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RESEARCH ARTICLE

Fixing the misalignment of the concession of corporate legal personality

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Abstract

The nature of separate legal personality is a perennial debate in corporate law. This paper uses insights from a previous iteration of the debate to argue that separate legal personality is best seen as a two-step process: it is a concession from the state to something real. That real thing is the economic concept of the firm, which has been recently debated within institutional economics. Viewing separate legal personality as a two-step process lets us explore whether the concession of separate legal personality is operating as it should. Law imposes no prerequisite requirement that a firm exists before establishing a company, nor limits firms to only one company. Law thus facilitates misalignments between the firm and the company. Such misalignments will only occur if two constituencies within the company structure – the ultimate shareholders and directors – consider it in their interests to create such misalignment. As a result, these misalignments harm third parties by allowing risk to be exported to them through opportunistic misalignment. This paper then explores the methods of misalignment and reviews current legal tools which are available to be deployed to re-align the company to the firm, and argues that they should be deployed.

Keywords: company law; separate legal personality; nature of the firm; concession theory; real entity; state gift

'It is said by many that the juristic controversy over the nature of corporate personality is dead'.[1]

Introduction

UK company law has become misaligned: it has forgotten why companies exist. Not what each individual company's purpose should be – on which a burgeoning amount of material is available.[2] Instead, we have forgotten why companies attain the special concessions provided to them from the state in the form of a company's separate legal personality and features that flow from it. This paper advances this argument and existing corporate law analysis by reconnecting historic company law arguments to recent developments in economics and political science which run counter to dominant modern company law analysis. It therefore argues that the company's separate legal personality is important, exists as a concession to an economic firm, but that its boundaries and scope have become misaligned to the firm, risking avoidable harms.

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[1]HLA Hart *Definition and Theory in Jurisprudence* (Cambridge: Cambridge University Press, 1953) p 17.

[2]Eg E Pollman and RB Thompson (eds) *Research Handbook on Corporate Purpose and Personhood* (Cheltenham: Edward Elgar, 2021).

The nature of the company's separate legal personality was, between the 1870s and 1920s, a 'virtual obsession' in the US.[3] The debate's crux was, ultimately, whether the company's separate legal personality meant the company was a 'real entity',[4] or a 'persona ficta', which existed as a concession from the state.[5] The debate affects the state's locus to intervene in the activities of the company: if the company is a real entity, then state intervention in its activities is harder to justify than if the company is merely a legal fiction[6] whose boundaries are set by the state.[7] This debate was thought to have been resolved in 1926 when a philosopher[8] pointed out that separate legal personality merely meant whatever law said it did,[9] but has been revived recently.[10]

In the meantime, economic analysis of corporate law has increasingly become dominant.[11] Transaction cost economics minimises the role of separate legal personality – arguing that it is, instead, merely a cheaper mechanism to achieve private ordering.[12] Corporate law literature follows this approach – the contractarian school of corporate law holds that all interactions in respect of the company are, effectively, contracts,[13] and so considers that separate legal personality merely reduced transaction costs. It is thus trivial.[14] Even the Law Commission, when exploring whether English partnerships should obtain separate legal personality, considered that it was primarily a convenience (or, perhaps, not having it was an inconvenience).[15] Corporate personality returned to relevance at the start of the new millennium, with a defence of 'organisational law', which separates the assets of the company from the assets of the investor, thus preventing the creditors of the investor from having a claim to the assets of the vehicle.[16] Similarly, the ability to create a permanent legal personality – which survives the change of all human parts – has been hailed as a vital part of company law.[17] Nevertheless, separate personality remains downplayed within modern company law commentary. It is thought merely a 'convenient heuristic formula' for a combination of features, with 'no functional rationale' to provide a more foundational basis for separate legal personality.[18] Such analysis implies that we should pay no attention to why we grant companies separate legal personality or whether its operation works satisfactorily in respect of any specific rationale.

[3]MJ Horwitz *The Transformation of American Law, 1870–1960: The Crisis of Legal Orthodoxy* (Oxford: Oxford University Press, 1992) p 101.

[4]FW Maitland 'The corporation sole' (1900) 16 LQR 335; F Pollock 'Has the common law received the fiction theory of corporations?' (1911) 27 LQR 219.

[5]J Dewey 'The historic background of corporate legal personality' (1926) 35 YLJ 655; M Koessler 'The person in imagination or persona ficta of the corporation' (1949) 9 Louisiana Law Review 435.

[6]Note 'What we talk about when we talk about persons: the language of a legal fiction' (2001) 114 HLR 1745.

[7]J Hardman 'Looking beyond separate legal personality, or how many titles have Rangers won?' (2022) Juridical Review 1 at 4–8.

[8]Dewey, above n 5.

[9]BR Cheffins *The Trajectory of (Corporate Law) Scholarship* (Cambridge: Cambridge University Press, 2004) p 39; GA Marks 'The personification of the business corporation in American law' (1987) 54 UCLR 1441.

[10]For concession theory see SM Watson 'The corporate legal person' (2019) 19 JCLS 137; for real entity see E Micheler *Company Law: A Real Entity Theory* (Oxford: Oxford University Press, 2021).

[11]Eg F Easterbrook and DRR Fischel *The Economic Structure of Corporate Law* (Cambridge, MA: Harvard University Press, 1991); R Kraakman et al *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford: Oxford University Press, 3rd edn, 2017).

[12]OE Williamson 'Assessing contract' (1985) 1 Journal of Law, Economics and Organization 177.

[13]F Easterbrook and DRR Fischel 'The corporate contract' (1989) 89 CLRev 1416; MT Moore 'Private ordering and public policy: the paradoxical foundations of corporate contractarianism' (2014) 34 OJLS 693.

[14]BS Black 'Is corporate law trivial? A political and economic analysis' (1990) 84 Northwestern Law Review 542; R Romano 'Answering the wrong question: the tenuous case for mandatory corporate laws' (1989) 89 CLRev 1599.

[15]Partnership Law (Law Com No 283, SLC Com No 192) (2003) ch 5.

[16]H Hansmann and R Kraakman 'The essential role of organizational law' (2000) 110 YLJ 387; H Hansmann et al 'Law and the rise of the firm' (2006) 119 HLR 1335.

[17]MA Eisenberg *The Structure of the Corporation: A Legal Analysis* (Washington: Beard Books, reprint, 2006) p 17; MM Blair 'Corporate personhood and the corporate persona' (2013) University of Illinois Law Review 785.

[18]Kraakman et al, above n 11, pp 5–8.

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Yet separate legal personality remains important for four primary reasons. First, as Susanna Ripken's excellent book on corporate personhood demonstrates, law is only one field for which separate legal personality is relevant: it has philosophical and other social science dimensions.[19] It is thus not only law's to disclaim – legal commentators minimising the role of separate legal personality risk a disconnect between law and complementary fields looking at the same phenomenon. Similarly, such a theoretical approach may lead non-lawyers to misunderstand the effect of the law. Both are to be avoided. As Geldart stated 111 years ago '[t]the question is… one which law shares with other sciences, political science, ethics, psychology, and metaphysics'.[20] Secondly, even within law, it does not merely belong to corporate law. Granting a company separate legal personality places it on a spectrum of law's persons – being all those recognised by law as being capable of holding rights and owing duties.[21] This thus means that the company's separate legal personality must cohere with other areas regulating the activities of law's persons – for example, criminal law, which has struggled to hold companies adequately to account (with difficulties in attributing mens rea and actus reus to the company).[22] Similarly, it has been argued that non-companies (often unincorporated associations like sports clubs) should enjoy separate legal personality.[23] Thus not only is it not only law's to minimise, it is not only corporate law's to minimise. Thirdly, even if separate legal personality is merely a tool to reduce transaction costs, we need to know how good it is at achieving this aim. Fourthly, separate legal personality is a major legal concession to the business community. We therefore need to understand more clearly what this concession provides and why we provide it. As such, it is wrong for corporate law commentators to consider that separate legal personality has limited relevance beyond its practical utility.

Thus separate legal personality remains an important aspect of corporate law. The next issue is why law grants separate legal personality to companies. Vinogradoff demonstrated that there is no fundamental dichotomy between a real entity (a business reality) operationalising by way of a concession from the state (a company), as each company has two sides – real business interactions take place within a state-created legal entity.[24] He stated that 'the life of groups has two sides' – a real business association and an artificial legal form that is provided by the state.[25] Vinogradoff hints that this occurs in sequence: a real entity is created and then looks to artificial legal tools to operationalise, however it is left implicit and not elaborated upon.

Making this two-step process explicit demonstrates that the two sides of the historic debate were talking at cross purposes. Nearly 100 years ago it was noted that the debate was frustrating because non-legal features were being used to argue legal points – commentators were arguing certain universal statements predicated upon features that did not appear in all companies.[26] Further, both sides were trying to cater for a different aspect of the realities of corporate law: real entity theorists were, ultimately, arguing that business would find a way through even without a company; state gift theorists were, ultimately, arguing that certain features of corporate life (eg limited liability) only became possible due to rules promulgated by the state. Both were right, merely talking about slightly different things. Reconciling them through a two-step process thus adds clarity to the future direction of corporate law research.

If a company's separate legal personality is a state concession to something real, then what is that real thing? Corporate law analysis assumes that this real thing is the economic concept of the firm. We

[19]SK Ripken *Corporate Personhood* (Cambridge: Cambridge University Press, 2019).

[20]WM Geldart 'Legal personality' (1911) 27 LQR 90 at 94.

[21]N Naffine 'Who are law's persons? From Cheshire cats to responsible subjects' (2003) 66 MLR 346; N Lacey 'Philosophical foundations of the common law: social not metaphysical' in J Horder (ed) *Oxford Essays on Jurisprudence* (Oxford: Oxford University Press, 2000); A Grear 'Human rights – human bodies? Some reflections on corporate human rights distortion, the legal subject, embodiment and human rights theory' (2006) 17 Law & Critique 171.

[22]CMV Clarkson 'Kicking corporate bodies and damning their souls' (1996) 59 MLR 557.

[23]HJ Laski 'The personality of associations' (1916) 29 HLR 404; N MacCormick *Institutions of Law* (Oxford: Oxford University Press, 2007) p 84.

[24]P Vinogradoff 'Juridical persons' (1924) 24 CLRev 594.

[25]Ibid, at 604.

[26]Dewey, above n 5.

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can think of the firm as a liquid which, to be utilised, needs to be poured into a vessel. Different vessels have different 'shapes' depending on their legal features. For example, the differential deployment of limited liability between partnerships,[27] limited partnerships,[28] and companies,[29] can be perceived as features which contribute to different vessel shapes. As the firm needs to deploy legal methods to be able to undertake its activity,[30] the liquid must be poured into a vessel for economic activity to take place. So long as the volume of the liquid matches perfectly the volume of the vessel there is no issue. This is often assumed – for example, when Jensen and Meckling created the concept of nexus of contracts, they referred interchangeably to this nexus applying to the company and the firm,[31] arguably evidencing that they were thinking of a single, large public company: if the boundaries of your firm are identical to the boundaries of the company, it does not matter which term you use.[32] Analysing the company as a two-step process, though, raises the question of which of the two they were envisaging: were they viewing the real business entity as a nexus of contracts, or the state concession of the legal form that it operationalises through?

It is not inevitable that the volume of the two will be the same. The liquid and vessel analogy immediately raises a number of conceptual questions: what is the nature of the vessel before liquid has been poured into it (eg a pre-incorporated shelf company waiting to be tailored)? What is the link between the vessel and the liquid when the volume of the liquid exceeds the volume of the container (eg a multinational corporate group with legal entities in a number of jurisdictions)? What if the pourer deliberately chooses to split the liquid across a number of vessels (eg a private equity holding structure)? Is it conceptually possible for two different liquids to sit within the same vessel (eg a corporate cell structure, with siloed assets and liabilities)? Temporally, what happens if the liquid is subsequently poured into a different vessel (eg an asset sale) and a different liquid is poured into it (eg an existing company which sold its business and became dormant was purchased and a new business run from it)?

These are all methods by which separate legal personality can become misaligned with the firm. Law has the tools at its disposal to align the two, but chooses not to: in fact law facilitates misalignment at every stage of corporate life, starting with law allowing a company to be created without a real entity to be present. Misalignment between the company and the firm causes harms to third parties. Misalignment between the legal entity and the firm has resulted in shareholders[33] and certain dominant creditors[34] being able opportunistically to maximise their returns and recoveries at the expense of other creditors. Certainly, more complicated group structures are associated with higher ratios of debt to equity overall.[35] This issue transcends the empirical but instead represents a manifestation of the incentive provided by separate legal personality: procedurally, UK companies are established by shareholders and directors.[36] Thus misalignment of the corporate form from the business reality will only occur when the ultimate shareholders and directors of the top company consider that misalignment would be beneficial *for them*. This is not to say, of course, that misalignment invariably causes harm to third parties. However, it provides an opportunity for pre- identified incentives for

[27]Partnership Act 1890, s 9.

[28]Limited Partnerships Act 1907, s 4(2A) and 4(2B).

[29]Insolvency Act 1986, s 74.

[30]S Deakin et al 'Legal institutionalism: capitalism and the constitutive role of law' (2017) 45 Journal of Comparative Economics 188.

[31]M Jensen and W Meckling 'Theory of the firm: managerial behaviour, agency costs and ownership structure' (1976) 3 Journal of Financial Economics 305 at 310 and 311.

[32]J Hardman 'The nexus of contracts revisited: delineating the business, the firm, and the legal entity' (2022) 34 Bond Law Review 1.

[33]H Hansmann and R Kraakman 'Towards unlimited shareholder liability for corporate torts' (1991) 100 YLJ 1879.

[34]AJ Casey 'The new corporate web: tailored entity partitions and creditors' selective enforcement' (2015) 124 YLJ 2680.

[35]T Paligorova and Z Xu 'Complex ownership and capital structure' (2012) 18 Journal of Corporate Finance 701. The author became aware of this research due to a lecture by Professor Katerina Pistor, available at https://www.systemicrisk.ac.uk/events/financializing-non-financial-firm.

[36]Hardman, above n 32.

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two key corporate constituencies to manifest to harm third parties. Company law itself has increasingly retreated from its role in mitigating such manifestations, and has increasingly left it to other areas of the legal taxonomy to remedy company law's mistakes. This is untenable. As the corporate form is a concession from the state to the firm, the potential for self-serving misalignment between corporate form and the real entity that it exists as a concession to is a mistake that should be remedied. Historical company law, and current partnership law, provide a series of legal tools which could be deployed for this purpose, and they are explored in this paper.

The step forward taken by this paper, then, is making the two-stage process that Vinogradoff alludes to explicit and exploring its implications. The author's contention is that the state concession of the modern company exists for real business entities. We thus develop currently prevailing ideas that the company is created by the activities of the state[37] by exploring why such state concessions are provided. In doing so, this paper develops our existing legal understanding of the company. It builds on Ripken's notion that the company's legal personality is too complicated for a simple, one-stage interpretation.[38] This provides a conceptual development for company law – fusing together the advantages of the real entity theory and of the concession theory to produce a holistic unified approach which resolves recurring debates. This approach provides a normative claim for UK company law: that law provides companies as a concession to the business community. As such, we must ensure that the extent of this concession meets policy objectives without causing disproportionate harms. This provides a greater locus for the state to be able to curtail activities of companies which appear to cause societal harms. By foregrounding law, then, in the analysis of the company we understand more clearly the role that law can play in remedying problems it has created and facilitated.

The rest of this paper proceeds as follows. Section 1 explores separate legal personality: the historical debate and modern discussion. Section 2 explores the economic concept of the firm. Section 3 explores misalignment between the two – problems of misalignment, how law provides spaces for temporal misalignments, and misalignments in scope, and legal methods available to undo such misalignment. The paper ends with a short conclusion.

1. The concession of separate legal personality

We start, then, with the nature of separate legal personality, which we shall see is a state concession to a real entity. Under Roman law, human individuals only had separate legal personality if they could sue and be sued, and some non-natural persons enjoyed the same privilege.[39] The nature of a group's ability to sue and be sued was inherently linked to prevailing political attitudes to freedom of association.[40] However, Roman law concepts do not neatly map onto modern understanding of corporate separate legal personality, and thus cannot really be analogised.[41]

The modern debate began under German law at the time of German unification.[42] It is here that attention was brought to earlier views of Pope Innocent IV, Pope between 1243 and 1254, who thought that only humans could be excommunicated:[43] as ecclesiastical bodies were mere fictions,[44] they

[37]Watson, above n 10.

[38]Ripken, above n 19, pp 270–274.

[39]LJM Waelkens 'Medieval family and marriage law: from actions of status to legal doctrine' in JW Cairns and PJ de Plessis (eds) *The Creation of the Ius Commune* (Edinburgh: Edinburgh University Press, 2010) pp 104–105.

[40]JL Patterson 'Development of the concept of corporation from earliest Roman times to AD 476' (1984) 10 Accounting Historians Journal 87.

[41]PW Duff *Personality in Roman Private Law* (Cambridge: Cambridge University Press, 1938) pp 35–66.

[42]R Harris 'The transplantation of the legal discourse on corporate personality theories: from German codification to British political pluralism and American business' (2006) 63 Washington and Lee Law Review 1421; Cheffins, above n 9; MH Hager 'Bodies politic: the progressive history of organizational "real entity" theory' (1989) 50 University of Pittsburgh Law Review 575.

[43]FC Savigny *Savigny's Jural Relations* tr WH Rattigan (London: Wildy & Sons, 1884) p 239.

[44]O Gierke *Das Deutsche Genossenschaftsrecht* vol 3 tr G Heiman (Toronto: University of Toronto Press, 1977) p 32.

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could not.[45] This argumentation structure remains in modern day secular analysis – often predicated on the idea that a company has no single mind, making it harder to hold the company to account for wrongdoing under criminal law.[46] The fiction argument, though, did not exist as a single school of thought but was actually two arguments. The first strand was that the legitimacy of the company arises from the authority of the state. The second strand was that the interactions arising in respect of the company were purely imaginary – legal recognition of a company was purely an ex post method of rationalising interactions between humans who solely considered themselves dealing with other humans.[47]

The second strand was quickly dropped. Savigny stated that '[w]e now have to consider it (juristic personality) as extended to artificial subjects by means of pure fiction',[48] and believed in 'the necessity of State sanction for the creation of every legal person'.[49] It is here that we start to see the voluntary surrender of the 'fictitious' aspect of the fiction theory as artificial does not equate to fictitious – indeed they were viewed by corporate law authors as dichotomous:

> a corporation cannot possibly be both an artificial person and an imaginary or fictitious person. That which is artificial is real, and not imaginary: an artificial lake is not an imaginary lake, nor is an artificial waterfall a fictitious waterfall.[50]

Savigny's adherents would agree: something real needs a legal mechanism to operate through, and this is the artificial creation of the company.[51] The issues arise when commentators conflate the company and this real thing. Often, even where this conflation is avoided, commentators have assumed that this real thing is the sum of the individuals behind the company, or merely an aggregate of their interests.[52] However, this ignores an important aspect of group dynamics – individuals can decide to act as a group before choosing the group's legal form.[53] There is thus something between a mere aggregation of individuals and the company – individuals must decide to act as a group, then that group must decide to use a corporate form. The company is, at the same time, artificial (as it is using a legal form provided for by the state) and intended to be the operationalisation of something real. It is not contradictory to state that something real operationalises through something artificial. The fiction theory, then, dropped the eponymous aspect of its name. What is left is the notion that the company's powers arise from the legitimacy of the state: in particular, that the precise legal calibrations of the company are decided by the state.[54]

The fiction theory's scope thus narrowed. Expositions of the 'fictitious' part of the fiction theory fell away. It became more of a straw man to be argued against, without many strong adherents. It is mostly espoused by those wishing to disagree with it. As such, it is dangerous to interpret the fiction theory by reference to what those disagreeing with it hold it out to be. It was in response to the 'prevalent' persona ficta theory that Gierke's concept of the corporation as a real entity was developed.[55] Thus Gierke stated strongly that, as Maitland's translator's introduction reads, a company 'is no fiction… no piece

[45]Koessler, above n 5, at 438.

[46]Clarkson, above n 22; JC Coffee '"No soul to damn: no body to kick": an unscandalised inquiry into the problem of corporate punishment' (1981) 79 Michigan Law Review 386.

[47]Hager, above n 42, at 579–580.

[48]Savigny, above n 43, p 176.

[49]Ibid, p 206.

[50]AW Machen 'Corporate personality' (1910) 24 HLR 253 at 257.

[51]Ibid, at 255.

[52]V Morawetz *A Treatise on the Law of Private Corporations* (Boston: Little Brown, 2nd edn, 1886) pp 1–2; H Wells 'The personality of partnership' (2021) 74 Vanderbilt Law Review 1835.

[53]P French 'The corporation as a moral person' (1979) 16 American Philosophical Quarterly 207; P French 'Types of collectivities and blame' (1975) 56 The Personalist 160; G Teubner 'Enterprise corporatism: new industrial policy and the "essence" of the legal person' (1988) 36 AJCL 130.

[54]Watson, above n 10.

[55]O Gierke *Political Theories of the Middle Ages* tr FW Maitland (Cambridge: Cambridge University Press, 1900) p 69.

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of the State's machinery… but a living organism and a real person, with body and members and a will of its own'.[56] This twists the narrow focus of the fiction theory. The argument is not that the company is part of the state, but that the company's personality arises by concession from the state. The former seeks to adopt the company as part of the operations of the state, the latter merely notes that it arises by reference to the state's gift. Maitland was thus slightly misrepresenting the main aspect of the fiction theory: the state gift, or concession, aspect.

Gierke's ideas were promoted in England by Maitland and Pollock. Maitland's defences were strong,[57] but Pollock was the most strident. Pollock argued that English law had rejected the 'most important consequence of the Fiction theory', that a company only has the capacity that is expressly conferred upon it. Pollock argued that the court had a number of opportunities to limit the activities of the company, and had failed to, actively interpreting the charter of a company widely.[58] Pollock does not refer to the list of things that a human can do that a company cannot,[59] making his argument not quite complete. He goes on to state:

> Such is the normal use of legal fiction, not, as the vulgar suppose, to escape from the truth of things, but to make room for it by the recognition of pressing facts. In form it may be, and generally is, transparent; but no one is expected to accept it literally.[60]

We again see here a way to reconcile again the two sides of the argument – fiction theory does not need to accept that the company is an actual fiction. Indeed, corporate law's use of the term 'legal fiction' in debates is different to law's normal understanding of the term. Normal legal analysis tends to use legal fictions as an analogy – a fiction is used so that something that is manifestly not present is deemed present in order to create a just outcome – for example implied terms in contracts.[61] As Fuller stated 'judges and writers on legal topics frequently make statements that they know to be false. These statements are called "fictions"'.[62] These statements are not believed.[63] Corporate law's fiction approach is different, in that it merely considers the boundaries of the company as being set by law – the state gift aspect of the fiction theory.

The state's role in setting such boundaries is evident in two clear examples. First, despite contractarian claims to the contrary,[64] under English law limited liability for shareholders in companies[65] requires a statutory footing to be provided by the state.[66] Secondly, separate legal personality itself is an inherent concession provided by the state through incorporation. Incorporation is the 'mysterious rite' of creating a new corporate person.[67] English law has long held that there can be no incorporation without 'the King', or the operation of the state.[68] This remains the case today.[69] There is no dichotomy in acknowledging that real entities exist, and that the state gifts them a legal body to operate

[56]ibid, p xxvi.

[57]FW Maitland 'Moral personality and legal personality' (1905) 6 Journal of the Society of Comparative Legislation 192.

[58]Pollock, above n 4, at 235. See also H Ke Chin Wang 'The corporate entity concept (or fiction theory) in the year book period' (1942) 58 LQR 498; M Wolff 'On the nature of legal persons' (1938) 54 LQR 494. The debate was mostly seen as irrelevant: WS Holdsworth 'English corporation law in the 16th and 17th centuries' (1922) 31 YLJ 382 at 405–406.

[59]MA Pickering 'The company as a separate legal entity' (1968) 31 MLR 481.

[60]Pollock, above n 4, at 228.

[61]FH Lawson 'The creative use of legal concepts' (1957) 32 NYULR 909.

[62]LL Fuller *Legal Fictions* (Stanford; Stanford University Press, 1967) p 1.

[63]Ibid, p 6.

[64]See FH Easterbrook and DR Fischel 'Limited liability and the corporation' (1985) 52 UCLR 89.

[65]Limited liability can be included in the terms of the contract: *Hallett, Gooden, Clark, Allan and Hatfield v Dowdall* (1852) 18 Queen's Bench Reports 2. However, it cannot bind a party who has not expressly agreed to a limitation of liability in a contract: *Walburn v Ingilby* (1833) 39 ER 604.

[66]Limited Liability Act 1855.

[67]EM Dodd 'For whom are corporate managers trustees' (1932) 45 HLR 1145 at 1160.

[68]*Sutton's Hospital* (1612) 77 ER 937.

[69]Watson, above n 10.

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within. Radin argued that the realness of human persons and the artificiality of corporate persons are both overstated,[70] once more bringing the two positions closer together than acknowledged by Pollock. Certainly, Gierke overstated his argument. The above quotation from Maitland refers to the company as being a living organism and a real person. As Gindis stated:

> There is something suspicious about Gierke's theory because it transforms what could in some respects be deemed as an interesting analogy between associations and human beings into something more. It is one thing to claim that when the bond of association is strong a group of human beings can be properly described as a singular decision-making unit. It is quite another to argue that the group is physically a living unit.[71]

Accepting this valid criticism means that as the fiction theory rows back to state gift aspects, the real entity theory also rows back – acknowledging instead that there is a single unit, rather than a biological organism. A two-step process reconciles the two positions. A group forms a real singular unit for decisions, and it then uses the state gift of the corporate form. Vinogradoff foreshadowed this argument in 1924. He stated

> There are two sides to be considered in the case of companies and corporations. There is the business side directed towards a material purpose, which is created, not by the law, but by the respective interests involved. On the other hand, there are the legal consequences attached to the association, which may amount to the appearance on the scene of a new 'juridical person'.[72]

Vinogradoff thus focused on a dual aspect of the company. This is easily extended to a two-step process – a group of individuals come together for a business purpose, and form a business association. They then operationalise that through legal means. The former is a natural, or real process. The latter must use legal tools available. This includes company law. Vinogradoff hinted at this in the above when he referred to the legal consequences attaching to the association, implying that association is the precursor to legal consequences. By embracing this two-step process and making it more explicit, we can gain further clarity into the optimal operation of companies and company law. Thus whilst the company remains a way for the real entity to operationalise, the company itself is not a real entity. It is a concession from the state to allow the real entity to operate. The two-step process is implicit within both historic arguments: from the concession side, there must be a concession to something – implicitly something real. From the real entity side, the company is clearly established by the state and it cannot be down to the state to create the real entity – otherwise such real entity relies more heavily on the state than even concessionists would argue. Thus the two-step process demonstrates that the two sides were actually arguing at cross purposes.

Were the concession of corporate personality not present, market participants would find other ways to allow the real entity to operationalise. If incorporations of new companies were banned, business activity would continue to take place through different legal methods.[73] Similarly, a new form of business entity will not dramatically increase business activity.[74] At the margin, the increase/saving of transaction costs involved may be determinative as to whether the real entity is operationally viable.[75] This shows the two-way interaction between the real entity and the legal concession.

[70]M Radin 'The endless problem of corporate personality' (1932) 32 CLRev 643.

[71]D Gindis *The Nexus Paradox: Legal Personality and the Theory of the Firm* (PhD thesis, 2013) pp 195–196.

[72]Vinogradoff, above n 24, at 596–597.

[73]See Bubble Act discussion in M Patterson and D Reiffen 'The effect of the Bubble Act on the market for joint stock shares' (1990) 50 Journal of Economic History 163.

[74]J McCahery and EPM Vermeulen 'The evolution of closely held business forms in Europe' (2001) 26 Journal of Corporation Law 855.

[75]Williamson, above n 12; OE Williamson *The Economic Institutions of Capitalism* (New York: Macmillan, 1985) ch 11.

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Vinogradoff's insights were overshadowed by Dewey's two years later that separate legal personality merely meant what the law made it mean, and that at its core it merely meant that a company was a right and duty bearing unit, 'the constant unit in the logic of a legal system'.[76] Nékám further argued that we needed to disaggregate conceptually being a right and duty bearing unit from the administrator of such rights and duties.[77] Nevertheless, the fundamental 'dual nature' insight is important as it is sequential in nature – the decision to act as a group is taken separately and conceptually prior to the decision as to the organisational form that such group will take. This lets us resolve these long running debates – something is real, and the state's concessions provide the operational form to that something. Importantly, it is not the company itself that is real – that is simply a legal form that the real thing utilises. As Smith stated in 1928, separate legal personality facilitates and regulates conduct.[78]

We thus need to de-couple the conduct itself (for companies, traditionally agreement to act as a group for profit), from the operationalisation of that conduct through the legal form. Extreme forms of fiction arguments were unpersuasive because they denied that real activity took place. Extreme forms of real entity arguments were unpersuasive because they denied that state gifts were involved in company life. Extending Vinogradoff's insights lets us fuse the two: the company exists primarily to allow something real a way to operationalise, via the state gift of the company.

However, the legal tools that allow such operationalisation do *not* require a real entity to be present. Thus whilst the company may exist as a concession to something real, it can be established without something real. There is thus a risk of a false syllogism: the company exists for something real, but that does not mean that every company represents something real. Law has the tools available to make such an alignment between the legal form and real entity, yet does not deploy them. This is discussed further in Section 3 below, but suffice to note here that one person can form a company,[79] and no additional shareholders are required later.[80] This undermines the pure version of the real entity theory, as there is not always something real behind the company. As such, Maitland (in the real entity tradition) denounced the corporation sole[81] as being an aberration to corporate theory.[82] Liberalisation of minimum shareholder numbers[83] thus poses a major challenge for the pure version of real entity logic. In the modern day, we do not need group activity to set up or run a company, meaning that 'the boundaries of organizations do not have to align with the boundaries of the corporate form'.[84] The paradigmatic use of a company is as a legal tool through which a real entity can operationalise. No extra-human real entity, though, is required as a prerequisite to create or operate a company. Corporate law has de-tethered from the two-step process that tacitly underpins corporate law theory. We shall argue later that this causes avoidable harms and requires remedy.

2. The firm

We must look beyond the company, then, to establish the real thing that the company exists as a concession to. Understanding this will help us ascertain whether the boundaries of the concession of company law are appropriate or not. In economics, the real thing that companies exist as a concession for

[76]DP Derham 'Theories of legal personality' in LC Webb (ed) *Legal Personality and Political Pluralism* (Melbourne: Melbourne University Press, 1958) p 7.

[77]A Nékám *The Personality Conceptual of the Legal Entity* (Cambridge: Harvard University Press, 1938) pp 28–33.

[78]B Smith 'Legal personality' (1928) 37 YLJ 283.

[79]Companies Act 2006, s 7(1).

[80]Ibid, s 38.

[81]Maitland, above n 4.

[82]See SJ Stoljar 'Corporate theories of Frederick William Maitland' in LC Webb (ed) *Legal Personality and Political Pluralism* (Melbourne: Melbourne University Press, 1958).

[83]Compare Companies Act 1948, s 31 with Companies Act 2006, s 7(1).

[84]Micheler, above n 10, p 41.

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is known as the firm. The firm was raised by a number of historical commentators[85] but became foregrounded by the 1930s.[86] In particular, in 1937 Coase argued that there were costs of going to the market (what we would now think of as transaction costs[87]) that can be saved by bringing such activity into the firm, thus replacing market risk with internal authority.[88] Thus the firm is set up as a form of collective activity; the dichotomous alternative to the market.

There are also associated costs of such authority – including ensuring that work is undertaken by insiders whose output is variable but whose income from the collective endeavour is fixed.[89] This focus on economic forces within the firm resulted in the blurring of the edges of the firm,[90] with some commentators talking of a continuum between the market and the firm, with it being possible to conceive of a hybrid between the two.[91] This led to a lack of certainty over what the core characteristics of the firm were – for some, it was control,[92] for others co-ordination about the joint outcome of a team,[93] for some joint property.[94] Unfortunately, most expositions of the firm say 'very little about the firm. The problem is that there are really no firms in these models, just representative entrepreneurs'.[95] It has been argued that the firm is too complicated for one single model,[96] with Machlup identifying at least 21 different usages of the term.[97] Hart stated:

> [m]ost formal models of the firm are extremely rudimentary, capable only of portraying hypothetical firms that bear little relation to the complex organizations we see in the word. Furthermore, theories that attempt to incorporate real world features of corporations, partnerships and the like often lack precision and rigor.[98]

Others have argued that this means that there is no point trying to define a firm,[99] or that any definition would be arbitrary.[100] However, our understanding of the firm is important – the boundaries of the firm have a series of other knock-on effects, such as the boundaries of corporate finance.[101]

[85]Eg Alfred Marshall: see J-L Ravix 'Alfred Marshall and the Marshallian theory of the firm' in M Dietrich and J Kraaft (eds) *Handbook on the Economics and Theory of the Firm* (Cheltenham: Edward Elgar, 2012); T Ulen 'The Coeasean firm in law and economics' (1993) 18 Journal of Corporation Law 301.

[86]F Machlup 'Theories of the firm: marginalist, behavioral, managerial' (1967) 57 American Economic Review 1.

[87]R Coase 'The problem of social cost' (1960) 3 Journal of Law and Economics 1; RC Ellickson 'The case for Coase and against Coaseanism' (1989) 99 YLJ 611.

[88]R Coase 'The nature of the firm' (1937) 4 Economica 386; B Klein 'Vertical integration as organizational ownership: the Fisher Body-General Motors relationship revisited' (1988) 4 Journal of Law, Economics & Organization 199.

[89]AA Alchian and H Demsetz 'Production, information costs, and economic organization' (1972) 62 American Economic Review 777.

[90]For rebuttal see GM Hodgson 'The legal nature of the firm and the myth of the firm-market hybrid' (2002) 9 International Journal of the Economics of Business 37.

[91]OE Williamson 'Comparative economic organization: the analysis of discrete structural alternatives' (1991) 36 Administrative Science Quarterly 269; C Ménard 'Hybrids: where are we?' (2022) 18 Journal of Institutional Economics 297.

[92]Eg Coase, above n 88; K Cowling and R Sugden 'The essence of the modern corporation: markets, strategic decision-making and the theory of the firm' (1998) 66 The Manchester School 59; E van den Steen 'Interpersonal authority in the theory of the firm' (2010) 100 American Economic Review 466.

[93]Alchian and Demsetz, above n 89; AA Alchian and SE Woodward 'The firm is dead: long live the firm' (1988) 26 Journal of Economic Literature 65.

[94]O Hart and J Moore 'Property rights and the nature of the firm' (1990) 98 Journal of Political Economy 1119; SJ Grossman and O Hart 'The costs and benefits of ownership: a theory of vertical and lateral integration (1986) 94 Journal of Political Economy 691.

[95]B Holmström 'The firm as a subeconomy' (1999) 15 Journal of Law, Economics and Organization 74 at 100.

[96]P Behrens 'The firm as a complex institution' (1985) 141 Journal of Institutional and Theoretical Economics 62.

[97]Machlup, above n 86, at 26–28.

[98]O Hart 'An economist's perspective on the theory of the firm' (1989) 89 CLRev 1757 at 1757.

[99]SNS Cheung 'The contractual nature of the firm' (1983) 26 Journal of Law and Economics 1.

[100]AA Alchian and SE Woodward 'Reflections on the theory of the firm' (1987) 143 Journal of Institutional and Theoretical Economics 110.

[101]L Zingales 'In search of new foundations' (2000) 55 Journal of Finance 1623.

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Similarly, we must understand the firm to understand the legal limits of the concession made by the state to it – the company form. Hodgson argued that there was little development on the theory of the firm from 2000 to recent years.[102]

This changed in 2017, when Deakin, Gindis, Hodgson, Huang and Pistor advanced the understanding of the firm considerably in economic literature.[103] They argued that firms 'have to be treated as creatures of the law'.[104] Further,

> [t]hese puzzles concerning the nature and identity of the firm are solved once we recognize it as a legal entity. The glue that holds the firm together consists of the legal provisions that bind the parties into one legal entity, and in turn draw on appropriate legislation.[105]

Thus the boundaries of the firm are replaced by the legal boundaries identifiable. This has been objected to by Robé on the grounds that 'firms are structured *using* corporations; they are **not** corporations'.[106] For Robé, the economic concept of the firm and the legal concept of the company exist in different universes.[107] If matters stopped there, then we would simply have further alternative conceptions of the firm to add to those outlined above. However, the debate has been ongoing. In 2021, Deakin, Gindis and Hodgson (DGH) replied to Robé.[108] They argue that it is common for legal articles to refer to companies and firms interchangeably.[109] They reiterated the definition advanced in 2017 that a firm is 'individuals or organizations with the legally recognised capacity to produce goods or services for sale'.[110]

DGH refer to a number of areas of agreement with Robé. They argue, though, that the legal form dictates economic activity, such that '[t]he law of the business firm… is so deeply imbricated with the operation of firms in the economy that it makes no sense for the economist's conception of the firm to ignore the law; hence our claim that a productive entity which is not "legally structured" is not "in economic or other terms, a firm"'.[111] This, then, doubles down on the insight that legal rules are important to the firm. It goes further, and argues that firms require legal structuring. This does not mean, though, that there is an inevitable overlap between the company and the firm: special purpose vehicles are set up as companies, but are not firms.[112] Similarly, firms do not only structure by way of legal entity – also by reference to partnerships.[113] It is also not inevitable that each company within a company group structure is its own firm.[114]

Robé replied again, reiterating his claim that the company and the firm are two totally different concepts.[115] DGH have responded yet again to evidence common synonymy between the firm and the corporation.[116] They go further and argue that legal form is a requirement for a firm – thus 'all corporations are firms, but not all firms are corporations'.[117]

[102]GM Hodgson 'Taxonomic definitions in social science, with firms, markets and institutions as case studies' (2019) 15 Journal of Institutional Economics 207 at 220.

[103]Deakin et al, above n 30.

[104]Ibid, at 196.

[105]Ibid, at 197.

[106]JP Robé *Property, Power and Politics: Why We Need to Rethink the World Power System* (Bristol: Bristol University Press, 2020) p 11.

[107]See also JP Robé 'The legal structure of the firm' (2011) 1 Accounting, Economics and Law: A Convivium, article 5.

[108]S Deakin et al, 'What is a firm? A reply to Jean-Philippe Robé' (2021) 17 Journal of Institutional Economics 861.

[109]Ibid, at 863–867.

[110]Ibid, at 865; Deakin et al, above n 30, at 194.

[111]Deakin et al, above n 108, at 866–867.

[112]Ibid, at 868.

[113]Ibid, at 867.

[114]Ibid, see the use of 'may' at 869.

[115]JP Robé 'Firms *versus* corporations: a rebuttal of Simon Deakin, David Gindis and Geoffrey M. Hodgson' (2022) 18 Journal of Institutional Economics 693.

[116]S Deakin et al 'A further reply to Jean-Philippe Robé' (2022) 18 Journal of Institutional Economics 703.

[117]Ibid, at 703.

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DGH were writing for an economic audience, arguing that legal form is important to economic analysis. They are therefore less concerned with legal delineation. Thus whilst they consider every corporation to be a firm, they do not mean that every company is a corporation, nor that a corporation can only consist of one legal entity. For DGH, a corporation is a type of company that is undertaking firm activity. As such, not every company falls within the term corporation as used by DGH. They state of special purpose vehicles and passive asset holding vehicles that '[t]hese companies are not firms in any real sense of the term, and our definition of the firm as a legally constituted entity set up for the production and sale of goods and services does not require us to treat them as such.'[118] Similarly, within groups, DGH note that 'regardless of the country in which it is incorporated, a national subsidiary of a multinational enterprise may well be operating as a singular firm'.[119] The use of 'may' indicates that whilst there may be multiple firms within a multinational corporate group, it is not inevitable and automatic that there will be – it is instead a question of how each subsidiary is used. As such, separate legal personality is an important aspect of the firm, but not exclusively determinative of its boundaries – firms can be split across multiple legal persons, and a separate legal person can exist without a firm. Whilst the company's separate legal personality exists as a concession to the firm, there is space for the boundaries of the company's legal personality to misalign with the boundaries of the firm.

Beyond separate legal personality, the firm has further implications for corporate law analysis. First, the terms company and firm are frequently used interchangeably.[120] This is often unreflexive – not an overt argument that the boundaries are the same, but a tacit assumption that the two perfectly overlap.[121] Secondly, where this is avoided, for example in comparative company law, the firm is used as a jurisdiction-neutral term, to refer to a wider concept of which a jurisdiction's specific legal vehicles form part.[122] Thirdly, arguments about the design or reform of corporate law tend to be based on conceptions of the firm.[123] Space for misalignment, then, between the boundaries of the company and the boundaries of the firm cause risks for corporate law analysis.

3. The misalignment of corporate law

(a) The problems of misalignment

So the company's separate legal personality arises as a concession to the firm. Companies and their separate legal personality accordingly 'transgress all the basic dichotomies that structure liberal treatments of law, economics and politics'.[124] Political science has recently focused on the concession provided of the corporate form.[125] This concession is not provided to every group who wish for it.[126] It is provided because society expects to receive overall benefits from allowing the incorporation of companies, particularly wealth generation across wider society as a whole.[127] It is also, though, associated with real societal harms. These harms are often flagged in respect of limited liability,[128] particularly the

[118]Deakin et al, above n 108, at 868.

[119]Ibid, at 869.

[120]Deakin et al, above n 116, conducted a search on JSTOR for articles using both the words 'firm' and 'corporation' in 139 law journals and found 19,924 results.

[121]Hardman, above n 32.

[122]Eg C Gerner-Beuerle and M Schillig *Comparative Company Law* (Oxford: Oxford University Press, 2019) pp 5–7, 25–28.

[123]Eg Easterbrook and Fischel, above n 13, at 1417; J Armour and MJ Whincop 'The proprietary foundations of corporate law' (2007) 27 OJLS 429 at 430.

[124]D Ciepley 'Beyond public and private: towards a political theory of the corporation' (2013) 107 American Political Science Review 139.

[125]Eg RJG Claassen 'Hobbes meets the modern business corporation' (2021) 53 Polity 101; RJG Claassen 'Wealth creation without domination: the fiduciary duties of corporations' (2022) Critical Review of International Social and Political Philosophy https://doi.org/10.1080/13698230.2022.2113224.

[126]Laski, above n 23.

[127]M Bennett and RJG Claassen 'The corporate power trilemma' (2022) 84 The Journal of Politics 2094.

[128]Hansmann and Kraakman, above n 33.

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deployment of strategic liability within the corporate group.[129] These, though, are merely a manifestation of the bigger issue that misalignment between company and firm can be manipulated by certain constituencies for personal gain to the detriment of other constituencies. It is therefore logical that the state should be able to provide limitations on the gift that it provides to be corresponding to its benefits. State locus to do so becomes evident when we acknowledge the role of the state in granting the concession that provides certain constituencies with the means to cause harm to other constituencies.

Corporate separate legal personality exists for a real entity of a firm.[130] Yet UK company law creates a number of opportunities for such legal personalities to be created without a corresponding real thing being there, and does not limit each real thing to only having access to one legal person. Law therefore allows a misalignment between the legal form and the organisational form.

Allowing a concession for a firm does not, of course, automatically mean that each firm must only receive one concession. However, there are harms associated with multiple concessions and misalignments of company and firm. Specifically, it has been argued that such misalignment can be a deliberate ploy to maximise leverage to excessive or unsustainable levels within the group,[131] undertaken by directors at the behest of shareholders (or in response to pressure from them), or in cahoots with major creditors.[132] This can be seen, though, as part of a more general point. We know that corporate law incentivises shareholders to utilise the corporate form to maximise their own income at the expense of third party creditors.[133] We also know that there is a concern that directors will maximise their own income at the cost of others.[134] Yet it is precisely these two constituencies who drive misalignment between the firm and the company.

Conceptually, it has been argued that these two constituencies take decisions as to the structuring of legal form.[135] It is also doctrinally the case in the UK: a new company is set up upon processing of a form signed just by shareholders and of directors.[136] We can thus assume that ultimate shareholders (ie the shareholders of the parent company) and directors will only create the misalignment of the legal form to the organisational form if they perceive some personal benefit to them which would not otherwise be available. Unsecured creditors who cannot adjust the price that they interact with the organisation with (be they voluntary creditors without the power to adjust, or involuntary creditors whose interactions with the organisation are not of their choosing at all) are less likely to know about organisational structure. Whilst the claim of each individual such creditor may be small, in aggregate they are likely to add up to a material quantum of claims against the company.[137] It is thus rational for directors and shareholders to use their knowledge and power to structure the legal operation of the firm in the way that diverts (or provides the most opportunity to divert) funds from such non-adjusting unsecured creditors to directors and shareholders. Such methods of diversion would not be possible if the boundaries of the legal form automatically aligned to the boundary of the firm, as then creditors to the firm would have access to all the firm's resources. Mandatory re-alignment

[129]R Squire 'Strategic liability in the corporate group' (2011) 78 UCLR 605; P Blumberg 'Limited liability and corporate groups' (1986) 11 Journal of Corporation Law 573.

[130]Accordingly real entities can exist without personality: above n 108, at 864.

[131]Paligorova and Xu, above n 35.

[132]Casey, above n 34.

[133]Hansmann and Kraakman, above n 33; CAE Goodhart and RM Lastra 'Equity finance: matching liability to power' (2021) 7 JFR 1.

[134]The origin of modern agency cost analysis: SA Ross 'The economic theory of agency: the principal's problem' (1973) 63 American Economic Review 134.

[135]Romano, above n 14; H Hansmann and R Kraakman 'The end of history for corporate law' (2001) 89 Georgetown Law Journal 439.

[136]Hardman, above n 32.

[137]LA Bebchuk and JM Fried 'The uneasy case for the priority of secured claims in bankruptcy' (1996) 105 YLJ 857; LA Bebchuk and JM Fried 'The uneasy case for the priority of secured claims in bankruptcy: further thoughts and a reply' (1997) 82 Cornell Law Review 1279.

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would protect, for example, asbestos miners from the use of a smaller overseas subsidiary to shield the main assets of a global firm from risk of damages claims.[138]

The misalignment between legal form and the firm is something that other areas of the legal taxonomy are acutely aware of and actively dealing with. Various other areas of the legal taxonomy, such as tort law,[139] and competition law[140] provide mechanisms for ensuring that liability applies to all legal vehicles within a firm. Yet company law does not. Indeed, company law has retreated in this regard – the concept of piercing the corporate veil which used to be company law's method of resolution of part of the issue[141] has been considerably weakened.[142]

It is tempting to view this as the optimal operation of law: company law establishes a legal framework in which such misalignment is possible, and other areas of the legal system act to mitigate any harms caused by such misalignment.[143] However, there are three reasons why such analysis should be rejected. First, it ignores the incentives that are faced by directors and shareholders, which are to export such risk as possible to nonadjusting unsecured creditors.[144] The operation of other areas of the legal system require some form of actionable wrong to be undertaken to provide a remedy. Not all loss suffered by such nonadjusting creditors as a result of misalignment will result from an identifiable wrong – company law incentivises strategic deployment of separate legal personality to the repeated advantage of only parent company shareholders and directors. As such, this analysis admits that harm will be caused by the use of the corporate form, and only the most egregious of it will be prevented. In light of the foregoing conclusion that the corporate form exists as a concession to the business community, this seems an inadequate counter-concession to obtain.

Secondly, it starts from the default position that company law allows misalignment, then leaves it to other areas of the legal taxonomy to decide when this should be ignored. This is an abrogation of responsibility from company law. We consider it axiomatic that companies cannot marry or have children.[145] It is for private law to establish that a company cannot do this. It is not unreasonable, though, to ask that corporate law provides: (a) an acknowledgment that there can be limitations on separate legal personality; and (b) a thorough understanding of such for other legal disciplines to work from. Only then can subtle questions, like whether a company should enjoy human rights,[146] be fully explored. Similar issues arise in criminal law.[147] Particularly, it has been argued that existing discussion within the criminal law field of the 'Scottish laundromat' of abuse of Scottish limited partnerships[148] misses nuances of the Scots law rules in respect of separate legal personality.[149] This illustrates a much wider point: it is unsustainable to uphold a limitless freedom for only directors and shareholders to choose the boundaries of separate legal personality. Company law's attempts to

[138]Analogous to *Adams v Cape Industries plc* [1990] Ch 433.

[139]*Lungowe v Vendata Resources plc* [2019] UKSC 20; *Okpabi v Royal Dutch Shell plc* [2021] UKSC 3. See C van Dam 'Breakthrough in parent company liability: three Shell defeats, the end of an era and new paradigms' (2021) 18 ECFLR 714.

[140]See A Jones 'The boundaries of an undertaking in EU competition law' (2012) 8 European Competition Journal 301.

[141]D Cabrelli 'The case against outsider reverse veil piercing' (2010) 10 JCLS 343; S Ottolenghi 'From peeping behind the corporate veil, to ignoring it completely' (1990) 53 MLR 338; IM Wormser 'Piercing the veil of corporate entity' (1912) 12 CLRev 496.

[142]*Prest v Petrodel Resources Ltd* [2013] UKSC 34; A Dignam and P Oh 'Rationalising corporate disregard' (2020) 40 LS 187; G Allan and S Griffin 'Corporate personality: utilising trust law to invoke the application of the concealment principle' (2018) 38 LS 79.

[143]Eg AK Sundarem and AC Inkpen 'The corporate objective revisited' (2004) 15 Organization Science 350.

[144]Above n 133.

[145]See Hardman, above n 7.

[146]Grear, above n 21; A Grear 'Challenging corporate "humanity": legal disembodiment, embodiment and human rights' (2007) 7 Human Rights Law Review 511.

[147]Eg N Friedman 'Corporations as moral agents: trade-offs in criminal liability and human rights for corporations' (2020) 83 MLR 255.

[148]L Campbell 'Dirty cash (money talks): 4AMLD and the Money Laundering Regulations 2017' (2018) Criminal Law Review 102; N Lord 'Organising the monies of corporate financial crimes via organisational structures: ostensible legitimacy, effective anonymity, and third-party facilitation' (2018) 8 Administrative Sciences 17.

[149]J Hardman 'Reconceptualising Scottish limited partnership law' (2021) 21 JCLS 179.

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uphold such a position requires non-corporate lawyers (eg tort lawyers) to establish where separate legal personality should be ignored. They can easily miss nuances. Corporate law therefore cannot leave matters to other areas of the legal taxonomy to resolve and should, itself, provide limitations on the misalignment of the corporate form and the firm.

Thirdly, we have argued that separate legal personality is a concession from the state to a real thing. Given that there are potential societal harms caused by misalignment between the legal form and the firm, the default position should be that the legal form is provided for a real thing, and each real thing only has access to one legal form to operate through. Unfortunately, UK company law has repeatedly refused to remedy this alignment, and has in fact facilitated it. The rest of this section explores how law allows and facilitates two different types of misalignments between the company and the firm which can cause such harms: temporal misalignments and misalignments in scope.

(b) Temporal misalignments

It was open to the legal system to stipulate that incorporation was only available to proposed actual business associations, and then they could only access one. Company law has not chosen to do so. There are very few requirements to set up a UK company – merely someone to act as a director, some person to act as a shareholder, a name, a constitution (the default will apply in the absence of stipulation), filling in the relevant form and the payment of the relevant fee.[150] A large number of companies are incorporated by formation agents, sitting on the 'shelf' until acquired by a business. These pre-incorporated companies tend to be incorporated in batches, all with the same directors, shareholders, constitutions, and names with only one sequential number difference. Each is certainly a company. They have, though, done nothing yet. They are only associated with business activity as a fungible commodity of the formation agent's to sell: the object of business activity rather than its subject. Company law, then, requires no 'real thing' in existence to allow this concession to exist. Requirement of more than one individual to have genuine, substantial involvement in the business was precisely one of the concepts raised in the famous[151] company law case of *Salomon v Salomon*,[152] and rejected. UK company law used to contain more formal requirements which acted as proxies for the presence of a real thing, but these have been gradually rowed back.[153]

In the same way that the incorporation process does not require more than one person (therefore no distinguishable 'real thing'), it does not require any activity to be in active contemplation. Once again, there is no legal inevitability in this: partnership law provides a model to link the commencement of the vehicle to undertaking business activity.[154] No incorporation, of course, is necessary to create a partnership, but a hybrid model is entirely possible in which either something real must be a precursor to incorporation, or the company existed from the later date of its incorporation and intention to undertake business activity. Not only do companies exist without a real thing (either shelf companies or one-man companies), but they have, as a matter of company law, the same personality as the largest traded companies. If we consider the real thing company law requires to be a liquid, and the corporate form to be the vessel into which the liquid needs to be poured to be utilised, these shelf companies are akin to vessels into which no liquid has yet been poured. They retain the same capacity to hold liquid, but have not yet received any. They have become de-tethered from the two-stage process: the concession is available without something real having to underpin it. This demonstrates further that the legal form of the company cannot automatically on its own be seen as any form of 'real entity'.

[150]Companies Act 2006, Part 2.

[151]Eg A Dignam and P Oh 'Disregarding the *Salomon* principle: an empirical analysis, 1885–2014' (2019) 39 OJLS 16.

[152]*Salomon v Salomon and Co Ltd* [1897] AC 22 at 34.

[153]Historically, at least seven persons were required to incorporate a company: see Joint Stock Companies Act 1856, s III, Companies Act 1948, s 1(1). This became two persons in the Companies Act 1985, s 1(1), and is now merely one person: Companies Act 2006, s 7(1).

[154]Partnerships occur automatically: Partnership Act 1890, s 1 and s 2. Scottish partnerships have legal personality: s 4.

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Temporal misalignments are not limited to the start of the company's life. They also exist upon change of corporate participants and the cessation of business activity. The company's primary advantage over other business forms[155] is that it transcends changes for individuals involved in the business. The identity of shareholders, directors, employees, and underlying business can change – but the company continues. The example has been used of football clubs – a company could own one football club, sell it, change directors and shareholders, and purchase a different football club.[156] The company, as a matter of company law, is the same, even though the 'real thing' it operates changes. The author has argued elsewhere, in the context of the liquidation of the company that held Rangers football club in Scotland, that this exposed the dangers of focusing too closely on the legal limits of organisational form:

> if OldCo sold Rangers to NewCo, but instead of being liquidated OldCo then bought the Italian football club SS Lazio, we would not believe that, in some way, SS Lazio had won any Scottish football titles even though the same legal person would technically have done so.[157]

The company continues even if the change is sudden. For example, if there is a corporate acquisition, directors will often resign on the same day as the shareholders change. If at the same time all liabilities were paid, all assets distributed to remove all distributable reserves and assets, all employees were terminated, the name of the company changed, and the company changed its business entirely: the company would still be the same despite the firm shedding it.

This misalignment is harmless if the creditors are paid off fully. However, that is not always the case. This is especially so in pre-packaged administrations,[158] where the business of the firm is often transferred to another legal entity, often with linked major creditors, directors and shareholders, and unsecured creditors in the old vehicle are left behind.[159] This lets the firm continue whilst jettisoning legal forms and harming unsecured creditors. Some legal protections exist in respect of this risk – phoenix company legislation provides that someone who is a director of a company in the 12 months up to it entering insolvency cannot be the director of a company which is known by that name or a similar name within five years.[160] This focuses on names, though, rather than underlying business activity. There are also insolvency practitioner requirements to ensure that there is fairness to the unsecured creditors of those left behind.[161] These, though, merely provide a series of steps for the insolvency practitioner to take to try to maximise the value of the business in the sale, rather than letting creditors to the firm follow it to a new legal entity.

Once more, this is not a legal inevitability. Scottish partnership law has created a model whereby if assets are transferred from one partnership to another, it is presumed that related liabilities are also transferred.[162] Introducing such a rule to corporate asset sales would help mitigate the harm of creditors being left behind, by aligning the legal form to the firm.

Requiring something real (in terms of number of participants and intention to undertake business activities) at the start of the company, and preventing the firm from leaving creditors behind in the old

[155]AA Schwartz 'The perpetual corporation' (2012) 80 George Washington Law Review 764; Eisenberg, above n 17; Blair, above n 17.

[156]Hardman, above n 7.

[157]Hardman, above n 7, at 19.

[158]V Finch 'Pre-packaged administrations and the construction of propriety' (2011) 11 JCLS 1; P Walton 'Pre-packin' in the UK' (2009) 18 IIR 85.

[159]H Anderson 'Creditors' rights of recovery: economic theory, corporate jurisprudence and the role of fairness' (2006) 30 Melbourne University Law Review 1.

[160]Insolvency Act 1986, s 216; H Anderson 'Directors' liability for fraudulent phoenix activity – a comparison of the Australian and UK approaches' (2014) 14 JCLS 139; D Milman 'Curbing the phoenix syndrome' (1997) Journal of Business Law 224.

[161]Statement of Insolvency Practice 16 – see JM Wood 'The sun is setting: is it time to legislate pre-packs?' (2016) 67 NILQ 173.

[162]*Scottish Pension Fund Trustees Ltd v Marshall Ross & Munro* [2018] CSIH 39; L Macgregor 'Partnerships and legal personality: cautionary tales from Scotland' (2020) 20 JCLS 237.

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company whilst it continues, would align the company to the firm temporally, so reducing the manifestations of the systematic abuse of opportunistic misalignment noted above. Existing legal tools can be deployed to mandate such re-alignment.

(c) Misalignments of scope

Misalignments can also occur contemporaneously. This is most commonly seen within company law's perennial conceptual problem – corporate groups.[163] Here, the liquid is split amongst a number of vessels. The situation arises in two particular contexts. The first is where a company has a number of subsidiaries. This is common many in industries – for example in the property owning industry property sales taxes are higher than share sales taxes,[164] meaning that transaction costs are lower in selling the shares of a company that owns a property compared to selling the property itself. It is therefore usual for property owning groups to have one holding company (which may provide central services to the others), which owns the shares in other companies, each of which only owns one property and contracts with the holding company. Here, the firm is split over many corporate entities. As noted above, the decision to misalign the corporate boundaries from the firm is undertaken by the ultimate shareholders and directors of the top company, based on what is likely to maximise their income. This is the tool deployed famously[165] in the New York case of *Walkovsky v Carlton*,[166] where Carlton's business owned 20 taxies split across 10 companies, each owning two cabs. When one cab negligently struck Walkovsky, he was only able to obtain recourse against the two taxis held in the one company (Seon Cab Corporation) which owned the taxi that hit him.

Secondly, it is common in corporate acquisitions (especially in the private equity market) to establish a series of new companies to act as holding companies at the top of the corporate chain, to distance ultimate shareholders from the ultimate business.[167] The same issues arise (the real entity's liquid is split across multiple operational vessels). However, whilst the former example can be dismissed as the creation of a subsidiary (sometimes called a special purpose vehicle) which is somehow lesser than a typical company and therefore to be treated differently,[168] the insertion of a holding company provides different challenges. It is not the case that the trading aspects of the business have been segregated, but the holding aspects.[169] Again, the features of business activity remain the same, as do owners and managers.

These misalignments represent the archetypical problems of misalignment – in the former, liability is kept away from assets or risks to third parties increased by business practice, and in the latter excessive leverage is facilitated. Once more, company law had tools to mitigate this, but rejected them. First, it was entirely possible for company law to hold that companies could not hold shares in other companies, yet this was rejected.[170] Secondly, law had tools to apply liability to shareholders in one-man

[163]See P Blumberg 'The corporate entity in an era of multinational corporations' (1990) 15 Delaware Journal of Corporate Law 283; M Petrin and B Choudhury 'Group company liability' (2018) 19 EBOR 771; C Witting *Liability of Corporate Groups and Networks* (Cambridge: Cambridge University Press, 2018); C Witting 'The corporate group: system, design and responsibility' (2021) 80 CLJ 581.

[164]See DS Ryland 'Single properties – new vehicles of ownership' (1989) 4 Journal of International Banking Law 177; K Pocock and J Cottrell 'A note of caution' (2007) 191 Property Law Journal 11.

[165]See 'Should shareholders be personally liabile for the torts of their corporations?' (1967) 76 YLJ 1190; P Halpern et al 'An economic analysis of limited liability in corporation law' (1980) 30 University of Toronto Law Journal 117.

[166]*Walkovsky v Carlton* 18 NY 2d 414.

[167]L Gullifer and J Payne *Corporate Finance: Law, Principles and Policy* (Oxford: Hart Publishing, 3rd edn, 2020) ch 16.

[168]Eg J-C Wolff 'Offshore holdings for global investments of multinational enterprises: just evil?' (2015) JBL 445; E Hupkes '"Form follows function" – a new architecture for regulating and resolving global financial institutions' (2009) 10 EBOR 369; SL Schwarcz 'The alchemy of asset securitization' (1994) 1 Stanford Journal of Law, Business and Finance 133.

[169]Often to achieve 'structural subordination', which prevents distributable profits repaying equity investments upstream until downstream debt has been reduced: see C Wells and N Devaney 'Is the future secure for second lien lenders in Europe?' (2007) 22 Journal of International Banking Law and Regulation 443.

[170]Since Companies Clauses Consolidation Act 1845, s 3: see discussion in Witting, *Liability of Corporate Groups,* above n 163, ch 3.

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companies, thus undoing the advantage of corporate groups. These have been rowed back over time,[171] segregating liability within a group context.[172] Thirdly, automatic cross-liability within corporate groups as a matter of company law has been rejected under UK company law.[173] Fourthly, as outlined above, company law tools to apply liability in specific situations within company groups have retreated, leaving this to other areas of the legal taxonomy as noted above, with the risks outlined above.

These failures to align the boundaries of business entity to the boundaries of the firm represent a failure of company law. The company exists as a concession from the state for business activity to promote a public good. However, it comes with risks of opportunism. Misalignment exacerbates these risks, and company law should deploy the available tools set out above to remove such misalignment.

Conclusion

This paper has argued that corporate separate legal personality arises as a concession to something real. That real thing is the firm. However, there is a misalignment between the two concepts. This misalignment is ripe for abuse by those who pick the boundaries of legal forms – ultimate shareholders and directors. Further, there is evidence that misalignment has been abused and analytical grounds to believe that it is structurally likely to be abused.

Company law has consistently rejected attempts to align the extent of the business entity to the extent of the firm. Temporally, company law rejected requiring a real thing, or even an intention of a real thing, from being a prerequisite to the establishment of a company, and it fails to ensure that liability tracks the firm. In terms of scope, corporate groups have become possible with segregated asset and liability pools. Both methods of corporate group creation – new subsidiaries and new holding companies – create risks (segregating liabilities and excessively financialising assets, respectively). Once more, company law has failed to align these boundaries.

This is a material failure for company law. It means that the corporate form is de-tethered from the two-stage process that the company is created for. Company law cannot continue to leave other parts of the legal taxonomy to remedy this error, and needs to remedy it itself. By drawing on historical UK company law tools and existing partnership law tools, company law can align the boundaries of the company to the boundaries of the firm. This will provide the concession intended to the firm, whilst mitigating some of the risks of harm emanating therefrom.

[171]For example, Companies Act 1985, s 24 stipulated that if a company had a sole shareholder for six months, and the shareholder knew it, they were joint and severally liable for the debts of the company. See A Muscat *The Liability of the Holding Company for the Debts of its Insolvent Subsidiaries* (Aldershot: Dartmouth, 1996).

[172]Arguably, limited liability conceptually follows personality: PL Davies et al *Gower Principles of Modern Company Law* (London: Sweet & Maxwell, 11th edn, 2021) para 2-008.

[173]See P Muchlinski 'Limited liability in multinational enterprises: a case for reform?' (2010) 34 Cambridge Journal of Economics 915; WO Douglas and CM Shanks 'Insulation from liability through subsidiary corporations' (1929) 39 YLJ 193.

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