

The Constitutional Corporation

Rethinking Corporate
Governance

Stephen Bottomley



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The Constitutional Corporation

Rethinking Corporate Governance

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ASHGATE

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Preface

This book has had a long gestation (far too long, for those who have been closely involved in its production). What sparked it off was the decision of the Australian High Court in *Gambotto v WCP Ltd* in 1995, which upheld the claim of a minority shareholder not to have his shares compulsorily bought from him by the majority shareholder in the corporation. My sense was that the High Court had made an important contribution to corporate jurisprudence, although one that required more explanation and justification than could be found in the pages of the judgements. But I was also struck by the speed with which the many critics of that case were able to muster their counter-attack (and I don't think that 'attack' overstates the nature of some of the responses). Several articles, books, and conference papers appeared within a short period after the decision was handed down. Without wanting to down-play the diversity of those responses, it is accurate to say that most of the criticisms were anchored, one way or another, in a law and economics framework. It occurred to me that these critics had something of a strategic advantage — the well-established law and economics framework supplied them with a ready-made conceptual model which could be used to respond quickly to the High Court's decision. On the other hand, those corporate law scholars who found something of value in the decision, and who were troubled by some of the criticisms, were largely (but not entirely) silent, myself included. Perhaps, I thought, a competing conceptual framework was needed, from which to mount a response to the issues raised by that case and future developments.

This book is the outcome of my attempt to develop such a framework. As the work continued, the specific issues raised by the *Gambotto* decision ceased to be my central concern (indeed, the case is mentioned only occasionally in what follows). But my wish to develop a conceptual framework for analysing corporate law issues, that could work as an alternative to the widely accepted law and economics model, persisted. Whether the ideas presented in this book are successful in achieving this goal is, of course, for readers to decide.

The book draws on a number of previously published articles, book chapters and conference papers. It is not, however, a simple compilation of that work. In attempting to integrate that work I found that my ideas had changed at many points. Also, the task of 'putting it all together' for the purposes of the book revealed inconsistencies and conceptual gaps, forcing me to re-think, develop and (I hope) clarify my arguments.

Over the years many people have helped me in the process of organising my thoughts for this book. Given the passage of time, it is quite likely that some have forgotten their contribution, but every argument and idea presented here has been assisted by the questions, comments and gentle critique of others. Here, at last, is the chance to acknowledge and thank John Braithwaite, Angus Corbett, Christine

Parker, Philip Pettit, Colin Scott, Peta Spender (who read through many of the chapters in their near final form), Daniel Stewart, the late Michael Whincop, and John Williams. Thanks also to Tom Campbell for urging some last minute revisions. I have listened to their ideas and suggestions, although I confess that I have not always acted on them. In line with customary practice, I absolve them from any responsibility for what lies between the covers of this book, although I don't see why I should. After all, they encouraged me to continue with the project.

Thanks also to Jenna Bottomley for her work in compiling the tables of statutes and cases, and to Vera Joveska for formatting and preparing the text for publication.

The real driving force behind this book, however, has been my wife, Sheri. She has the good sense not to be engrossed in corporate law, but nevertheless she has continually challenged, urged and encouraged me to write this book (occasionally enlisting the aid of our daughters, Kristen, Sarah, Taryn and Jenna). Moreover — and here is my greatest debt — she has made space for me to do so. Acknowledging her support and patience in this, the final product, seems to be both an appropriate and a perverse way of thanking her.

Finally, the long period during which this book was being written witnessed the untimely and unexpected deaths of two corporate law scholars whose work is referred to on a number of occasions in the following chapters. Michael Whincop (Professor of Law at Griffith University) died in June 2003. I knew Michael, and his death was a great shock. John Parkinson (Professor of Law at Bristol University) died in February 2004, and although I didn't know him (we were to have met at a conference I was organising, but he died shortly before this), the news of his death was nevertheless saddening. They were scholars of different theoretical persuasions, but I have great admiration for their contributions to corporate law scholarship. I hope that this book might be regarded as being in the same company as theirs.

Stephen Bottomley

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‘From Contractualism to Constitutionalism: A Framework for Corporate Governance’ (1997) *Sydney Law Review* 277.

‘The Birds, The Beasts and The Bat: Developing a Constitutionalist Theory of Corporate Regulation’ (1999) 27 *Federal Law Review* 243.

The book also refers to my research into company general meetings. This research was funded by a grant from the Australian Research Council, which I acknowledge with thanks.

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Chapter 1

Corporations and Shareholders

It's a Corporate World

The renowned English legal scholar William Twining demonstrates the pervasiveness of law to his first year students by asking them to read a daily newspaper and to mark all the passages that they think are 'law-related'.¹ He finds that students frequently have difficulty deciding what to leave out. I suspect that the exercise would be only marginally less difficult if the assignment was to mark all the passages that relate to corporations.

We live in a corporate world.² Corporations are so much a part of our lives that their role is usually taken for granted, going unnoticed until the occurrence of some dramatic event brings it to our attention (all too often, that event is a corporation's seemingly unheralded descent into insolvency).³ Principally it is corporations that supply or control our access to goods and services, work and leisure, knowledge and information. Indeed, most of what we know about the corporate world is communicated to us through media that are controlled by corporations. The activities of corporations shape or influence national economies, they affect the quality of the environment, and they influence the actions of nation states.⁴ Corporations are increasingly called upon to contribute to the provision of social welfare and national development, either in partnership with or by taking over from the work of governments.⁵ Corporations, especially transnational corporations, have a major impact on, and thus are called upon to

¹ W Twining, *Law in Context: Enlarging a Discipline* (1997) 210-213; *Globalisation and Legal Theory* (2000) 1-2.

² For a readable history of the rise of the corporation, see J Micklethwait and A Wooldridge, *The Company - A Short History of a Revolutionary Idea* (2003).

³ Well known examples in the United States are the Enron Corporation in late 2001 and WorldCom Inc in mid-2002. In Australia One.Tel Ltd in May 2001, and HIH Insurance Ltd in March 2001 have a similar significance.

⁴ This is not to say that interaction between corporations and states is all one-way. Corporations frequently have to adjust or structure their own activities to meet the demands of state agencies or court rulings, as in monopoly or anti-trust actions.

⁵ For example, in 1998 the Australian Prime Minister John Howard called on the Australian corporate sector to contribute more to community welfare – Keynote Address to the Australian Council of Social Service National Congress, Adelaide, November 1998.

accept responsibility for the protection of, human rights.⁶ Corporations work behind the scenes (and increasingly on centre-stage) to influence many aspects of national government policy and legislative action. Corporate donations are a major source of funding for political parties.⁷ It is large corporations that determine the formulation of a wide array of regulatory standards on issues ranging from air safety to pharmaceutical products and telecommunications.⁸

This corporate influence is not always the product of deliberate lobbying or planned political pressure. More often it is simply the product of ordinary commercial activity. A corporation's decision to 'downsize', relocate, or expand its operations can have a significant impact on local and national economies and on social policy. Consequently, the mere threat of a major corporate restructuring can often produce governmental responses that individual citizens are unable to achieve.⁹

The significance of corporations in modern society is not confined to the private business sector. Corporate forms of organisation are now commonplace in the non-business and non-profit sectors, including social groups and religious organisations, sports and recreational clubs, educational institutions, professional firms, and welfare organisations.¹⁰ There are many reasons behind this spread of the corporate form, including the perceived attractions of limited legal liability, perceptions (accurate or otherwise) about the efficiency of corporate styles of management, and the risk-assessments of lenders and grant-giving bodies about

⁶ See United Nations Sub-Commission on the Promotion and Protection of Human Rights, *Norms On The Responsibilities of Transnational Corporations and Other Business Enterprises With Regard to Human Rights*, August 2003; also M Addo (ed), *Human Rights and the Responsibility of Transnational Corporations* (1999); S Bottomley and D Kinley (eds), *Commercial Law and Human Rights* (2002).

⁷ I Ramsay, G Stapledon, and J Vernon, 'Political Donations by Australian Companies' (2001) 29 *Federal Law Review* 117 (also referring to the situation in the United Kingdom).

⁸ See generally J Braithwaite and P Drahos, *Global Business Regulation* (2000); C Scott, 'Private Regulation of the Public Sector: A Neglected Facet of Contemporary Governance' (2002) 29 *Journal of Law and Society* 56.

⁹ A recent example in Australia concerned the closure by Mitsubishi Motors Australia of its car assembly operations in the State of South Australia. With the prospect of losing an estimated 22,000 jobs and \$2 billion gross state product, the South Australian Treasurer and the Federal Industry Minister flew to Japan to negotiate with the parent corporation: 'South Australia must drive its own future', *Australian Financial Review* (Sydney), 29 April 2004, 62; Brendan Pearson 'Mitsubishi on brink after crisis talks' *Australian Financial Review* (Sydney), 18 May 2004, 1. In June 2004, the Australian Government announced a \$10 million subsidy for Mitsubishi workers.

¹⁰ In some jurisdictions there are specialised forms or methods of incorporation for these types of corporations. See, for example, the associations incorporation legislation in Australian States and Territories (for example the *Associations Incorporation Act* 1991 (ACT)). In the United Kingdom there is a recommendation that there should be a separate form of incorporation specifically for charities: Company Law Review Steering Group, *Modern Company Law For a Competitive Economy: Final Report* (2001), para 4.63.