

Who's In Charge ?

What are Corporations ?

Where did they come from ?

How did they become so powerful ?

By Daniel Bennett, with Helena Paul
For Programme on Corporations, Law & Democracy (1998)

Abstract

Corporations are treated as if they are people by the law. The first Corporations were charities. The first Corporations to act for commercial ends did so fraudulently.

The State (through the Government and the Courts) has (1) Abandoned rules which forbade the creation and continuance of Corporations that acted in a manner that caused the public harm; (2) Abandoned state control over the types of business operation that could become Corporations (3) Restricted and then abolished the right of anyone who is not the "Corporation" to challenge the right of the Corporation to take various courses of action and (4) Transferred from the Government to the Courts and then to the Directors of the Corporation itself the final say over what any Corporation has the power to do.

The above has allowed Directors of Corporations knowingly to cause harm to the public in the pursuit of profit, knowing that the Corporate form protects them from legal responsibility for their actions. Shareholders, with full knowledge of the harm, can invest without fear of being found legally responsible.

Keywords

Development of Corporations - Britain – Erosion of public control

Introduction

By becoming a Corporation (a process called "incorporation"), a business is given a distinct legal identity separate from the people who run it. The effect of this arrangement is to shield those who actually run the business from responsibility for their actions.

Rather than people carrying out business in their own name, a Corporation is considered to be a person in its own right. The Courts, when dealing with a Corporation, accept the fiction that the Corporation has a birth, a death (although a corporation can live forever) and more importantly, entitlement to human and civil rights. A Corporation, which exists solely on paper, can assert that it has the right to do something (e.g. pollute) and that that right can prevail over a real person's right to object.

A Commercial Corporation can create for itself a fictional multiple personality with separate Corporations (all owned by the same parent Corporation) existing simultaneously. All risky and dangerous operations can be carried out by subsidiaries. The parent Corporation is only a shareholder in the subsidiaries. As far as the legal fiction is concerned, the parent cannot in any way be held responsible for the actions of the subsidiary¹.

These subsidiaries can be registered "off-shore" in a national register of companies which does not allow you to find out who is the ultimate parent Corporation (ie you cannot find out who, ultimately, should be responsible).

A Commercial Corporation can be created owning no assets. It can then accept the risk and responsibility of transporting crude oil and nuclear fuels (by air as well as by road and sea), running chemical plants, creating new drugs and even life-forms, drilling and excavating sensitive areas. At all times this Corporate (fictitious) person bears the sole responsibility for its actions. If anything goes wrong, the Corporation simply folds and disappears. The directors, shareholders (often corporations themselves), investors and others know that, should anything go wrong, we are not entitled to look beyond the veil of the Corporate person to see if the real persons who took those decisions should have been allowed to do so. Whilst this may encourage financial risk, it also appears to encourage risks with public health and welfare, in the name of encouraging profits.

Whilst Corporations (as legal persons) do not have the right to vote, they do have the right to lobby and fund political parties. Corporations also have enormous influence in determining the manner in which resources are allocated and the nature of their products and markets. Whilst it is in the public's interest that resources be used sparingly and in a sustainable,

¹ This is often referred to as "the corporate veil". A consideration of how subsidiaries developed and how the Courts have treated the relationship between parents and subsidiary corporations would justify a whole article in itself.

reusable manner, Corporations choose to create disposable products which require constant replacement/repurchase.

Modern Corporations are given not just the right to exploit resources but also the right to choose how they are exploited, marketed and packaged, usurping all the public's democratic rights except the right to choose the method of cleaning up the mess left behind. The Corporations' obligation to maximise sales and profits directly conflicts with what should be our democratic right to choose how society's finite resources are allocated.

As neighbours of these Corporate Persons (in that we share the same environment and society) and as citizens, why do we have so little say how Corporations use their rights and powers? How did Corporate persons come to have no responsibility for their actions?

A very brief history of Corporate development²

Four hundred years ago there was no such thing as a commercial corporation. The concept of the corporation was initially³ created in England for charities such as churches, schools and universities, clubs, hospitals and so on and then latterly extended to municipal councils. These "not-for-profit" corporations were, by their nature, intended to advance the public good.

Only not-for-profit entities could become corporations. By making a hospital (for instance) into a corporate person its function was simplified and difficulties that could otherwise occur when control passed to later generations (death duties, transfer of assets etc.) could be avoided. It clearly served the public good for the long-term administration of such bodies to be simple.

Not-for-profit corporations had constitutions drafted and approved by the Crown or the Government, which set out the powers and the objects the corporation sought to attain. If a corporation acted outside its constitution (i.e. sought to attain an objective not within its objects or not within the spirit of its constitution), it was acting "ultra vires"⁴ and the Court had the power to declare the offending action void and unlawful. Before the development of Commercial Corporations, this doctrine of ultra vires was relatively simple but rarely used⁵. But, making a profit (for what was always a charitable organisation) was clearly ultra vires.

² The discussion of the history of corporate development is brief and misses many key points. For a more in-depth analysis (but from a pro-corporate/anti-democratic perspective) see Holdsworth *History of English Law Vol 8*; Formoy *The Historical Foundations of Modern Company Law*; Hunt *The Development of the Business Corporation in England 1800-1867* and Gower *Principles of Modern Company Law*

³ It appears that this idea of incorporation came to Britain following the Norman invasion in 1066.

⁴ Ultra vires: A phrase used in relation to corporate activities that are beyond the scope of their rights or charters. "Ultra" means beyond and "vires" is the plural of "vis", strength.

⁵ Suttons Hospital Case [1612] 10 Co Rep 30b is a rare example. For an in depth analysis of the development of ultra vires law see Street *A Treatise on the Doctrine of Ultra Vires*.

Businesses at this time were all co-operatives and partnerships and had no legal identity of their own (like law, accountancy and architects firms in the UK to this day). Each partner retained a share of responsibility for the actions and decisions taken. The name of their business remained, before the law, merely a name by which to identify the collective.

How Commercial Corporations developed First Wave (1600 - 1720)

Businesses at the time typically involved small numbers of people operating as partners, sharing the risks of the business. Towards the end of the 1500s, Royal Charters of Incorporation from the Crown were granted to trade associations. These trade associations did not carry out trade in their own names but were not-for-profit corporations. The Crown would grant the trade association a monopoly over a narrow area of trade.

The role of the trade association was to regulate and develop the trade not to carry out trade itself. Business partners could become "members" of the trade association, so entitling them to carry out business in that trade. It is important to remember that these partners remained personally responsible for their own business's activities.

The East India Company received its Royal Charter in 1600. When incorporated it too was merely a trade association, its members having the right to share in the monopoly on trade in "the Indies". During the course of the century, all the individual member/ partners started to amalgamate their stock until they became one big partnership owning all the stock jointly. That is, the East India Company had only one partnership operating within it carrying out all the trade.

Later in the seventeenth century⁶, the partnership sold its stock to the East India Company itself and the partners received in exchange a "share" in the Company. That is; the stock from being owned collectively by all the members/ partners, became owned by the East India Company itself. The Corporation then traded this stock in its own name and made its own profit. The profits were then distributed amongst the members/shareholders.

So the East India Company came to be the first Corporation to operate for a profit. Or the first Commercial Corporation owned by shareholding members, carrying out trade in the person of the Corporation. The first Commercial Corporation was created by the actions of its members alone. Not by the Government or the Courts or the public deciding it was a good idea but simply by the members of the East India Company choosing to act in that manner.

As a result, there was neither debate on the ethics of allowing a business association to use the corporate form nor consideration of how this development might affect the public in general. The East India Company was undoubtedly exercising powers not within its constitution (i.e. "ultra vires") by operating for a profit. It

⁶ The exact date appears to be unclear within a range of 10-20 years.

was without doubt acting unlawfully. No one really challenged this.

Trading as a Commercial Corporation offered clear advantages over business partnerships. These advantages greatly exceeded the advantages to a hospital or other charity being incorporated as the Corporate form effectively protected business people from many of the risks of business.

The Corporation continued to exist even if the original partners died or transferred their shares. The Corporation could bring and defend legal actions in its own name rather than the names of the partners. The Corporation would not die, so did not pay death duties. If one shareholder became bankrupt, company assets could not be used to pay his debts as company assets belonged to the Corporation (its own separate legal person) and not the shareholder. Although not fully realised at the time, if the Corporation couldn't pay its debts, shareholders own assets could not be used to pay the debts of the company. However, the Courts did at that time allow creditors to sue the shareholders and directors when a Corporation could not pay its debts.

The corporate form drew a veil between the actions of the Corporation and the people directing it, protecting them from responsibility for the actions of the Corporation. It avoided the individual and collective responsibility for all business activities that previously existed (a responsibility that natural people continue to have for their activities).

Over the course of the late 1600s until 1720 many other trade associations started to trade unlawfully on joint stock so becoming Corporations that carried out commerce. The Crown began to grant charters to new Corporations expressly for them to trade as Commercial Corporations. In time, new Corporations were formed by both Royal Charter and Act of Parliament to develop new patents and domestic trade, by now asking for outside investors to provide the finance.

Dubious Corporations were created and persons masqueraded as Corporations to obtain investors money fraudulently. The greatest of these was the South Sea Company. Formed in 1711, it was given a monopoly on trade to ports in South America then under Spanish control. Shares in the Company were traded wildly, speculating on the rich profits that would be made as soon as access to the port was obtained. The investors only realised that access to the ports would never be obtained when the company founders fled the country. The share price collapsed overnight to nothing, triggering similar collapses in numerous other similar companies causing the first stock market crash.

The East India Company created further problems for the Government. Its vast expansion in India meant that it not only had a monopoly on trade but was also in charge of the army, the roads, food supply, in fact all the domestic and foreign powers of a government. The East India Company had, through its business activities, conquered and ruled the whole of India. The Government realised that British foreign policy must be reclaimed from the East India Company as well as others such as the Levant Company and Hudson Bay Company.

The Reforms of 1720

The Government responses were, first, to wind up or nationalise many of the Chartered Corporations, bringing their territories into the British Empire. Then, to control fraudulent activity, the Government created the "Bubble Act" of 1720.⁷

This Act provided in section 18 that all commercial undertakings (both Corporations and partnerships) "*tending to the common grievance, prejudice and inconvenience of His Majesty's subjects*" would be illegal and void. The Act also banned speculative buying and selling of shares and outlawed stockbroking in such shares. After 1720 (until 1825) shares could only legally be sold to persons genuinely taking over a role in running the Corporation or partnership.

Second Wave (1720 - 1825)

Between 1720 and 1825 new businesses that might previously have sought incorporation were operated as partnerships. Investigations into the old Corporations found many instances of fraud and a large number collapsed due to debts. Crown Servants became reluctant to grant Charters for new Commercial Corporations fearing that their creations would fall foul of the Bubble Act. However, the Bubble Act was rarely used. Only one prosecution under the Act is reported to have occurred. The general public did not have the resources to use the Act and the State did not appear to have the desire.

Parliament at first was wary of creating new Corporations by Act of Parliament. However, there was a public need for canals and waterworks to be built and the State did not have the money to finance such schemes without the assistance of outside financiers. The financiers where not prepared to put up the money if it meant that they would be responsible for all future debts and liabilities of the project. The corporate form appeared ideal.

Parliament approved specific Corporations to be created by Act of Parliament ("Statutory Corporations"). These Corporations were similar to those founded to build the Channel Tunnel and develop London Docklands in recent years. An Act of Parliament would authorise the creation of a Corporation for a specific and narrow project and allow it to bring and defend legal actions in its own name (so protecting the financiers from personal responsibility should the Corporation fail).

The general view at the time was that Corporations should only be created for very specific purposes. Adam Smith commented in 1776 that the only trades that justified incorporation were banking, insurance, canal building and waterworks. He believed it was contrary to the public interest for any other businesses or trades to be incorporated and that all should be run as partnerships⁸.

⁷ 6 Geo 1, cap 18

⁸ Wealth of Nations, vol V, Chap 1, Part III, Art. 1

Third Wave (1825 - 2000)

Between 1825 and 1856 a series of Acts of Parliament abandoned the controlled formation of Corporations and created the Registered Corporation as we know it today. Two Presidents of the Board of Trade, Huskisson and more importantly, Gladstone sponsored these moves.

In 1825 the Bubble Act was repealed,⁹ allowing shares to be traded freely. Also repealed was the rule that, for a Corporation to be allowed to trade, “*it must not tend to the common grievance, prejudice and inconvenience of His Majesty’s subjects*”.

The Joint Stock Companies Act of 1844¹⁰ created the contemporary form of Corporation for general business and trade. Via a simple process of registration, a Corporation with its own legal identity could be created (“Registered Corporation”) to carry out any stated commercial activity, subject to approval by the Company Registrar. The Corporation would be required to register its constitution including an “objects clause” stating its purpose. However, the founders of the Corporation were free to decide the Corporation’s purposes and limitations. The debate in the House of Commons records Gladstone stating:

Joint Stock Companies at present could not be formed with any privilege such as that of suing and being sued, except, by coming to Her Majesty in Council, or by applying to Parliament... Under this Bill, there would be a power for the first time, for persons to associate themselves in companies, for the purpose of commercial pursuits, without the fear of interference from any human being whatsoever.¹¹

The intention of the bill was clearly to grant the corporate person civil and human rights. The risks associated with allowing fictitious persons to hold these rights were downplayed. Hansard goes on to state:

*Mr Parker agreed that great harm had been done by the abuse of the principles of Joint-Stock Companies; but ... One great principle distinguishing this country from others was the non-interference of the Government with the regulations of trade.*¹²

Initially, these new Registered Corporations did not have limited liability. If the Corporation could not pay its debts, creditors could recover their money from the shareholders. However, following 10 years of debate, in 1855 an Act was passed¹³ limiting shareholders liability to the amount they had paid for their shares (i.e. once the shares are paid for, a shareholder had no further responsibility for any debts or actions of the Corporation).

The debates include two instances illuminating the State's view of who the public is. In 1850, a select committee reported on “*Investments for the Savings of*

the Middle and Working Classes”¹⁴. This report argued that limited liability for company shareholders was in the interests of the poor. The idea was that the poor could buy shares for their own purposes and limited liability would protect them. What was not considered was what would happen when Corporations with limited liability could not (for instance) pay wages?

When a Corporation collapses we are given the choice between shareholders bearing the cost or the employees bearing the cost. A limited liability scheme clearly chose the employees to bear the cost. A similar choice had to be made when a bank cannot repay its savers' money. Again, limited liability favours the bank’s shareholders over its customers.

The second argument used in favour of limited liability was that by adding the word “limited” or “ltd” after the name of the Corporation, anyone dealing with the Corporation would know that they were dealing with a corporate person and not a real person. They would then know the risks they were facing and had the “choice” whether or not to deal with the Corporation. Whilst this may be true for lenders and other traders, employees and neighbours of a Corporation have little choice. Further, those who put forward these arguments failed to foresee the day when corporate persons would carry out all business activity. No one considered the idea that Corporations could spawn subsidiary Corporations to carry out the dirty work.

What parliamentary concerns there were concerned fraud and misuse of investors money. There was no debate on whether Directors of a Corporation might knowingly harm public health and welfare for the purposes of personal profit. Nowadays, when such matters are raised, it is considered to be a matter for the Courts to decide and that intervention by Parliament would place too great a brake on innovation and entrepreneurial activity¹⁵.

Rights to Challenge Corporate Behaviour

Officially, whilst a Corporation had all the rights of a person, it could perform no acts nor enter into transactions other than that which sprang naturally out its objects¹⁶. Now that a Corporation (rather than Parliament or the Crown) could choose its own objects, the power to control a Corporation's activity passed from the Government to the Courts.

Judicial Control of Corporations

Between 1846 and 1875, a series of cases concerning the acts of Commercial Corporations came before the Courts. Through the course of these cases, the Judges made absolutely clear that the doctrine of ultra vires did apply to Commercial Corporations and that, ultimately, the Courts controlled corporate behaviour.

It must be stressed that the general public did not bring these cases. Until very recently, the cost of using the

⁹ 6 Geo 4. Cap. 91

¹⁰ An Act for the Registration, Incorporation and Regulation of Joint Stock Companies 7 & 8 Vic Cap 110

¹¹ Hansard – Jul 3 1844, p 277

¹² p 278

¹³ An Act for Limiting the Liability of Members of certain Joint Stock Companies 18 & 19 Vict. Cap 132 p993

¹⁴ 1850 BPP Vol XIX 169

¹⁵ See Department of Trade & Industry 1999 Company Law Review

¹⁶ A Treatise on the Doctrine of Ultra Vires, HA Street, p 7

Courts made the law inaccessible to almost everyone. These cases concerned debts of Corporations and often attempts by the debtor to avoid paying by claiming its actions were ultra vires.

The first cases concerned the railway Corporations created by Act of Parliament. In *East Anglian Railways Company v Eastern Counties Railways Co* [1851]¹⁷ Lord Chief Justice Jervis stated:

It is clear that the [Eastern Counties Railway Co] have a limited authority only, and are a corporation only, for the purpose of making and maintaining the railway sanctioned by the Act; and that their funds can only be applied for the purposes directed and provided for by the statute.

Adding support to this, in *Shrewsbury Railway Company v L&NW Railway Company* [1853]¹⁸ Lord Justice Turner stated:

[T]hese bodies have no existence independent of the Acts which created them, and they are created by Parliament with special and limited powers, and for limited purposes... The fact of their being endowed with such powers ... only shows that Parliament did not think fit to entrust them with more extended powers, or to incorporate them for other purposes.

Finally, leaving no doubt over the Court's control of Statutory Corporations, in *Eastern Counties Railways Company v Hawkes* [1859]¹⁹, Lord Chief Justice Pollock stated that:

[A] Parliamentary Corporation is a corporation merely for the purposes for which it is established...; and it has no existence for any other purpose. Whatever is done beyond that purpose is ultra vires and void.

It was presumed that the new Registered Corporations created by the 1844 Act were also to be controlled by the Courts through the doctrine of ultra vires. As stated above, a Registered Corporation has, within its constitution, an "objects clause" which sets out what the Corporation was formed to do. However, by the 1844 Act, the Government had given the founders of these Corporations the power to create their own objects clause. Could the Courts, with the doctrine of ultra vires, still limit corporate behaviour?

In the first case of ultra vires of a Registered Corporation (*Riche v Ashbury Railway Carriage Company* [1875]²⁰) Lord Selborne confirmed the application of "ultra vires" to Registered Corporations, stating:

[C]ontracts for objects and purposes foreign to, or inconsistent with, [the objects clause] are ultra vires of the corporation itself.

However, there followed a series of developments that rendered the doctrine useless. First, in the case of *Bournemouth Corporation v Watts* [1884]²¹ it was decided that outsiders could not use the doctrine of ultra

vires to challenge corporate actions²². With respect to Commercial Corporations, that limited the right to use the doctrine to shareholders and directors and, in limited circumstances, creditors of the Corporation.

Second, Corporate lawyers realised that the 1844 Act gave them the power to circumvent the Courts. New Registered Corporations gave themselves wide objects clauses, giving them the right to do more and more and adding final clauses stating that:

The objects specified in each paragraph of this clause shall be in no way limited or restricted by reference to or inference from the terms of any other paragraph or the name of the company.

The Courts were not prepared to allow such clauses. In *Stephens v Mysore Reefs (Kangundy) Company* [1902]²³ Justice Swinfen Eady stated:

It is not right to accept a construction which would virtually enable the company to carry on any business or undertaking of any kind whatsoever.

Between 1902 and 1965 Corporations ignored this judgment. As in the days of the East India Company, they simply broke the law. Case after case was brought before the Courts where Corporations used unlawfully wide, all encompassing objects clauses to give them the right to do anything. Sometimes the Courts were brave and ruled the Corporate act ultra vires. The judges were attacked by the Corporations and by Parliament for restricting the "freedom" of trade. The consequences of granting freedoms to fictitious persons who existed only to make profits, was never discussed.

Eventually, the Court abandoned any attempt at control of Commercial Corporations in the case of *Bell Houses Limited v City Wall Properties Limited* [1966]²⁴. The Court of Appeal approved an objects clause giving the Corporation power to:

Carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses or the general business of the company...

The effect of the so-called "*Bell Houses clause*" and the Court of Appeal's decision was to transfer the right to decide the limits of a Corporation's powers from the Courts to the Board of Directors of each Corporation.

The final demise of the doctrine of ultra vires (so far as it related to the restriction on the rights of Commercial Corporations) took place in the Companies Act 1989²⁵. The Act maintained the requirement for Corporations to include a statement of their objects in the constitution. But, under section 3A, allowed the Corporation to (a) state simply that it was a "*general commercial company*" and (b) that the Corporation has "*power to do all such things as are incidental or conducive to the carrying on of any trade or business by it*".

²² This case concerned a municipal corporation and a ratepayer but the decision also applied to commercial corporations

²³ [1902] 1 Chan p745

²⁴ [1966] 2 QB p693

²⁵ This Act applied only to Commercial Corporations. The law relating to charitable corporations has not changed that much since 1612.

¹⁷ [1851] 11 C.B. p775 at p881

¹⁸ [1853] 4 De G M & G p132-3

¹⁹ [1859] 4 H&N p8 at p16

²⁰ [1875] LR 7 HL p653 at p694

²¹ [1884] 14 QBD p87

Finally, section 35(1) of the same Act altered the law so that “the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company’s [objects clause]”.

Conclusion

The first Commercial Corporation was created by direct unlawful action by the members of the company. From that date onwards our democratic right to control what Corporations do has been eroded and diminished until no control remains at all. Corporations and Governments have defined this erosion of control as being the liberation of Corporations from the shackles of the past. Corporations have achieved this “liberation” by breaking the law until the Courts and the Government gave up trying to control them.

The State (through the Government and the Courts) has:

1. Abandoned rules which forbade the creation and continuance of Corporations that acted in a manner that caused the public harm (introduced in 1720 – repealed 1825);
2. Abandoned state control over the types of business operation that could become Corporations (finally abandoned in 1844);
3. Restricted then abolished the right of anyone who isn't the "Corporation" to challenge the right of the Corporation to take various courses of action (abolished by the Companies Act 1989); and
4. Transferred from the Government to the Courts and then to the Directors of the Corporation itself the final say over what any Corporation has the power to do.

In theory, a Corporation can still be brought to book for its breaches of duty to the public as neighbours, just as we are to each other. However, with subsidiary Corporations holding all the duty and responsibility for corporate behaviour and with the legal, scientific and lobbying power at the disposal of the Corporations, this control is somewhat illusionary.

As the public was being disempowered, the only issue seemed the freeing of Corporations from any democratic control. Those making the changes appear to have decided that the freer the Corporation, the

better the public's interest would be served.

It was not envisaged that Directors would abuse the protection offered to them by the corporate veil and harm the public in the pursuit of profit, knowing they bore no legal responsibility for their actions. Nor that shareholder would be happy to invest in harmful industries knowing that limited liability protected them from responsibility whilst delivering good returns on their investments. Without such blanket legal protection from responsibility for their actions, there could be no profit in tobacco, asbestos, DDT, PCBs or many other known harmful activities.

Bibliography

- Formoy, The Historical Foundations of Modern Company Law
- Gower, Principles of Modern Company Law
- Holdsworth, The Historical of English Law, Volume 8
- Hunt, The Development of the Business Corporation in England 1800-1867
- Smith, A, Wealth of Nations, Vol 5, Chap 1, Part III, Article 1
- Street, A Treaty on the Doctrine of Ultra Vires

Dan Bennett is a barrister who litigates against corporations on behalf of people. His work involves workplace, environmental and consumer cases and, when required, defends people against injunctions brought by corporations to restrain political protest.

Helena Paul investigates corporate involvement in genetic engineering and patents on life. She has been looking at the rise of the modern for profit corporation, its rights and lack of accountability with the aim of finding ways to redefine the corporation and limit its power.

EcoNEXUS

P.O. Box 3279,
Brighton BN1 1TL, UK
(+44) 0845-456-9328
info@econexus.info
www.exonexus.info

EcoNexus is a not-for-profit public interest research organisation and science watchdog. It offers a rigorous scientific critique of genetic engineering (GE) and genetically modified organisms. It investigates and reports on the impacts of GE on the environment, health, food security, agriculture, human rights and society. EcoNexus also examines the influence of transnational corporations (TNCs) on development issues and scientific, social, economic and political processes. It is based in the UK and collaborates with a diversity of networks nationally and internationally.