

Corporate Social Responsibility: questions of equality
before the law, property rights and de-regulation

by

Dan Plesch

dan@danplesch.net

<http://www.danplesch.net/>

CORPORATE SOCIAL RESPONSIBILITY: questions of equality before the law, property rights and de-regulation.¹

People are ripped off, day in, day out, by the easy availability of limited liability for off-the-shelf companies and the protections provided for them, and with no real remedies.

Andrew Phillips,
legal advisor on the BBC *Jimmy Young Show*

This paper reviews the present debate on corporate social responsibility and suggests measures to advance the interests of those concerned to ensure that corporations are responsible. The power of big businesses can be balanced and controlled by removing the special-interest protection that enables the shareholders who own corporations to avoid legal responsibility for the consequences of their actions. This protection is called limited liability.

It argues limited liability is as Adam Smith put it an 'unreasonable' special interest privilege that distorts the free market and is ripe for de-regulation. Further, limited liability breaches two fundamental principles of a free society, that all are inviolably equal before the law and that property rights should not be infringed.

Corporate power

There is widespread public concern over the power of corporations. The needs of business have come to define politics today. The Anglo-American 'Third Way' and Britain's New Labour have been attempts to fit public demands for a fair and just society with the needs of business. At a global level the strength and diversity of resistance to a political agenda driven by the needs of major corporations has been made evident by protests at the world trade talks in Seattle and Cancun. Meanwhile, Enron, WorldCom and similar scandals have produced a feeling in the general public, and even amongst shareholders, that they are being ripped off.

Attempts to make businesses behave by campaigns for good corporate governance have had little effect. Corporations usually follow the legal advice that it is unlawful to pursue any other goal than delivering profit to shareholders. Other social or environmental objectives can

¹ This paper develops chapter four of the author's *The Beauty Queen's Guide to World Peace*, (Politico's, London, 2004).

be pursued, but they must contribute to this primary directive. The political energy poured into corporate governance can achieve little because of this legal imperative.

A new strategy is needed to help corporations reinforce rather than undermine the fabric of society. The reforms I suggest would hold owners accountable in law. A close examination of the core of the common structure of corporations reveals fundamental breaches of the principles of a free, liberal democratic society. Focusing on the reform of limited liability can provide the basis within capitalist-liberal democracy for a radical redistribution of wealth and power based on the fundamental principles of equality before the law and the right to property.

The key idea in the modern corporation is the concept of limited liability. This concept provides the owners, the shareholders, with complete power, but with no responsibility for the consequences of their actions. Their liability is limited to the sum of money they invest. This power without responsibility is driving the whole structure of global civilisation and yet it violates fundamental principles of justice and human rights in a free society. Limited liability creates inequality before the law by allowing the most powerful to be above the law, when in a free society all should be equal before the law.

Attempts to find voluntary means of controlling corporate power have not had sufficient impact. There now needs to be a debate about the need for legal reforms to make shareholders and directors accountable for the actions of the companies they own. A movement for this reform should be the economic centrepiece of a global strategy for stability and prosperity. Such reform is necessary because existing attempts to obtain voluntary agreements from corporations to behave well are not working. Many people are unaware of the injustice created by limited liability, and consequently it is necessary to make the argument plainly and strongly. This does not mean that I believe that there are millions of people out there going to work every day saying to themselves, 'I'm off to operate an unjust system.' The dominance of limited liability has crept up on us over the years; people are rarely if at all deliberately operating a system that they are aware is unjust and violating the human rights of their fellow citizens.

The existing debate on corporate power

Corporate power has grown considerably since the collapse of communism and the widespread discrediting of state socialist approaches to running society. Will Hutton has argued with great clarity that the world as a whole has to face the damaging consequences of the triumph of Anglo-American business practice.² Agreements in the World Trade Organisation and the Organisation for Economic Co-operation and Development (OECD) have extended and entrenched an agenda that favours international corporations in the name of free trade and free markets.

² Hutton, W, *The World We're In* (Abacus, London, 2003).

Hutton's argument is echoed by many of those supporting the Anglo-American model. Two leading US academic economists, Henry Hansmann and Reinier Kraakman, provide a typical example of this analysis in their paper 'The End of History for Corporate Law'.³ They argue:

Despite the apparent divergence in institutions of governance, share ownership, capital markets, and business culture across developed economies, the basic law of the corporate form has already achieved a high degree of uniformity, and continued convergence is likely. A principal reason for convergence is a widespread normative consensus that corporate managers should act exclusively in the economic interests of shareholders, including noncontrolling shareholders. This consensus on a shareholder-oriented model of the corporation results in part from the failure of alternative models of the corporation, including the manager-oriented model that evolved in the US in the 1950's and 60's, the labor-oriented model that reached its apogee in German co-determination, and the state-oriented model that until recently was dominant in France and much of Asia. Other reasons for the new consensus include the competitive success of contemporary British and American firms, the growing influence worldwide of the academic disciplines of economics and finance, the diffusion of share ownership in developed countries, and the emergence of active shareholder representatives and interest groups in major jurisdictions. Since the dominant corporate ideology of shareholder primacy is unlikely to be undone, its success represents the end of history for corporate law. The ideology of shareholder primacy is likely to press all major jurisdictions toward similar rules of corporate law and practice.

The notion of organising the world around the needs of shareholders has been questioned across the political spectrum, from the World Social Forum at Porto Alegre to the billionaire George Soros.⁴ Noam Chomsky,⁵ Naomi Klein and George Monbiot are authors whose work provides insights into the problems of corporate power and who begin to suggest alternatives.

I do not wish to take time here to go over the familiar arguments about the problems presented by uncontrolled corporations beholden to their shareholders. But to summarise: corporations are accused of ignoring the interests of communities; of polluting the air, land and water; and of forcing nations and communities to give up nationalised and community-based businesses and services. These problems are compounded by a tendency for national

³ Hansmann, H. and Kraakman, R, *The End of History for Corporate Law*, Working Paper #CLB-99-013 (New York University Center for Law and Business, New York, January 2000).

⁴ Soros, G, *George Soros on Globalization* (PublicAffairs, Oxford, 2002).

⁵ Herman, E. and Chomsky, N, *Manufacturing Consent: The Political Economy of the Mass Media*, rev. ed. (Pantheon, New York, 2002).

and global markets to become dominated by a handful of huge corporations. Their resources are often larger than those of the countries in which they operate and they are able to use structures of linked corporations in many countries to avoid being held to account by the governments of the countries in which they operate.

Think about cars, oil, accounting or pharmaceuticals, for example. In each of these industries only a handful of companies control the market. The problems caused by these corporations have come to dominate the proceedings of elite international gatherings such as the World Economic Forum at Davos.

The opponents of corporate power suggest two main types of strategy for opposing it: local initiatives and corporate governance. Supporters of local initiatives, for example Colin Hines in *Localization: A Global Manifesto*,⁶ propose strengthening networks of local non-corporate economies and cultures, such as cooperatives and schemes to promote local produce. These networks include resistance to the idea of third-world farmers being driven into producing cash crops at the expense of existing, more integrated and sustainable economies. An example in the developed world is the network of Italian cities supporting local produce and using local-authority regulations to keep out global chains on the basis that they lack local content. These initiatives appear to work well, but they are by definition small scale, working at the edges of the economy. They can provide a safe place to hide from the trampling feet of the megacorps, but they are neither an effective defence nor an effective means of control. They are, however, a potential base from which such efforts at control can be built.

In parallel with the growth of localism, there has also been a movement to reach voluntary agreements with corporations to persuade them to act with more consideration towards the people and the environment that they affect. Often termed 'corporate governance', this strategy aims to persuade business to become more socially and environmentally responsible. According to John Wolfensohn, then President of the World Bank, 'Corporate governance is about promoting corporate fairness, transparency and accountability.'⁷

The rebranding of British Petroleum as 'Beyond Petroleum' is an example of the effects of campaigns for corporate responsibility. The company has, at least in its advertising, engaged in social and environmental issues. Corporate governance has led to a less confrontational and more constructive relationship between pressure groups such as Oxfam or Greenpeace and the business community, but it has not led to much change.

Christian Aid's case studies of corporate social responsibility make a powerful case

⁶ Hines, C, *Localization: A Global Manifesto* (Earthscan, London, 2000).

⁷ *Financial Times*, 21 June 1999.

'The image of companies working hard to make the world a better place is too often just that – a carefully manufactured image,' – says 'Behind the Mask: The Real Face of Corporate Social Responsibility', a new report from Christian Aid. Its target is the burgeoning industry known as corporate social responsibility – or CSR – which is now seen as a vital tool in promoting and improving the public image of some of the world's largest companies and corporations.

But, as the case studies in this report – featuring Shell, British American Tobacco and Coca-Cola – demonstrate, the rhetoric can also mask corporate activity that makes things worse for the communities in which they work.

'Some of those shouting the loudest about their corporate virtues are also among those inflicting continuing damage on communities where they work – particularly poor communities,' says Andrew Pendleton, senior policy officer at Christian Aid and author of the report. 'Legally binding regulation is now needed to lessen the devastating impact that companies can have in an ever-more globalised world.'

Christian Aid, January 2004

Stock market scandals at the end of the twentieth century revived a different type of call for reform. This time it was not from those who had bad experiences from the direct operations of corporations, but from shareholders who lost money when the businesses failed. Corporate misdeeds have produced periodic reforms back into the nineteenth century. These reactions were at times especially strong in the US. At the time of Presidents Taft and Theodore Roosevelt in the late nineteenth and early twentieth centuries, regulations against monopolies and price-fixing were introduced and monopolies such as that in the oil industry were broken up. The notorious stock market crash of 1929 produced some useful regulation of stock market activity and, under President Franklin D. Roosevelt, a host of union-friendly legislation.

The latest scandals had two notable characteristics. Accountants had themselves cooked the books on a massive scale as their role morphed from being independent auditors to becoming integrated into company operations as 'consultants'. Secondly, on the stock market, the corruption of independent financial advisers into sales staff for particular companies' shares destroyed their hard-won reputation for impartiality.

The effort at reform after the excesses of the 1990s has been weak and is already failing. The *Financial Times* reported in August 2003 that William Donaldson, the new chairman of the Securities and Exchange Commission, had 'voiced worries that entrepreneurial zeal was being stifled by regulations and new legal advice'. And Alan Greenspan, the guru chairing the US Central Bank, said that 'such concerns might be one reason why corporate investment was being held back'.⁸

In Britain, the chairman of Unilever, Niall FitzGerald, has elegantly described how demands for stronger corporate governance have been deflected:

⁸ Michaels, A, *Financial Times*, 27 August 2003.

On corporate governance, the trade and industry department should be congratulated for having resisted knee-jerk legislation or regulation in the wake of the Enron and WorldCom scandals. Initially it appeared too quick to accept recommendations in the Higgs report on corporate governance, but effective and extensive consultation has led to an outcome acceptable to all parties. In future such consultation will help head off a growing sense that Britain is no longer as friendly a place for business.⁹

Fitzgerald's final remark is interesting for its implied threat that business might move elsewhere, not because Britain may become unfriendly to business, but because it may just not remain friendly enough. That this hostility to better governance comes not from some speculator, but from a company which sells soap powder, indicates that the problem of improving corporate behaviour is deep-rooted.

As Andrew Phillips, Lord Phillips of Sudbury, explains, once a private company becomes a limited-liability company, any thought that wider interests may be served is apt to be set aside and even government studies on governance pay little attention to broader issues:

As the chairman of a large family business [Cadbury] put it when they finally went public, 'once we became a quoted company, we were answerable to our shareholders in the same way as any other company and subject to the same external disciplines. We are, therefore, not in a position to make any special claims about the way in which the business is run and the values which lie behind its management, nor would it be right for us to do so.' How sad, and how diminishing for our society.

The fact of the matter is that the only stakeholders of the modern limited company recognised by law, beyond a sidelong glance at employees, are the shareholders. Indeed, the government report last month [January 2003] by a business luminary, Derek Higgs, on the role of non-executive directors, reinforces that narrow focus. In over one hundred pages there is scarcely a nod in the direction of the wider public interest, or of corporate citizenship. He repeatedly asserts that the required attributes of such directors are those of 'skills, knowledge and experience' without reference to their character, judgement or wisdom. This reflects the reality, namely that most such businesses operate within exceedingly introspective, two-dimensional parameters.¹⁰

One of Higgs's key recommendations was to improve corporate governance to widen the

⁹ Fitzgerald, N, *Financial Times*, 8 September 2003.

¹⁰ 'The Charity/Business Duet: Harmony or Discord?', Allen Lane Lecture, London, 11 February 2003.

role of non-executive directors. These are people who sit on boards but are not involved in the day-to-day running of the business. Their purpose is mainly to protect the rights of investors from managers and directors seeking to feather their own nests.

One form of developing corporate responsibility is the idea of stakeholding, which has been made popular by Will Hutton. His approach focuses on the question of the distortions caused by the requirement to maximise profits for shareholders. He attempts to redress this distortion by suggesting a change to company law that would require companies also to take into account a broader range of people with an interest in the company's activities. Such people with an interest, or stake, in the company are termed 'stakeholders'. Key stakeholders, such as insurance companies, pension funds and other large institutional investors, could be made to control companies. Tony Blair had a brief flirtation with stakeholding shortly before coming to power in 1997. However, the negative reaction from business led to his dropping the idea.

Stakeholding is an attractive idea because it offers the prospect of involving a broader range of people in a company's activities. But this also creates significant problems of defining who does and does not have a stake in the company, and precisely what companies would have to do to meet these somewhat ill-defined demands. Hutton recommends that stakeholding be introduced by revisions to company law. This would be welcome, but as he recognises, it has so far failed to gather enough support. More fundamentally, although it adds some rights to people who are not shareholders, the stakeholding concept does not emphasise restoring natural responsibilities on owners for the consequences of their actions.

A number of economists and business leaders have always rejected the idea that business should have a conscience and so far this view prevails. Milton Friedman consistently argued that anything that reduces the priority of delivering financial returns to shareholders is wrong.¹¹ This view predominates today, as is indicated by the definition of corporate governance given by the OECD. The OECD is a club of the world's richest nations. Its view of corporate governance is quite different from Wolfensohn's. According to the OECD,

*Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.*¹²

There is nothing here about fairness, transparency and accountability. This definition is concerned with the rights and responsibilities of corporate decision-making.

¹¹ Friedman, M, *Capitalism and Freedom* (University of Chicago Press, Chicago, 1962).

¹² *Corporate Governance 1999* (OECD, Paris, 1999).

The application of this narrow definition of corporate responsibility is intended to ensure that business plays by the rules and minimises corruption. An example of this approach is a speech to key Chinese business leaders by Britain's top financial regulator, Howard Davies. His topic was 'Corporate Governance and the Development of Global Capital Markets'.¹³ That is to say, he was discussing the ways in which corporate governance matters to the development of global capitalism. His key point is that corruption in business makes doing business more expensive and so less attractive to investors coming from outside a particular culture:

Another, harder piece of evidence comes from some American research on the cost of capital. US academic researchers have found that in countries where the policing of insider trading is regarded as weak, or where the legal framework is poor, the cost of capital for firms is typically some 3 percentage points higher than in countries where insider dealing is policed effectively.

So good corporate governance, and effective regulation, contribute both to the attractiveness of a country in terms of inward investment and business development, and also to the efficiency of its capital markets, and their effectiveness in the service of the real economy. It is always as well to remember these points when considering what can sometimes be a rather dry topic. And it is important to make these arguments robustly to those who argue that efforts devoted to upgrading corporate governance are costly and bureaucratic, and add little value to the economy. In my view, investment in good corporate governance arrangements, and good regulation of those arrangements, is among the most effective and rewarding investments a developing market can make, and there are figures to prove it.

These are important objectives as far as they go but they ignore the broader question of the relationship of the corporation to society.

The concept of corporate governance contains no financial or legal power to correct business behaviour beyond improving returns to shareholders. It is an ill-defined approach that absorbs enormous energy from NGOs, academics, unions, government departments and businesses. After more than a decade of political activity, attempts to control businesses through this approach have failed to produce results that even keep up with the problems.

Another approach to controlling corporations has centred on the idea of increasing the power of shareholders. In large modern corporations, the directors and managers of the business have come to assume a very large degree of power. Shareholders often own too few shares, are too ill-informed, or are simply too uninterested to get a grip on company

¹³ Howard Davies, Chairman, UK Financial Services Authority, 'Corporate Governance and the Development of Global Capital Markets', China Securities Regulatory Commission, Beijing, 22 April 2002.

operations. The scandals of the 1990s produced new calls for accountability to shareholders as a means of preventing financial mismanagement. It is this type of concern that the Higgs report in Britain and new regulations from the US Securities and Exchange Commission were meant to address. But, unfortunately, it is these very same constraints that the leading business figures quoted earlier were so keen to cast aside. The push for shareholder accountability is thus proving as ineffective as the governance and stakeholding efforts to control corporations.

Pressure groups have often used purchasing shares as a means of putting corporate behaviour in the spotlight. The idea is that as shareowners, protestors can gain access to the annual general meetings of corporations and then ask questions and make points during the meeting. A typical example comes from Greenpeace in New Zealand, where it was seeking to stop pollution:

Greenpeace campaigns don't always end up in inflatable boats or with activists locked on to smokestacks. We took the Auckland International Airport Ltd (AIAL) incineration campaign straight to the boardroom challenging AIAL to live up to its vision through a shareholder resolution at their AGM.

Greenpeace purchased the minimum number of shares to allow it to take the resolution forward. Greenpeace board chair Gordon Duncan and campaigner Sue Connor presented the argument for a clean alternative to a packed AGM in Auckland. Residents of Mangere community, located downwind of the incinerator, also attended to convey their concerns.

The resolution was not formally passed but there was a lot of support for its spirit. AIAL can be left in no doubt that this is an important issue for many individual and corporate shareholders.

AIAL agreed to fulfil the demand of Manukau City Council, the third largest shareholder, that the company urgently investigate alternative ways of treating their waste. However, they have yet to make any real change.

Greenpeace will continue to put pressure on AIAL to ensure that the investigation is robust and that the true social and environmental costs of incineration are taken in to account. Any thorough investigation will show the only viable option is to move to a cleaner alternative such as steam sterilisation.

This type of activity can be used to forward the public interest, but it is rare that these activist shareholders have the money and numbers to win at the end of the day. Nevertheless, the tactic serves to highlight the privileged immunity that shareholders enjoy. Greenpeace had rights to debate with the company because it became a part-owner in it. Had Greenpeace members just been citizens standing choking in the fumes, the company would have had no automatic duty to engage with them.

Limiting Limited Liability: a case for the de-regulation of a special interest protection, and the restoration of legal and property rights.

Most businesses are organised as companies with a legal structure in which the owners or shareholders (I will use the two words as synonyms) hold limited liability. This means that if the company fails or causes damage, the shareholders only lose the sum of money they invested. The company is designed to provide them with money, while protecting them from the responsibility for their actions or inactions in relation to it. A company can be prosecuted or sued if it sells defective products, destroys the environment or sells weapons to the enemy, but its shareholders are immune. Shareholders have regulated protection, at a time when other regulation is being swept away in their favour. Company directors also escape personal liability, seemingly because they are agents of shareholders, who are not liable. Nowadays, directors seem to exist in a privileged twilight zone beyond the reach of shareholders and public alike.

Owners' power without responsibility is central to the problem of corporate globalisation. Owners are the greatest beneficiaries of government regulation, yet demand that only they enjoy the protection of such regulation. As corporate power has grown, owners together have exercised vast powers over the world economy without having to take responsibility for the consequences of their actions. Some of the worst examples of abuse in fact come from undemocratic societies, or societies with elites that have recently moved from communism to democracy. All too often these cliques have neatly grabbed a nation's assets during privatisation and find that the protected existence of a new economic aristocracy provides them with an even more special status than they enjoyed so recently as members of the Communist Party elites.

In the modern world the assumption that a neo-liberal form of capitalism is the only form of economic activity acceptable had created an economic monoculture. We appear to have entered an era of Totalitarian Capitalism in which owners are beyond the law to an extent not enjoyed by the Central Committees of the Communist Parties and whose only parallel in Europe is the aristocracy of the Ancien Regimes of the pre-enlightenment.

To restore the balance in society, shareholders' limited liability must be deregulated so that they no longer hold a special status. The very phrase 'free market' is a nonsense because the special interests of shareholders are protected from free-market forces.

The economist Adam Smith was one of the first to identify the problems of limited liability companies, or joint-stock companies, as they were originally called (and are so still in some parts of the world, such as Russia). Joint-stock companies had first been developed by the Dutch and were quickly taken up in London when the Dutchman William of Orange became King William III of England in 1689. The first stock market speculations and crashes came soon afterwards, the crashes following on from scams involving Dutch tulips and the famous 'South Sea Bubble'. This was not, as I fondly imagined as a child, some gigantic soap bubble

– perhaps blown by a whale – but an investment con selling the idea of luxury imports from newly discovered territories in the oceans of the Southern hemisphere.

It was against this background that Smith considered limited-liability companies in *The Wealth of Nation*. In it he opposes the development of limited-liability companies, though he saw a limited value for them in the construction of some public works.

**Adam Smith denounces limited liability in
*The Wealth of Nations*** (emphasis added)

“Joint stock companies, established either by royal charter or by act of parliament, differ in several respects, not only from regulated companies, but from private copartneries.

First, in a private copartnery, no partner, without the consent of the company, can transfer his share to another person, or introduce a new member into the company. Each member, however, may, upon proper warning, withdraw from the copartnery, and demand payment from them of his share of the common stock. In a joint stock company, on the contrary, no member can demand payment of his share from the company; but each person can, without their consent, transfer his share to another person, and thereby introduce a new member. The value of a share in a joint stock is always the price which it will bring in the market; and this may be either greater or less, in any proportion, than the sum which its owner stands credited for in the stock of the company.

Secondly, in a private copartnery, each partner is bound for the debts contracted by the company to the whole extent of his fortune. In a joint stock company, on the contrary, each partner is bound only to the extent of his share.

*The Trade of a joint stock company is always managed by a court of directors. The court, indeed, is frequently subject, in many respects, to the control of a general court of proprietors. But the greater part of those proprietors seldom pretend to understand anything of the business of the company; and when the spirit of faction happens not to prevail among them, give themselves no trouble about it, but receive contentedly such half yearly or yearly dividend, as the directors think proper to make to them. This total exemption from trouble and from risk, beyond a limited sum, encourages many people to become adventurers in joint stock companies, who would, upon no account, hazard their fortunes in any private copartnery ... The directors of such companies, however, being the managers rather of other people’s money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master’s honour, and very easily give themselves dispensation from having it. **Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.***

* * *

*To establish a joint stock company, however, for any undertaking, merely because such a company might be capable of managing it successfully; or **to exempt a particular set of***

dealers from some of the general laws which take place with regard to all their neighbours, merely because they might be capable of thriving if they had such an exemption, would certainly not be reasonable. To render such an establishment perfectly reasonable ... it ought to appear with the clearest evidence that the undertaking is of greater and more general utility than the greater part of common trades. ... The joint stock companies, which are established for the public-spirited purpose of promoting some particular manufacture, over and above managing their own affairs ill, to the diminution of the general stock of the society, can in other respects scarce ever fail to do more harm than good. Notwithstanding the most upright intentions, the unavoidable partiality of their directors to particular branches of the manufacture, of which the undertakers mislead and impose upon them, is a real discouragement to the rest, and necessarily breaks, more or less, that natural proportion which would otherwise establish itself between judicious industry and profit, and which, to the general industry of the country, is of all encouragements the greatest and the most effectual.¹⁴

So, the man held up as the ancestral guru of the business world opposed the legal structure of modern business. He also provided an analysis that accurately describes the concerns many feel about company mismanagement today. Company directors act as the 'stewards' of the rich absentee landlords – the shareholders. However, in the contemporary world the annual general meeting has minimal power. Perhaps it needs to be reinvigorated as the 'general court of proprietors' mentioned by Smith.

Smith's condemnation of limited liability is omitted from the way his views are handed down by free-market advocates. Britain's Adam Smith Institute is a bastion of corporate rights. Fans of globalisation such as Philippe Legrain find it useful to cite Smith's wisdom in support of their arguments, but omit his critique of the structure of modern capitalism. Even Arnold Schwarzenegger cited *The Wealth of Nations* as one of the most important books in his life, though he is scarcely an advocate of repealing limited liability.

Smith's concerns over limited liability are discussed by John Micklethwait and Adrian Wooldridge in their recent hymn to corporations, *The Company: A Short History of a Revolutionary Idea*.¹⁵ They state that Smith had two objections to limited liability: that such companies were inefficient and tended in his day to be monopolies. Whatever the merits of these objections, Micklethwait and Wooldridge fail to consider at all Smith's main objection, namely that society should not exempt some people from general laws simply because they may thrive as a result.

It may seem a startling idea to reform or remove limited liability. We look back at past ages and think, how could people have put up with an obvious injustice like feudal serfdom or the

¹⁴ Smith, A. *An Inquiry into the Nature and Causes of the Wealth of Nations* (University of Chicago Press, Chicago, [1776] 1976). An excerpt (Book V, ch. 1, pt iii, art. i, pp. 280-82).

¹⁵ Micklethwait, J. and Wooldridge, A. *The Company: A Short History of a Revolutionary Idea* (Weidenfeld and Nicolson, London, 2003).

slave trade? Perhaps when you are born and brought up in such a system it seems natural and it would be dangerous to tamper with it. 'Squire knows best,' mutters the peasant in many a period drama. A similar fear exists around business: 'It has always been like this and the economy will collapse if we challenge the basis of corporate organisation.'

Blindness to the issue of owner responsibility is illustrated in the recent *Progressive Manifesto* edited by Anthony Giddens, which offers new ideas for the centre-left. He argues that citizens need to take much greater responsibility, rather than relying so much on state provisions, but the key powerful class of owners is not even mentioned. The focus is on the mostly economically weak recipients of government money: they are the ones who have to change their ways. Nevertheless, there are some outright critics of limited liability, such as the Australian academic John Quiggen, who points out that many economists criticised the proposals for limited-liability laws in the nineteenth century. In the US, David Korten has written powerfully against the problem of limited liability.¹⁶

Equality before the law and property rights

Equality before the law is often cited as one of the fundamental rights of a free society. It is enshrined in Article 7 of the 1948 United Nations Universal Declaration of Human Rights, which states: 'All are equal before the law and are entitled without any discrimination to equal protection of the law. All are entitled to equal protection against any discrimination in violation of this Declaration and against any incitement to such discrimination.' Earlier in the seventeenth hundreds in the American Declaration of Independence and in the French Revolution, 'Equality' was a key assertion of political rights. But, as Smith pointed out so succinctly two hundred years ago, 'to exempt a particular set of dealers from some of the general laws which take place with regard to all their neighbours, merely because they might be capable of thriving if they had such an exemption, would certainly not be reasonable.'

The property rights of the many are infringed to the benefit of the minority through limited liability in violation of Articles 2 and 27 of the UN Declaration of Human Rights. It is not merely that limited liability gives those who enjoy it an advantage. Those whose property they injure have no redress against them. Anyone who has tried to gain redress from a company that has gone into liquidation will understand the point.

Do these exemptions amount to inequality? Well, that is what exemption means. Some people may argue that the limited-liability laws have been created democratically. This is true but also irrelevant since they can also be repealed democratically. The debate should be about changing the law which provides for this inequality, and it is clear that those who cling to the way things are believe that this inequality is a good thing, helping make society as a whole better off, and that to threaten this inequality is merely destructive nihilism.

¹⁶ Korten, D, *When Corporations Rule the World* (Kumarian Press/Berrett-Koehler, West Hartford, CT and San Francisco, 1995).

It is also true that shareholding was entrenched in the Western democracies long before the Universal Declaration on Human Rights. So, again I can hear an argument coming: 'Since shareholding existed before modern human-rights law, then surely it cannot be affected by it.' This argument is similar to an infamous argument over the US Constitution. It is based on the assumption made in the Declaration of Independence: 'We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness.' However, when it was written, few of the men who approved it would admit that black people were people at all. They were merely property. The point of relevance to the limited-liability debate is that it is possible to re-examine how definitions are applied as circumstances change.

It is especially helpful to reopening the debate over limited liability that there is a history of clear criticism from leading public figures all the way back to the time when limited liability was first introduced. Today the social damage created by limited-liability companies has become the major focus of political concern about the global economy and is overdue for reform.

In theory such reform should be a concern of American conservative and libertarian groups such as the Federalist Society, who aim to roll back laws that they construe as going beyond the statements of the Founding Fathers. Limited liability is the most damaging and glaring example of going beyond the intent of the Founding Fathers by creating a whole class of people exempt from the law.

To summarise, limited liability can be seen as removing the human right of the vast majority of people on the planet to equality before the law, the core value of a free society.

Limited liability protects corruption

When I started considering the reform of company law I stumbled over a legal idea that seems to come from *Lord of the Rings* or *Buffy the Vampire Slayer* – 'piercing the corporate veil'.

In the imposing terminology of the legal profession, there is a 'veil' that protects shareholders from liability. Now, I am sure that legal historians will be able to find all sorts of explanations for the evolution of this term. The veil is worn by women to hide their sexuality or grief, customary in Muslim societies and made erotic in the dance of the seven veils; this is the legal concept upon which corporate globalisation rests, a veil through which shareholders can see but not be seen, a one-way mirror, a one-way street of power where they can act but not be acted upon. I would have thought that both Freudian psychoanalysis and feminist theory would have generated a few dozen PhD theses on the imagery invoked by this idea, but sadly I have not found any.

The concept of 'piercing the veil' describes some barely known circumstances in which under certain states' laws shareholders can be held liable for their actions. According to one British specialist discussing a case relating to claims for asbestos-related injuries that were

thwarted by layers of Russian-doll-like limited-liability companies with one hiding inside another:

Any modern consideration of lifting the corporate veil must almost certainly begin with the decision of the Court of Appeal in Adams v Cape Industries [1991] 1 All ER 929. The case saw the most detailed judicial review of this aspect of company law ever undertaken in the UK. Justice Scott, and then the Court of Appeal, refused to allow the veil to be lifted on an English parent company whose American subsidiary had been successfully sued by American litigants but which had insufficient assets to satisfy judgement. Lord Justice Slade said: 'Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities.' The law will not permit the lifting of the corporate veil just because the interests of justice would be better served by doing so.¹⁷

This specialist went on to say that the veil of incorporation may be lifted where a company is a sham and no third party has an involvement with it. It may also be lifted where the company is a party to a fraud. It will not be lifted just because justice demands it. A director can escape personal liability to a third party in negligence by acting through his company and ensuring that he is perceived as accepting no personal liability for what he is doing. He cannot escape personal liability where he acts fraudulently on behalf of his company. A similar legal protection exists in the US.¹⁸

Even in a key organ of corporate globalisation, the OECD, there is a recognition that this type of activity, especially when hidden behind the seven veils of subsidiary companies, does represent an obstacle to shareholders turning an honest profit. The 2001 OECD study 'Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes' concludes:

Corporate entities – corporations, trusts, foundations and partnerships – are often misused for money laundering, bribery and corruption, shielding assets from creditors, tax evasion, self-dealing, market fraud and other illicit activities. The veil of secrecy they provide in some jurisdictions may also facilitate the flow of funds to terrorist organisations.

¹⁷ Griffiths, M. 'Lifting the Corporate Veil', Kensington Business School, London, 2003.

¹⁸ <http://www.vssp.com/CM/Environmental%20Alerts/environmental%20alerts100.asp>

'Behind the Corporate Veil' concludes that the types of corporate entities that are most frequently misused are those that provide the greatest degree of anonymity to their beneficial owners. In response, the OECD calls on governments and other relevant authorities to ensure they are able to obtain information on the beneficial ownership and control of corporate entities and, where appropriate, to share this information with law enforcement authorities domestically and internationally. Specifically, the OECD recommends that governments should consider taking action to:

- Require up front disclosure of beneficial ownership and control information to the authorities upon the formation of the corporate vehicle;
- Oblige intermediaries involved in the formation and management of corporate vehicles (such as company formation agents, trust companies, lawyers, trustees, and other professionals) to maintain such information;
- Develop the appropriate law enforcement infrastructure to enable them to launch investigations into beneficial ownership and control when illicit activity is suspected.

As should now be clear, it is now the company that gets sued; even though the company is not actually a person, just an idea, the law says that a company is treated as a person. In his book, *The Corporation*, the leading Canadian legal theorist Professor Joel Bakan argues that the modern business corporation is created by law to function like a psychopathic personality. However, although Bakan suggests that the artificial personality of the corporation be limited he does not develop a strategy of reform.

A limited-liability company can simply be the expendable fall guy that can be declared bankrupt or shut down while the shareholders are long gone. Companies have additional structures to protect themselves even further. This is through the creation of subsidiary companies. In this case the subsidiary may be sued but its parent company cannot because it is the shareholder. In this way a further incentive to irresponsible behaviour has been created.

The argument for owners' privilege

John Micklethwait and Adrian Wooldridge uphold a tradition of enthusiastic supporters of limited liability. They assert that 'the most important organisation in the world is the company: the basis of the prosperity of the West and the best hope of the rest of the world.' This is the main idea used to defend the special-interest protection enjoyed by shareholders. It is at least odd to hear the argument that limited liability provides a unique public benefit from those who argue at the same time that there must be no public duty at all placed upon shareholders and companies. They seem to be saying, 'Look, we are making the whole world work, don't mess it up.' In addition, there is the argument that there is no real privilege because anyone can buy shares or, as Marie Antoinette might have said, 'anyone can buy cake.'

Limited liability is credited with creating the vast increase in wealth since the Industrial Revolution. Any attempt to tamper with it will meet great resistance. Even calls for a minimum wage and for social security have been thought to have the potential to cause lasting damage to business. The first time I raised the issue of deregulating shareholder immunity, I came across the vehement objection of a group of venture capitalists. They argued that even raising the prospect of suing shareholders would damage investor confidence and was therefore a dangerous idea. It is certainly true that a market in stocks and shares has been an effective means of raising capital for businesses for more than two hundred years. Some people believe that raising money in this way is essential to the organisation of the economy.

The Industrial Revolution was well under way before the limited liability became the norm.¹⁹ The joint-stock company with tradable shares was not made generally available for business activities in England until 1844, and limited liability was not added to the form until 1855. While some American states developed the form for general use a few years earlier, all general business corporation statutes appear to date from well after 1800. By around 1900, however, every major commercial jurisdiction appears to have provided for at least one joint-stock company. As the BBC's History Timeline explains,

*this allowed companies to limit the liability of their individual investors to the value of their shares. Prior to this, investors in a company stood to lose all their wealth if economic circumstances forced the company they had invested in out of business. The curtailing of risk as a result of the act is credited with being the basis for the increased investment in trade and industry, although most of the evidence for this is apocryphal.*²⁰

Until the 1930s in the US there were two major exceptions to limited liability. California not only had no limited-liability law, but it insisted that companies based in other parts of the US did not have limited liability in California. The US banking system did not operate under limited liability either.

Different approaches to liability were used in these instances. In California there was a system called pro-rata liability.²¹ Pro-rata liability means that in addition to risking their investment, shareholders are responsible for the debts of the company in proportion to the amount of the company they own. Own one per cent of the shares and be responsible for one per cent of the debt. In the US banking sector it was common until the 1930s for shareholders to be responsible for the debts of the company to the extent of two or three times the face value of the shares that they owned. The face value is the value of the shares when they were sold to the public. For example, a company might offer 1,000,000 £1 shares for sale on

¹⁹ Hansmann and Kraakman, op. cit. passim.

²⁰ BBC History Timeline on the Limited Liability Act of 1855.

²¹ Weinstein, M. *Share Price Changes and the Arrival of Limited Liability in California* (University of Southern California Law School, Los Angeles, 2002).

the stock market, they might then be traded at a value of 10p or £10, but the liability would be based on the issued share price of £1.

There have been a few studies that attempt to provide evidence that unlimited liability can work as well as or better than limited. Lewis Evans and Neil Quigley studied the legal structure of shareholding in the banking industry of nineteenth-century Scotland.²² At this time some banks used the system of limited liability that we know so well today, while others used a system of unlimited liability. This was at a time when Scottish capital was playing a crucial role in the financial development of the British Empire. They found that in some special circumstances, unlimited liability might even be more effective. A study by Mark Weinstein of the introduction of limited liability in California found that it had no discernible effect on the stock market price of companies' shares, although at that time Californians had not developed the art of suing corporations, still less their shareholders.²³ This form of company law, which I will call 'traditional Californian capitalism', has much to offer the twenty-first century.

In the modern age, perhaps the most famous and largest example of unlimited, rather than limited, liability is the practice in the London insurance market run by Lloyd's. Lloyd's of London has for many years been the major insurer of businesses in the world. Under this system people known as 'names' agree to put their entire wealth at risk to guarantee the insurance market. As a result of their willingness to accept an unlimited risk they receive high returns on their investments. For many years, the insurance industry was regarded as a source of great wealth for those already wealthy. Regardless of its recent problems where some insurers have gone bankrupt, Lloyd's of London provides an example of a key part of the structure of international business that is not run on the basis of limited liability. The existence of such a key, world-leading industry, not reliant on a limited-liability structure, is of great importance. It provides a substantial example to counter those who argue that limited liability is the only way global markets can operate.

Professions such as law, accountancy and architecture have all operated as successful businesses for many years without the protection of limited liability. However, starting in the US, a new concept of limited liability has been introduced to allow these professionals to escape liability for their actions. When new laws were proposed in Britain to extend limited liability to the professions, Phillips made a vain attempt to at least force companies to advertise any previous names they had used to conduct business. In debate, the government minister makes a crack at Phillips's own profession of law:

Lord McIntosh of Haringey: 'But was it not Adam Smith who also said that all professions were a conspiracy against the laity?'

²² Evans, L. and Quigley, N. 'Shareholder Liability Regimes, Principal-Agent Relationships, and Banking Industry Performance', *Journal of Law and Economics*, 1995, vol. 38, no. 2, pp. 497–520.

²³ Weinstein op. cit.

*Lord Phillips of Sudbury: 'That is precisely why I have opposed this Bill stock, root and branch. I am a great admirer of my own profession. But I am afraid that this measure is apt to be a conspiracy against the public interest from start to finish. However, I am more concerned with the small traders who will take advantage of the special privileges of this Bill. Let us make no bones about it; this will provide your two-man cowboy building outfit with a uniquely flexible and light framed means of screwing the public, to put it in Anglo-Saxon terms ... One of my jobs is that of legal adviser on the Jimmy Young Show. Over 25 years I have heard of hundreds of thousands of cases of abuse in relation to small, local companies that get nowhere near the attention of the DTI and get nowhere near being addressed by the various provisions to which the Minister refers. It depresses me that in this House we are so far out of touch with public opinion, if I may put it this way, at the bottom end of the social spectrum. People are ripped off, day in, day out, by the easy availability of limited liability for off-the-shelf companies and the protections provided for them, and with no real remedies.'*²⁴

Supporters of the expansion of limited liability as the dominant form of social organisation downplay other economic models, including European social democracy and various forms of Japanese and south-east Asian economies that have all produced significant and sustained economic growth in the contemporary world. In much of the world and indeed in much of US history, shareholder privilege was balanced by other laws and powers in society. At present these balanced and socialised forms of business are under attack. This may be because they are less effective, or simply because they provide fewer benefits to those with power.

Today corporations and their political allies are seeking to sweep all of these protections away. Rather than resist this by defending the more socially integrated forms of business, it will be more effective to attack the injustice fundamental to unfettered shareholder power.

The idea that the economy can only function when property-owners are protected from having any responsibility for their actions is not historically accurate. It is easy to forget that an international economy had existed and prospered for thousands of years before the invention of limited liability. Business and trade are ancient practices that have been helped and hindered by the social practices of the times. In England for example, Cornish tin-miners were trading successfully as far away as the Mediterranean even before the Roman Empire. Trade and business are as old as civilisation.

One of the reasons most often given on behalf of business and shareholders for the continuation of limited liability is that anyone can freely choose to go into business or invest through buying shares. Millions of people own shares through their pension

²⁴ House of Lords, 24 January 2004.

schemes or through investment companies that manage the money of many small investors. There is no doubt that this has benefited many millions of people, myself included; however, even in the US only one-half of all households participate in the stock market through pension plans, and of these households very few have more than a tiny proportion of the shares of any one company. It will be simple to if necessary, make a cut-off point for liability for small shareholders – just so long as that does not provide a loophole for large institutional investors. In any case, the major corporations, institutions and the super-rich are the groups that own significant parts of major companies. As has been demonstrated in the studies by Professor Edward N. Wolff of New York University in 1989, ten per cent of US families owned eighty-nine per cent of stocks and bonds traded on the stock exchange.²⁵ Since then these concentrations have increased. Similar concentrations of wealth protected by limited-liability laws now exist around the world.

US families are classified into wealth class by Wolff on the basis of their net worth. In the top one per cent of the wealth distribution (the 'Super Rich') are families with a net worth of \$2.35 million or more in 1989; in the next nine per cent (the 'Rich') are families with a net worth greater than or equal to \$346,400 but less than \$2.35 million; in the bottom ninety per cent ('Everybody Else') are families with a net worth less than \$346,400:

	Stocks	Bonds
Super Rich	46.2%	54.2%
Rich	43.1%	34.3%
Everybody Else	10.7%	11.5%

Supporters of mass shareholding often make exaggerated claims that a few years down the road result in great disappointment. In the 1980s Margaret Thatcher's government had TV advertising campaigns trying to persuade members of the public to buy shares in the newly privatised utilities. A few years later large corporations were buying out these small shareholders – few had ever bought more shares and the cost of providing them with information was very uneconomic for the privatised companies. During the stock market boom of the 1990s conservative politicians in the US and Britain began to campaign to privatise social-security holdings. This would have meant that this money was no longer held by the government bank but could be invested in companies. This idea was becoming fashionable until there was a sudden dramatic fall in the stock market, after which little more was heard of the idea.

²⁵ Wolff, E. 'How the Pie Is Sliced: America's Growing Concentration of Wealth', *American Prospect*, 1995, vol. 6, no. 22.

Strategies for restoring freedom

As I have discussed, the idea of freeing the market from special-interest protections and distortions should have special appeal in the US. Conservative and libertarian lawyers and activists are keen to remove regulations of all kinds. In their key network the Federalist Society they argue for some particular views of what they see as the original US Constitution and oppose laws that seek to develop and change policy with time. From this perspective, limited liability is a classic example of a distortion of the clear constitutional principle of equality before the law.

For Americans, restoring equal rights may be an especially important argument for creating a more equal society. This is because it destroys the myth that the rich are rich by dint of hard work or inheritance and that any tax to help the less well off is simply theft to assist the lazy. Exposing limited liability for what it is, explodes this delusion once and for all.

Proponents of the free-market-especially neo-liberal advocates in Universities, the media, think tanks and politics should sought out and asked for their support in removing the obstacle to the free market that is limited liability.

Lawyers and legally oriented pressure groups both conservative and progressive should be engaged very specifically on the contradiction between limited liability and the provisions of laws and principles of common law concerning the rights of the individual to both equality before the law and the enjoyment of their property without being injured by those against whom redress is impossible.

From the left, Professor Harry Glasbeek has argued: 'There is an entirely plausible argument to be made that criminal law should hold major shareholders responsible for the many evils done by the corporation on their behalf. And many social and environmental campaigners are now focusing their attentions on the laws that allow shareholders and investors the protection of their "invisible friend" – the legal fiction that is the corporation.'²⁶

'Sue the shareholders' may look good on a protest banner. But to be effective, a campaign to restore equal freedoms to the economic market needs to have some practical intermediate stages. In general terms a clear understanding of the special status enjoyed by shareholders should make it easier to argue for balancing rights for community groups, elected governments and trade unions. More specifically, there need to be some adjustments to the laws that govern corporations. Fortunately, there are useful historical examples. Two mentioned earlier should be considered. These are the ideas of having a liability two or three times the price of the share and of pro-rata liability.

²⁶ Glasbeek, H, 'The Invisible Friend', *New Internationalist*, July 2003, no. 358. Prof. Glasbeek is Professor Emeritus and Senior Scholar, Osgoode Hall Law School, York University, Toronto, and author of *Wealth by Stealth: Corporate Crime, Corporate Law, and the Perversion of Democracy* (Between the Lines, Toronto, 2002).

The limited liability issue can also be used in conjunction with and as foundation for more specific policy arguments such as those concerning the reform of accountancy and of artificial personality. The argument is based on the clear values of classical liberal-democratic philosophy and has multiple applications.

It is vital to accompany an unwavering laser-like focus on the language and values of the argument with a parallel and sweeter array of positive reforms. For example: the insurance system could be employed to help manage the risk. Apart from shareholders, almost every person in the industrialised world ends up needing insurance. Our car insurance protects us if we damage someone else or another car; every business needs public-liability insurance. Rent a civic centre to throw a party and you will find that, before you can, you will have to buy a public-liability insurance policy. This is because if someone is blinded by a party popper you could get sued. Even your house insurance is likely to provide cover in case a roof tile lands on someone's head.

The contrast between what does and does not need to be insured is easy to illustrate. Oxford University has a service for its academics looking to spin off limited-liability companies. It provides a fairly typical list of the types of insurance that will be needed: 'The spin-out will need to obtain a number of insurance policies including: directors, and officers, insurance; building and contents insurance; employer's liability insurance; public liability insurance and product liability insurance.' No sign of shareholder insurance.

The creation of insurance for shareholders could be a relatively simple way of re-establishing equality before the law and placing shareholders as normal citizens with responsibility for their actions equivalent to everyone else in society.

Some people may argue that the insurance industry is already too powerful and has introduced too much nannyism in society. If the insurance industry is itself behaving badly this is perhaps because it too has to provide maximum returns to shareholders, something a reform of limited liability would help solve. Insurance is an industry quite well suited to nationalisation or to non-profit status. Social insurance for health and old age are two of the best-known examples of the nation taking responsibility for insurance provision. Another less well-known example is where the nation underwrites mass damage from a terrorist attack, an innovation made in the UK after the Provisional IRA attacks on the City of London in the mid-1990s.

Restoring equality before the law will help many social, economic and environmental campaigns. The removal or reduction of limited liability would ensure that power does not come without responsibility. This would do much to redress the imbalance between the powerful and the powerless. The accelerating power of the business interest would be likely to come to an abrupt halt if it were faced with such a direct challenge to its privilege. Such a challenge would affect the organisation of thousands of companies all over the world. The mere threat of having their privilege exposed may encourage better behaviour.

The argument that the regulations protecting shareholders should be removed can be used as a direct reply to corporate demands for deregulation of other aspects of the market. Opponents of increasing corporate power can argue that the deregulation agenda pursued by corporations had better begin with the regulation that prevents citizens from suing shareholders. This argument is a much more effective lever than socialist demands for the abolition of capitalism or the idea that companies should start behaving like charities.

The removal or reduction of limited liability is consistent with the universal values that power should be matched with responsibility and that we all should be equal before the law.

Within the US, the restoration of the right to sue is a core American value that can be expressed in simple language. In the developing world and in the new European democracies, making shareholders liable can be a means of bringing within the law the rampant corruption that is aided and abetted by the immunity of limited liability. Campaigning to be able to sue shareholders in the same way as anyone else is a clear political demand that can reinforce and complement existing efforts to limit the damage caused by corporations. In recent years, attempts by the public and pressure groups to tackle corporate power have had several public campaigns. These include debt, fair trade, privatisation and climate change. Each of these has produced important and imaginative proposals, gained considerable public support, but in the end made insufficient progress.

When corporations destroy the environment, as for example in the case of the tanker *Exxon Valdez*, which was wrecked on the Alaskan coast, releasing vast quantities of oil that devastated marine life in the region, massive lawsuits can sometimes be brought against the company. All too often, the corporation is found to have been driven by the need to provide maximum returns to shareholders. But these shareholders are immune from any normal duty of care in carrying out their actions. Were it possible to sue the shareholders, one can be sure that they or their insurers would make much stronger demands upon the company to be certain that it was not cutting corners to maximise profit. Quite rightly, the environmental movement is concerned to introduce stronger legislation requiring corporations to act in an environmentally friendly manner. However, if environmentalists include the proposal that shareholders should no longer be above the law, then they are likely to find that corporations might well begin to make concessions to pre-empt demands on shareholders. In similar fashion, corporate demands to remove regulations protecting the environment should be met with a counterbalancing proposal to make their stockholders environmentally responsible in law.

Another area where removing special-interest protection can help existing campaigns is in the area of deregulation of public services. The demands for compulsory privatisation of public services and nationalised industries have been gaining ground continuously around the world since their inception in the early days of Margaret Thatcher's government in the 1980s. The debate in Britain has seen service after service put into private hands for the benefit of shareholders. Most recently, the issue that has come to the forefront of public attention is the use of private medical concerns to supplement the NHS.

The issue of shareholder liability, or lack of it, is especially interesting in the case of medical issues, not least because most of us are now familiar with the idea of suing incompetent doctors, administrators and hospitals. But consider the difference. Let us suppose that the same serious problem occurs in both an NHS and a private hospital. In the NHS any compensation claim will have to be met by the hospital and, if it runs out of money, by the government in London. A private hospital is in a very different situation. If it runs out of money its directors can declare it bankrupt and simply walk away from it. In the meantime, the shareholders could have sold up, taking their earlier profits with them. Even if their profits were made at the time that the medical negligence occurred, no one can touch them.

These imaginary examples are designed to show how much more powerful a campaign can be if it is reinforced with the issue of making shareholders equal before the law.

Paul Kingsnorth has shown the diversity and also lack of focus of the anti-globalisation movement in *One No, Many Yeses*.²⁷ I hope that reform of limited liability can serve as a unifying interest. The power of the argument can become mutually reinforced if it is taken up simultaneously on a wide range of issues and in a wide range of countries. The issue of making shareholders behave like normal people has the potential to focus the efforts of a lot of different campaigns.

The limited liability issue can unite everyone from those trying to get redress from the owners of bankrupt construction company in a suburban town to those fighting the privatisation of the water supply.

Reforming limited liability should improve the overall quality of business activity by providing a legal basis on which to build the social responsibility that so many people are working for from inside and outside corporations. The proportional liability used in the conservative Californian corporation can provide the basis of reform and should be able to attract support from across the political spectrum, including those who believe that governments should not provide any protection to interest groups.

²⁷ Kingsnorth, P. *One No, Many Yeses: a journey to the heart of the global resistance movement* (Free Press, London, 2003).

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Recent Court Decision Favorable for Corporate Shareholders on CERCLA Liability:

The United States Court of Appeals for the Sixth Circuit, which hears decisions from Ohio, Michigan, Kentucky and Tennessee, recently issued a decision on November 17, 1997 which is favorable for corporations and their shareholders with respect to when liability can be imposed on shareholders under the federal superfund law, CERCLA. The troublesome issue of a shareholder being an owner or operator of a contaminated facility has plagued businesses for some time. The Sixth Circuit has cleared up the issue, at least for courts within the Sixth Circuit's jurisdiction.

In *Donahey v. Bogle*, 1997 U.S. App. LEXIS 32146 (6th Cir. 1997), the court, in an *en banc* 10-2 decision, held that a shareholder of a corporation is not liable as an operator as defined under 107(a)(2) of CERCLA unless circumstances justify piercing the corporate veil. The court also reaffirmed the principle that the applicable state law must be used by federal courts to determine the veil-piercing standards. In this case, the shareholder was the sole shareholder of the corporation and was only involved with the financial aspects of the company. The day-to-day affairs, including the waste disposal activities, were handled by the hired managers who did not need the approval of the shareholder to execute their duties. As a general rule, state law corporate veil-piercing standards favor corporations.

Two justices dissented in the decision. The dissenting justices would not apply the veil-piercing standards to a sole shareholder who is active in the corporation, but instead would find direct liability under the CERCLA statute without first having to pierce the corporate veil. They expressed their concern that a savvy polluter can form a

closely held corporation of which he owns 100% of the shares, play an active role in the company, but follow a 'don't ask, don't tell policy' regarding disposal of environmental toxins and not be considered an owner or operator of the facility. The dissent also stated that it was reserving judgment on whether persons should be held liable under CERCLA who own less than 100% of the shares or are not active in management of the facility. However, the dissent offers no guidance on where it would draw the line for shareholder personal liability, except to state that an appropriate inquiry should be whether the corporate individual could have prevented or stopped the hazardous waste discharge.

The *Donahey* decision closely follows *U.S. v. Cordova*, 113 F.3d 572 (6th Cir. 1997), in which the Sixth Circuit recently held that under CERCLA, a parent corporation is liable for the environmental harms done by its subsidiary only if the elements necessary to pierce the corporate veil are present. The *Cordova* decision has been appealed to the U.S. Supreme Court, but the Court has not yet ruled whether it will accept the case for decision. Many of us that have followed these issues expect that the High Court will accept the case because of the split in authority around the United States.

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