivation, and collaboration. Company law captures and enhances this dynamic phenomenon. It supplies separate legal personality and collective decision-making.

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