

**The Quarrelsome and Contentious Shareholder:  
The Legitimacy of Corporate Ownership under Lockean Liberal Theory**

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Locke's natural property right derives from his objection to governments that usurp material resources from their laboring subjects.<sup>1</sup> To rebut this alleged divine right of "Quarrelsome and Contentious" lords, Locke, in his *Two Treatises on Government*, sets forth a relatively indelible individual property right based on its necessary role in the primary goods of human survival and prosperity. He also denies property rights to those who do not labor by illustrating the moral and practical significance of work in human industry -- work that monarchs and feudal lords fail, in his view, to undertake. Despite the broad and powerful natural property right Locke gives to mankind, however, he by no means permits the possession of material resources to command the involuntary compliance of others. Rather, Locke consistently maintains that the right to human freedom, including the freedom to provide for oneself and to voluntarily consent before entering into any authoritative relationship, must govern human relationships.

When applying this morally charged, yet pragmatic, means-ends conception of private property to the structure of the modern public corporation, any claim by shareholders to "own" the company is, at best, dubious. It becomes even more dubious as we witness the growing globalization of equity capital flows. The implementation of neoliberal structural reforms like free trade agreements, national treatment rules, and Anglo-American style corporate governance laws create the specter of lordship-style

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<sup>1</sup> See den Hartogh, at 658 (describing Tully's position).

ownership claims over productive organizations throughout much of the world.<sup>2</sup> We confront a “shareholder value” ideology that insists that company management must, at almost all costs, extract as much profit as possible, as quickly as possible, away from local communities and into the hedge funds of developed-world investors. If we were to hold tightly to the liberal project endorsed by Locke, we would recognize that these globetrotting shareholders resemble better the Quarrelsome and Contentious aristocracy against whom Locke railed. Accordingly, if the modern corporate shareholder is to have theoretical legitimacy, it must rest on the shoulders of someone other than John Locke.

### **I. The Lockean Property Right.**

Locke’s consequentialist natural property right, summarized below, reflects the fundamental importance assigned by Locke to (1) labor as the source of human flourishing; and (2) mankind’s natural liberty.

#### *A. The Means-Ends Function of Property.*

Under Locke’s argument, God directs mankind to cultivate the world to maximize not just the survival of the human race, but also its enjoyment and prosperity. Indeed, God gave the world for “the use of the Industrious and Rational” II.34, and forbade the waste and spoilage of his purposeful gift.<sup>3</sup> II.31. Thus, “[t]he material progress that was merely a possibility in the earlier thinkers becomes an imperative for Locke, a divine command.”<sup>4</sup> To facilitate the fulfillment of this command, Locke commands that any

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<sup>2</sup> Here, I recognize an argument that Locke perhaps may have developed his property right to justify, at least in part, English usurpation of indigenous lands in English colonies. See Jack Turner, “John Locke, Christian Mission and Colonial America” *Modern Intellectual History*, 8/2 (2011) pp. 267-297. I can distinguish this line of argument from my own in that the “as much and as good” caveat still held in Locke’s time; such is perhaps not the case in the modern day developing world.

<sup>3</sup> Dunn at 95: “God created all the world for some good purpose, and in creating it he did nothing in vain...so clearly none of it should be destroyed without good purpose. Hence that other central axiom of Lockean politics, the duty to maximize preservation and its curious consequence, the iniquity of waste.”

<sup>4</sup> Forde, at 448.

human industry must leave “as much and as good” for others and, upon the inevitable scarcity created by such industry, imposes a duty of charity while assuring us that such industry would lead to an overall increase in wealth that would benefit all. II.42.

The ends being thus defined, Locke sets forth the mechanism by which mankind might achieve it, namely, the productive and consumptive functions of property.<sup>5</sup> According to the law of nature, and the reason that illuminates that law, the natural world cannot serve its purpose unless people labor to create items of use. II.25, 28. Indeed, labor not only proves absolutely necessary to produce material resources, but also serves as the source of the substantial bulk of consumptive value in them. And it is the *only* means identified by Locke that enables mankind to fulfill his God-given directive to preserve himself and his fellow man. After all, only labor increases the “common stock of mankind” (II.37) while “[making] the far greatest part of the value of things.” II.42.<sup>6</sup> Yet people will not labor unless they can assert an exclusionary property right in the things they create. An individual cannot eat an apple unless she can consume it without worrying that another might snatch it from her hands.<sup>7</sup> Moreover, her desire for material goods, a manifestation of her natural reason, cannot function as an effective motivation to

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<sup>5</sup> See Henry, at 615 (“Individual property rights are promoted [by Locke] only in so far as those rights promote the use of labor in advancing society’s welfare.”); MacPherson at 200 (mixing a man’s labor is the means given to appropriate, because without appropriation man cannot fulfill the duty, derived from God and natural reason, to survive); Tully at 61, 122 (Locke’s property right is consequential: man has a natural duty to preserve himself and others, and reason and therefore natural law gives him the power to do the things necessary to achieve this, namely, a property right to labor and its fruits) (“A property in something is the completion of man’s natural right to the means necessary to preserve and comfort himself and others.”); Stevens (Locke’s prime directive to mankind is survival, and property is the necessary means to achieve it.); Forde at 435 (“If the common good is the grounding principle of Lockean property, the common good is the end to which private property is only a means”).

<sup>6</sup> See also II.40, Tully at 120, 142.

<sup>7</sup> See, e.g., Forde, at 448-449.

labor unless she can exclude others.<sup>8</sup> Thus property both motivates production and enables consumption.

B. *The Moral Force of Labor.*

Although property proves a necessary means to achieve the prime directive of human survival and prosperity, individual appropriation appears inconsistent with God's gift of the world to mankind in common. Locke elegantly resolves this inconsistency in the very activity he seeks to encourage, namely, labor, which Locke deems "the unquestionable Property of the Labourer." II.27. It is no mere prudential panacea, replaceable by some other equally adequate mechanism. Rather, labor possesses a moral force derived from God's command to Adam to sweat and toil after the Fall.<sup>9</sup> It also signifies an individual's ownership of herself and her unique creative efforts.<sup>10</sup> Simply, "Men have a property in their own person...The Labour of his Body, and the Work of his Hands, we may say are properly his." II.27.<sup>11</sup> Labor likewise brings man closer to God as he replicates, in his production of material resources, God's formation of the world.<sup>12</sup> Finally, it is labor, and not some other sort of phenomenon, that can fulfill the divine

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<sup>8</sup> Forde, at 448-50.

<sup>9</sup> See Dunn at 115 (the fall of Adam and the command to labor among conditions of scarcity gives labor its moral force); Tully at 99 (labor is the moral basis for property); Lamb & Thompson, 230-31.

<sup>10</sup> MacPherson at 3 (Locke's possessive individualism is "found in...the conception of the individual as essentially the proprietor of his own person or capacities, owing nothing to society for them."); Tully at 108 (A person owns his actions because he is conscious of them, directs them, and is their author or "maker." Therefore, "[a]lthough man makes not himself nor the world, he makes the actions of his person and so has a natural and exclusive maker's right in them"); Ince at 40 (citing Waldron, the author argues that labor is a moral act, a commandment from God, and the appropriate mode of using the resources given to humanity to use); Tully at 120 ("Locke and his contemporaries were seeking to emphasize man's creative accomplishments and their connection with the concept of a person as a moral and responsible agent.").

<sup>11</sup> Of course, if man is the ultimate owner of himself, and thus his labor and property, it is difficult to argue that his right to property may be overwhelmed by any higher principle. This conflict in Locke's thought is a source of lively debate. One argument that purports to resolve the conflict is that God, as God, has a greater ownership interest in man than he does in himself, and thus can modify man's own ownership interests as He sees fit. See Forde, at 435-38.

<sup>12</sup> See Tully at 108-110.

command to be industrious. Only labor,<sup>13</sup> therefore, provides the moral force capable of justifying the individual appropriation of the earth once given by God to all in common.

The praise assigned by Locke to the industrious laborer, in contrast to the contempt in which he holds the feudal aristocrat, summarizes the point well: Locke states unequivocally that God gave the earth not to the lazy and contentious, but to the “Industrious,” as only they fulfill God’s divine command to cultivate the earth.<sup>14</sup>

C. *Barter and the Master-Servant Relationship as Tools that Enhance The Productivity of Labor.*

Neither barter nor the master-servant relationship diminishes the moral and practical significance of labor in private property. Rather, each merely serves to enhance the capacity of labor to cultivate the world, thus cementing its fundamental role in human industry.

First, with barter and money, any potentially excessive produce that would otherwise wrongfully spoil becomes instead useful and used. Each therefore encourages and amplifies industry in accordance with God’s directive.<sup>15</sup> *See* II.45-49. Locke illustrates the point when he opines that fields would lay fallow and wasted but for the encouragement of money. II.45, 48. Meanwhile, the subsequent increase in human

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<sup>13</sup> Willing consent, for Locke, would likely also suffice.

<sup>14</sup> *See, e.g.,* Lamb & Thompson at 230-31 (those who are not “rational” and “industrious” can make only fraudulent claims on property).

<sup>15</sup> *See* MacPherson at 204-12. For example, MacPherson argues that “the purpose of capital (money) was not to provide a consumable income for its owners, but to beget further capital by profitable investment.”). *Id.* at 207. *See also* Ince, at 44 (money works, *deus ex machina*, as a solution to the problem created when mankind reaches the point where it must decide between leaving the earth unused or overproducing and leaving spoiled goods.); Dunn at 118-19 (the development of a money economy increased the standard of consumption in the world that God gave men “richly to enjoy”).

productivity<sup>16</sup> either prevents or justifies any risk of scarcity, such that the poorest peasant lives better off than indigenous chieftans. II.41.

Moreover, in both relationships, the sweat of the individual remains closely attached to the transaction. Though Locke's "Master" "owns" the labor of her willing servant, perhaps not dirtying her own hands, Locke paints her as part of a single organic productive unit: the master stands closely at hand, directing and supervising the work while incorporating her servant into her household.<sup>17</sup> And when individuals barter, even for gold coins, they barter with the surplus fruits of their own labor. *See* II.50. All parties involved can therefore be fairly described as industrious, with her fingerprints fresh on the final product.

D. *Authority, Property and Liberty*

Though Locke is certainly no Marxist -- he anticipates barter, an unequal accumulation of wealth (II.48-50), and at least a rudimentary form of master-servant relationship -- he clearly divorces the right of private property from social and political authority. I.41. Instead, private property should act as a reflection of mankind's natural freedom from nonconsensual authoritative arrangements.

First, Locke prohibits the use of superior material resources to coerce behavior and the exercise of social power to force others to relinquish their property. I. 42.<sup>18</sup>

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<sup>16</sup> Such increase in productivity arguably includes the use of "capital" as a substitute for Locke's money. *See, e.g.,* MacPherson at 204-06.

<sup>17</sup> Tully would add that Locke's Servant retains artistic and creative control over his work, unlike the modern wage worker. *See* Tully at 139-41.

<sup>18</sup> "[A] Man can no more justly make use of another's necessity, to force him to become his Vassal, by with-holding that Relief, God requires him to afford to the wants of his Brother, than he that has more strength can seize upon a weaker, master him to his Obedience, and with a Dagger at his Throat offer him Death or Slavery." Thus, property in land cannot give one dominion over men, unless de facto authority is obtained through the use of blackmail. *See, e.g.,* Cohen at 307-08 (Locke at all times divorced property

According to Locke, “[a] rich man has no right to seize the cottage of a poor man, power is far from being an excuse, much less a reason, for Rapine and Oppression.” II.202. Locke thus excoriates Filmer, the theorist who inspired his *Two Treatises*, just for conceptually conflating political authority with a property right. (First Treatise, Ch. 7).<sup>19</sup> Indeed, Locke’s argument throughout the *Two Treatises* culminates in the conclusion that political authority can only be justifiably exercised if it serves to *protect* individuals’ properties and liberties. I.92-93, II.45.<sup>20</sup> A legitimate government would not only refrain from taking property and restraining natural liberties, but would also protect those properties and liberties from private interlocutors. It would likewise ensure that it promulgated the same rules for the rich and the poor alike, for the court man and the man at the plow. II.135.

Of course, in a world of scarce resources, no intellectual gymnastics are required to conclude that an unequal division of property might create coercive situations.<sup>21</sup> Locke attempts to resolve such circumstances by (1) requiring that any master-servant relationship be temporary and truly consensual;<sup>22</sup> (2) insisting that the increase of

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rights from authority, critiquing the feudal identification of property and authority. Authority “is not owned by those who exercise it, but is entrusted to authorities subject to specified conditions...Thus the use of property advantages to compel submission to authority is an unjust use of that property. It is a direct threat to preservation; such threats being uses of force, they cannot justify the resulting submission.”).

<sup>19</sup> Dunn at 122.

<sup>20</sup> Per Locke, the increase in population and stock, especially upon the advent of money, renders material resources scarce. Human beings therefore create compacts – and government - to regulate the property which labor and industry began. *See, e.g.*, Dunn at 118-19.

<sup>21</sup> *See, e.g.*, Dunn at 119 (“economic prosperity provides much greater incentive to the abuse of power. And, since monarchs are just as much sinful men as are their subjects, this power is certain sooner or later to be abused.”).

<sup>22</sup> II.85 (“a Free-man makes himself a Servant to another by selling him for a certain time, the Service he undertakes to do, in exchange for Wages he is to receive: And though this commonly puts him in to the Family of his Master but a Temporary Power over him, and no greater, than what is contained in the Contract between ‘em.”). Notably, and important for the discussion *infra*, such consent resembles the implied voluntary consent men give when they relinquish some of their natural powers to a legislative. Otherwise, as in the words of Robert Nozick, one risks treating men not as ends in themselves but as means.

productivity arising from the use of private property will outweigh the detriments associated with any concomitant inequality – a judgment reflected in mankind’s rational and universal consent to the use of money;<sup>23</sup> and (3) imposing a duty of charity on (and assigning a concomitant right to sustenance for) all individuals. Locke, then, imagines a society where an individual could choose to plow her own field or, if such a relationship might provide more benefit, to insert herself into a master’s family as a servant.<sup>24</sup> In voluntarily choosing this service, she would not only increase her own share, but also that of all humanity. Finally, as a last-ditch safety net, Locke gives every person a title to anyone else’s surplus to avoid starvation. In this way, humanity both preserves its natural liberty while following its duty to cultivate the world.

Certainly, Locke’s solution appears naive when applied to a modern day economy where all the earth’s resources have been distributed – in some cases with radical inequality – and where a person’s choices as to occupation and remuneration face the constraints of global labor and product markets. A person, after all, cannot choose to farm his own field and has little bargaining power when consenting to work for someone

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*See* ASU, 49-50. *See also* Stevens at 431-32 (the Master-Servant relationship is temporary, and usually consisted in the exchange of children unable to fend for themselves); Henry at 618 (accord).

<sup>23</sup> *See* II.50: “it is plain, that Men have agreed to disproportionate and unequal Possession of the Earth.” The consent given, for Locke, is rational, as equality is exchanged for an increase in overall productivity and, subsequently, overall wealth for everyone. Locke thus takes pains to argue that the Indian chieftan lives less comfortably than the meanest English peasant. *See* MacPherson, at 211-14 (also noting that “the sufficiency principal remains valid in principle but now operates differently” because people no longer need as much and as good” of the natural common to survive and to prosper. *See also* Henry at 612, 616 (“Individuals now become dependent on the behavior of others, and while this represents a reduction in freedom...the expected increase in income resulting from the gains from trade compensate for the loss” but accumulation is only permitted so long as “there is no injury to anyone” and “does not impinge on the right to subsistence”); Tully at 104 (labor is one way to use the natural common in order to secure preservation and prosperity; money is another, and is justified only because it does a better job of it).

<sup>24</sup> *See* Henry at 612 (pointing out that wage labor, for Locke, could not exist without coercion unless the wage provided more benefit than the simple claiming of unused land. “[I]t is clear that the decision to sell the property rights to one’s own labor must compensate for the loss of non-labor property, and this must be agreed upon by sellers of that property right or, once again, coercion would enter the picture.”).



else. As the German idealist Otto Von Gierke might argue, the choice of a worker is not *whether* to work for someone else, but *where* to work – if you can find it.<sup>25</sup>

Yet the conclusion that society in its current manifestation does not mirror Locke's principles does not require that we abstract and interpret his principles to justify the world as it appears.<sup>26</sup> The burden of proof perhaps should shift to proponents of the status quo. We are not required to presume that anyone in an employment relationship freely consented to its terms – as perhaps a neoliberal outlook might suggest. Locke's principles suggest that we should examine that relationship to confirm that it accurately reflects those principles.<sup>27</sup> Surely, a false choice between starvation or obeisance to one with excess resources, as is the choice faced by many in the developing world, remains as equally applicable today as it did in Locke's time.

Similarly, even if people no longer possess a choice between subsistence farming and wage labor, we might nevertheless ensure that employment contracts reflect terms to

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<sup>25</sup> Gierke, 213.

<sup>26</sup> One common interpretation is of course the neoclassical one, whereby Locke's theory is selectively abstracted from actual circumstance to justify absolute property rights and laissez-faire capitalistic markets. Such abstraction, for example, leads to an analytical presumption that markets necessarily work to "preserve" mankind. But Locke would not permit such markets to run unfettered if they violated the ultimate ends he seeks to obtain, namely, the preservation, prosperity and freedom of all. Otherwise he would not have bothered with explaining a duty towards charity and with arguing against the use of poverty as blackmail. *See* Henry, at 613-14 ("For the neoclassical outcome to obtain, Locke's position has to represent a disembodied point of view in which the optimal, equilibrium outcomes are driven by the property rights assigned to self-interested individuals." This outcome, however, is wrong. Locke's property is based on a larger morality, where "Property holders...have a moral (or social) obligation that transcends 'best use' considerations as determined by markets.").

<sup>27</sup> In fact, Locke himself did the same thing. *See* Dunn at 93: "[I]t is perhaps not uncommon for political failure to elicit a sharper consciousness of the moral obliquities of past political conduct...The confrontation with Filmer at any rate did draw sharply to Locke's attention a possible practical bias in his earlier thought on politics and unsurprisingly his efforts to correct and commence with a re-examination of the theological premises of these earlier positions. Human political arrangements derive their sole legitimacy from their embodiment of the purposes of God. Most of their actual contours are grotesquely inadequate for this assignment. Hence the intellectual project for Locke in this book is to separate the moral (and thus legal) claims which the performance of these functions entitles them to make from those which their formal legal structure and their effective practical power enable them to make.").

which a self-sufficient individual might agree.<sup>28</sup> Arguably, Locke himself would not object to the creation of such agreements, even when based not upon explicit consent but upon rational assumptions about what explicit consent might look like. His own theory of government and money, after all, seems to demand the same logical leap.<sup>29</sup> Nor would such a solution deviate from Locke's directive that humanity pursue the industrious cultivation of the earth: a growing body of argument shows that income inequality not only risks the preservation of the poorest among us, but also harms overall macroeconomic conditions.<sup>30</sup> Thus, despite the circumstances of modern day capitalism, we can nevertheless conclude in accordance with Locke's liberal principles that certain disadvantageous wage bargains do not reflect either free consent or the manifestation of an indelible property right. We might instead conclude that they are shaped by coercion.<sup>31</sup>

## II. Public Company Stock's Dubious Qualification as Lockean Property

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<sup>28</sup> For example, we might require that wages equal at a minimum the marginal product of labor. *See* Henry at 620.

<sup>29</sup> A major weakness in Locke's argument is his failure to show how a real-life government might go about obtaining verifiable, empirical consent. Though Locke states that an acceptance of an inheritance serves as implied consent, he provides no mechanism by which consent can be presumed from those who do not inherit anything. Accordingly, for Locke's argument to hold, it seems we must accept some sort of implied consent. Similarly, as argued by Nozick, the invention of money appears to have come about organically, through an "invisible hand" kind of process, but, because rational, can be said to have been consensual. ASU at 18.

<sup>30</sup> *See, e.g.,* Stiglitz; Palley. I will also cite here Thomas Piketty's *Capitalism in the 21<sup>st</sup> Century*, although I admit that I have not as yet read it in any detail.

<sup>31</sup> *See* Henry at 620 (This equilibrating process [of the neoclassical economic story, where wages must equal the marginal product of labor in the aggregate economy] must be undertaken on a non-coercive basis. Should the seller of skills believe that the wage bargain is disadvantageous (the price commanded is too low), that individual will not enter this market. But this requires that one must have an option, and that option can only be independent production."); Cohen at 308 ("the use of property advantages to compel submission to authority is an unjust use of that property. It is a direct threat to preservation; such threats being uses of force, they cannot justify the resulting submission.").

To summarize, Locke's natural property right is consequentialist in two respects: (1) it is necessary to encourage human labor, which is the only means by which mankind can fulfill God's directive to preserve himself and to cultivate the earth for his use and enjoyment; and (2) it is a *function* of natural human liberty, and not a means by which to curtail it. When inspected to ascertain their function and role in modern society, however, it appears that public company shareholders serve neither of these purposes. First, the fingerprints of shareholders, if such ever existed on the products of corporate industry, linger now only tenuously. Shareholders do not labor for the corporation and, in fact, may even work against its interests. Indeed, it is unclear whether shareholders are even necessary to encourage corporate productivity. Second, shareholders resemble the very social arrangement that Locke fought to delegitimize, namely, those who impermissibly wield social authority by virtue of a conventional property right. They therefore do not serve to enhance human liberty, but to restrain it.

A. *The Claims and Duties of Public Company Shares.*

Before treating the phenomenon of public company shareholding with Locke's principles, however, a clear understanding of its nature is necessary. A brief summary is therefore provided in the following paragraphs, mostly derived from the author's own experience as a practicing corporate litigator.

While most modern discussion of the public corporation presumes that a corporation is "owned" by its shareholders, the "ownership" claimed looks very little like any conventional notion of "ownership."<sup>32</sup> Simply, stock as "property" in a company

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<sup>32</sup> See, e.g., Berle and Means at 64-65 ("The spiritual values that formerly went with ownership have been separated from it. Physical property capable of being shaped by its owner could bring to him direct satisfaction apart from the income it yielded in more concrete form. It represented an extension of his own personality. With the corporate revolution, this quality has been lost to the property owner much as it has

does not encompass the kinds of claims and duties one normally associates with a property right. It is not shareholders, but the corporate entity through its appointed delegates, that exercises control over corporate assets.<sup>33</sup> Title to the machines, contacts, inventories, liabilities, revenues and trademarks belong not to shareholders, but to the corporation itself. The name of the corporation, and not that of the shareholders, is signed at the bottom of contracts. Shareholders cannot alienate, direct, or use corporate intellectual property, customer lists, and goodwill. And under corporate law, shareholders have no say in ordinary business operations,<sup>34</sup> and can only vote “yes” or “no” during certain merger transactions.<sup>35</sup> They likewise remain untouched from the corporation’s liabilities when, for example, it faces tort claims against injured customers.<sup>36</sup> Indeed, corporate law does not even require that a corporation *have* shareholders.<sup>37</sup>

Instead, when a shareholder obtains a share, she receives some vague expectation to an indefinite portion of the corporation’s future profit streams<sup>38</sup> – as determined at the

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been lost to the worker through the industrial revolution”) and 8 (“Power over industrial property has been cut off from the beneficial ownership of this property,” leading to “the surrender and regrouping of the incidence of ownership, which formerly bracketed full power of manual disposition with complete right to enjoy the use, the fruits, and the proceeds of physical assets.”); McCall at 514-515.

<sup>33</sup> Berle & Means at 113-116; McCall at 516 (The board of directors has original, undelegated power to direct the affairs of the corporation. Their decisions are protected by the “business judgment rule,” a judicial convention that insulates their decision-making from second guessing by shareholders except upon the most egregious or exigent of circumstances, *e.g.*, conflict of interest transactions or the sale of control of the company to another.) (citing 8 Del. C. s 414(a)).

<sup>34</sup> Delaware’s “business judgment rule,” protecting boards of directors from liability for ordinary business decisions, is the most notorious example.

<sup>35</sup> Though laws vary, shareholders do not always get a right of “approval” in all change of control transactions, *i.e.*, when the company is “sold” to new shareholders (whether in the form of individuals, another company proposing to buy the shares to take it “private,” etc.).

<sup>36</sup> Berle & Means at 64.

<sup>37</sup> 8 Del. C. ss 102, 151 *et seq.*

<sup>38</sup> This ownership is reflected in investment banks’ method of appraising the value of shares using a discounted cash flow (“DCF”) analysis, *i.e.*, the discounted present value of the corporation’s expected future cash flows.

board of director's discretion and legal capital requirements -- as well as a promise that, upon bankruptcy, she will receive any remainder of the corporation's liquidated assets after all other creditors have been paid off. She may alienate these intangible claims for any reason: she may offer them as collateral, loan them out, sell them, or exchange them.

B. *The Productive Contribution of Shareholders.*

The limited scope of shareholders' claim to corporate assets reflects their relatively negligible role in corporate productivity.<sup>39</sup> Clearly, most<sup>40</sup> shareholders never contribute labor to the corporation. Nor do they provide an overwhelming role financing the operation as "they do not, apparently, enter the stream of direct commercial or productive use."<sup>41</sup> Indeed, public corporations fund the bulk of their activities using debt and retained earnings,<sup>42</sup> while the value floating around on equity markets rarely makes it onto corporate balance sheets.<sup>43</sup> Regardless, even if shareholders might identify a distinct chain of title from their purchase of stock to some historical contribution to tangible corporate assets, those assets do not represent a substantial portion of the corporation's value, in both the "use" and "market" sense of the term. That value derives not just from the material stuff a corporation may acquire with proceeds from shareholder

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<sup>39</sup> See generally, e.g., Berle & Means at 65, 116 (stock has only market value, not use value, and cannot be consumed or used); Ferreira et al., Shareholder Empowerment and Bank Bailouts, Working Paper, Columbia-Oxford Conference on Corporate Governance after the Crisis, available at <http://ssrn.com/abstract=2170392>.

<sup>40</sup> Major exceptions include, for example, management with stock options and workers with ESOPs. But such are the exception, rather than the rule.

<sup>41</sup> Berle & Means, at xxxiv.

<sup>42</sup> McCall at 513; Berle & Means at xxvii.

<sup>43</sup> See, e.g., Berle & Means at xxxiv. Only during an independent public offering ("IPO") do shareholders contribute assets to the corporation. And an IPO does not occur - and cannot legally occur - on public stock exchanges. Thus, every transaction on the NYSE, NASDAQ and other securities markets represent secondary trading, i.e., money passing between the hands of stockholders, not between stockholders and companies. If anything, the markets represent an opportunity for a corporation to divest its assets when, for example, it "buys back" its own stock to bolster shareholder value by lowering supply.

contributions. It also derives from a complex web of human relationships, intellectual know-how, contracted skilled labor, and managerial expertise, all developed over time within a distinct social organization.<sup>44</sup>

In fact, one cannot even categorize many shareholders as “investors,” at least when understood as persons that give resources to a company in exchange for a share of business profits derived upon that donation. Buying and selling daily, or even less than daily,<sup>45</sup> many shareholders have no expectation of receiving dividends or sticking around for the company’s liquidation payout. Rather, such shareholders place bets about future public perceptions regarding the stock price, usually based on mere *predictions* about the company’s future cash flows – or, rather, predictions about other peoples’ predictions on the company’s future cash flows.

Finally, while shareholders do possess the legal capacity to oversee management as it directs the company’s operations, they often neglect their duty and, perhaps more controversially, exercise it to their own benefit and at the expense of the corporation’s viability. Shareholders, upon discovery of, for example, accounting fraud, will rationally divest their shares rather than undertake a difficult a campaign to oust incompetent or dishonest executives. Shareholders at least occasionally turn a blind eye to unlawful activity so long as that activity yields strong cash flows in the near term.<sup>46</sup> Moreover, because shareholders confront no legal responsibility to use their shares to enhance the

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<sup>44</sup> Berle & Means, at xxvi, xxviii. This is why, for example, a corporation “sells” at a much higher price as an operating entity rather than in liquidation.

<sup>45</sup> Or even, in many cases, in hundredths and thousandths of seconds, as is the case with high frequency trading.

<sup>46</sup> E.g., *In Re: Massey Energy Company Derivative and Class Action Litigation*, C.A. No. 5430-VCS (available at <http://www.delawarelitigation.com/files/2011/06/In-re-Massey.pdf>) (shareholders continuously voted to reinstate CEO and Chairman Blankenship, the notorious CEO who blatantly and publicly violated EPA regulations, leading to the death of 29 miners).

productivity of the corporation, they often exercise their authority over their shares to harm the corporation. They can, for example, sell their shares to a hedge fund (the new shareholder) that plans to dismantle the company, lay off its workers, and divest the remainder at preferable capital gains tax rates.<sup>47</sup> They can likewise invest in, or create their own, competitor business enterprises. They might even “bet” against the corporation through, *e.g.*, short sales.<sup>48</sup> This, then, is a real-life example of the fox guarding the henhouse. Finally, of course, there is no reason why oversight role must be played by shareholders. The Federal Government in fact gives several regulatory bodies the power to perform the same function.

Rather than serve as productive members of the corporation, shareholders’ function in the modern economy consists primarily of the following: (1) to provide liquidity to previous shareholders; (2) to set a market price for shares; and (3) to give corporations motivation to generate profits.<sup>49</sup> However, the connection of each these to the real economy -- the economy that serves to make things that human beings use and consume -- is arguably tenuous. Certainly, liquidity encourages first generation investors, *e.g.*, those participating in an IPO, to transfer assets into a growing corporation. Without an ability to exit their investment, initial investors may refrain from transferring resources to growing companies. Yet while a certain amount of liquidity is therefore desirable, its purpose might be fulfilled with stock markets significantly smaller than those that exist

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<sup>47</sup> Whether such activities lead to overall economic efficiency is a matter of intense debate within legal and financial circles. It must at least be conceded, however, that the motivation to liquidate takeover targets derives from beneficial tax results on the sale of capital assets as opposed to the income tax imposed on operating companies. Accordingly, at least some liquidations must be motivated not by overall productivity, but instead by conventional tax policy.

<sup>48</sup> Short sales can lead to a “run” on the company’s stock, driving down its price and thus leaving it vulnerable to takeover by a hostile bidder. A takeover of this kind may lead subsequently to liquidation of corporate assets, layoffs, *etc.*

<sup>49</sup> Berle & Means, at xxxiv, 248-49.

currently.<sup>50</sup> Meanwhile, as stated above, corporations can always raise capital through debt and retained earnings, perhaps mooted the need for shareholder liquidity altogether.

The connection of public the price setting function to the real economy proves even more tenuous. According to the “efficient capital markets hypothesis,” a theory used by analysts and courts alike, the stock market pricing mechanism incorporates and disseminates accurate information about company performance. Corporations, however, do not serve as the main consumers of such information. Rather, it is the unproductive shareholders that reap the benefits of accurate prices as they look for yield when making investment decisions.<sup>51</sup>

Finally, shareholders-as-owners do not play an irreplaceable role in engendering the profit motivation presumably necessary in a competitive capitalistic economy. Simply, no reason exists that singles out *shareholders* as the best suited to fill that purpose. When directors manage a corporation in shareholders’ best interests, for example, corporate decision-making may reflect short-termist attitudes that are harmful not only to the to the corporation’s long run health, but also to the health of the economy at large.<sup>52</sup> If, in contrast, a corporation were managed in the best interests of its workers, decision-making

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<sup>50</sup> See Glasner (describing diminishing returns on informational advantages created by securities markets). Recent market pushback against HFTs, lead by Bill Ackman (The “Silver Fox”) of Pershing Square Capital, likewise makes the point clear.

<sup>51</sup> Regardless (and Eugene Fama’s recent nobel prize notwithstanding), as evidenced by the notorious accounting scandals over the past few decades, markets do not always serve as accurate predictors of corporate financial health.

<sup>52</sup> See, e.g., Eduardo Porter, when discussing privately-run health care companies: “From the high administrative costs incurred by health insurers to screen out sick patients to the array of expensive treatments prescribed by doctors who earn more money for every treatment they provide, our private health care industry provides perhaps the clearest illustration of how the profit motive can send incentives astray. By many objective measures, the mostly private American system delivers worse value for money than every other in the developed world. We spend nearly 18 percent of the nation’s economic output on health care and still manage to leave tens of millions of Americans without adequate access to care.”



might likewise aim at profits - required for workers' continued employment - but reflect more long-term, stable and risk-averse policies. A corporation's major creditors likewise can encourage corporations towards profitability, lest they see their loans go bad.<sup>53</sup>

C. *Shareholders' Influence.*

Despite shareholders' somewhat tenuous relationship with corporate productivity, they are the only non-directorial "constituent" granted power over the corporation by the law. Only shareholders may elect the corporate directors that hold responsibility for corporate actions. Only shareholders possess any distinct claim, however nebulous that claim might be, to corporate profits. And only shareholders may represent the company upon management malfeasance. Furthermore, they need not seek permission from anyone before purchasing this influence. It therefore comes as no surprise that when discussions touch on the proper stewardship of corporations, it is to shareholders' unique benefit that the conversation turns.<sup>54</sup> As a result, many conclude that corporate actions are taken not in the company's long-term interest, but instead in the shareholder's more short-termist one.<sup>55</sup>

D. *Locke's Consequential Property Right and Public Company Shares*

The phenomenon of shareholding, then, does not appear to serve well the purpose that Locke used to justify an indelible property right. In his *Two Treatises*, Locke argued

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<sup>53</sup> Berle & Means at 69. In fact, German creditors play a notoriously substantial role in corporate governance. Typically, the *Hausbank* even has its own seats on the boards of their borrower clients.

<sup>54</sup> McCall at 517.

<sup>55</sup> See Strine; Eduardo Porter, "When Public Outperforms Private in Services," *New York Times*, January 15, 2013 (citing a book by Profs. Ray Fisman (Columbia Business School) and Tim Sullivan (Harvard Business Review, explaining that organizations of any form manage according to what's measured, e.g., stock price: "If what gets measured is what gets managed, then what gets managed is what gets done.');

McCall at 510. Note, however, that this view is controversial. See, e.g., Roe.

that this right proves strictly necessary to encourage the productive use of the world. Specifically, the natural property right (1) motivates the labor necessary to create useful items; and (2) serves a means by which men could consume and enjoy the products of that labor. As shares do neither in any substantial manner, at least in comparison to other factors of corporate production, imputing to them a natural property right in the corporation proves somewhat difficult.<sup>56</sup> Furthermore, shares lack much of the moral weight Locke assigned to the fruits of one's labor, derived from the incorporation of individual personality and effort into the commons left to humanity by God. Therefore, instead of justifying a share as an ownership interest in a company, Locke's theory can only support the existence of a property right in some kind of financial instrument.

(1) Stock Fails to Fulfill the Productive and Consumptive Functions of Property.

One might easily imagine a universe where public corporations continue to produce useful items without the existence of shareholders-as-owners. First, under Locke's theory, the exercise of natural reason (law) suggests the existence of a property right because without such a right, individuals would have little motivation to work to create productive and useful items. But shareholders *qua* shareholders<sup>57</sup> do not participate in the labor that creates corporate assets. Nor, as described above, does the labor used to purchase the shares, if any, provide the corporation's primary operating capital. What's more, as described above, shareholders may even willingly present obstacles to corporate

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<sup>56</sup> See Tully at 145: "If Locke were to justify the capitalist anywhere in the Two Treatises, one would think that he would say capital played at least some role in creating valuable and useful things."

<sup>57</sup> Some shareholders also serve additional roles, *e.g.*, a corporate CEO or pensioner who also happens to own company shares.

productivity.<sup>58</sup> Clearly, then, shareholders' ownership interest does not necessarily serve to encourage the productive labor championed by Locke.<sup>59</sup>

Moreover, even assuming the phenomenon of shareholding is useful to human industry, it is anything but apparent that an ownership interest in a corporation itself is necessary to encourage it. Instead, an ownership interest in the financial instrument, as a unique claim distinct from a claim over the entire corporation, will suffice. After all, shareholders appear to purchase their shares primarily because of the benefits of that financial instrument, *viz*, the ability to trade those shares with other prospective shareholders for a profit, and to collect dividends.<sup>60</sup> Indeed, most contributors to a corporation's productive activity claim no ownership interest in the company itself, but only to discrete parcels of corporate assets. The corporation sufficiently motivates its workers by providing them with a wage. It motivates the banks that provide operating cash with interest payments. The corporation's suppliers, contractors, and vendors likewise participate as a result of mutually beneficial contractual arrangements. If these parties participate productively without an ownership claim over the corporate body, presumably shareholders would be happy with the same medicine.

Nor do shares fit comfortably with property's consumptive function. Under Locke's theory, unless an individual first obtains a property right in something, and

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<sup>58</sup> For a particularly trenchant example, *see* Porter; *see also* Ferreira.

<sup>59</sup> Berle & Means, at 9: "It has been assumed that, if the individual is protected in the right both to use his own property as he sees fit and to receive the full fruit of its use, his desire for personal gain, for profits, can be relied upon as an effective incentive to his efficient use of any industrial property he may possess." The phenomenon of public shareholding, however, "raises for reexamination the question of the motive force back of industry and the ends for which the modern corporation can or will be run.").

<sup>60</sup> Shares actually function more like Locke's gold coin money, *i.e.*, a conventional instrument that men, through consent, assign value during barter. Coincidentally, investors trade stock like they trade currencies, betting on expected future (conventionally assigned) values.

unless others assume a concomitant duty to refrain from interfering with that right, the individual cannot use it. But, of course, shareholders *never* purport to use the corporation. They do not direct its routine business activities; nor do they do not consume the products it creates. To enjoy the fruits of corporate labor, shareholders must wait in the cashier line with everybody else. Rather, shareholders deploy the shareholding instrument as a gambler might place a wager while collecting any associated discretionary dividend distribution.<sup>61</sup> In fact, their claim does not differ in quality than the claim an employee has in regards to her wage or a bank in regards to its interest payment.<sup>62</sup> In each case, the individual uses not the corporation itself, but the discrete wage, payment, or dividend. And it is not the corporation, but the wage, payment or dividend that they may exclude others from enjoying. It is therefore only an ownership interest in the wage, payment or dividend that is necessary before such items can be useful to people.

(2) Stock Lacks Labor's Moral Justification for Private Appropriation.

Not only do shares-qua-corporate-ownership fail to serve the productive and consumptive function of Locke's natural property right, they also lack the moral weight that Locke assigns to the fruits of human labor. In fact, other corporate constituents appear to possess a much stronger ownership claim. Under Locke's argument, individuals may only justify the appropriation of the natural commons by mixing a piece of themselves, which they undoubtedly own, with the material world. Most shareholders, however, even if they purchase shares with the fruits of their own labor, never "mix" themselves with the corporation. In turn, as described above, the corporation rarely

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<sup>61</sup> Berle & Means, at 157-59, 219 (management controls dividends unilaterally, and can even manipulate the value of stock without shareholder consent through, *e.g.*, stock buybacks and splits).

<sup>62</sup> Berle & Means, at 246 (shareholders look more like bondholders than owners of a company).

“mixes” with the shares after the IPO. Meanwhile, the individuals and entities that *do* contribute their labor to the corporation remain easily identifiable. One might casually observe the productive contributions of workers, managers and executives, even though the relative inputs may prove difficult to measure accurately.<sup>63</sup> Likewise, one can identify with facility the undertakings of independent contractors and the resources and individuals associated with creditors and suppliers. Thus, at least when compared to the labor of these other contributors, one can conclude with some confidence that the labor of shareholders does not meaningfully direct or render useful the corporation’s material resources. Accordingly, shareholders cannot receive the benefit of the moral weight associated with labor.

### **III. Shares as Impermissible Property Rights in Political Authority.**

Given the depth and variety of productive efforts involved in a corporation, justifying *any* unique “owner” of a corporation proves difficult indeed. Past participants may be dead and gone, while current participants never bother to keep track of their individual contributions.<sup>64</sup> This difficulty is compounded by the fact that a corporation is much more than an accumulation of diverse material things, but instead a social organization within which a collection of individuals work together, over time, in

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<sup>63</sup> A common criticism of Locke’s ostensible labor theory of value derives from the impossibility to accurately distinguish the relative contributions of capital and labor. Though such valuation is perhaps unnecessary to pinpoint the existence of a claim -- though perhaps not a controlling or exclusive -- to the products of capitalistic production, the point is moot here, where the contribution of shareholders to capital itself is questionable.

<sup>64</sup> It is even more difficult to argue that the corporation, as an individual entity, owns itself. First, it is a conventional creation incapable of labor or, indeed, of performing any action independently of its constituent members. An artificial entity, for example, is incapable of possessing the moral authority assigned to labor as a justification for private property – unless one is willing to embrace the idealist theory of corporate personhood of Otto von Gierke – something a good liberal would be loathe to do. Any “ownership” must therefore derive from the rights of its constituent members. And, as explained here, it is nigh impossible to flesh out any unique ownership claim among those members.

cooperative productive activity. Nor do shareholders assume well Locke's title of "Master," even presuming that Locke anticipated modern capitalist relationships.<sup>65</sup> Shareholders, unlike Locke's "Masters," possess little to no direct control over day-to-day corporate operations and do not own its assets. Moreover, no identifiable contract exists between workers and shareholders that might establish legitimate consent to any Master-Servant relationship between them. *See* II.85.<sup>66</sup> In fact, shareholders may disrupt the employment agreement by, *e.g.*, voting in favor of a takeover. They likewise possess no individual responsibility to ensure wages are paid. Additionally, shareholders and workers cannot be said to have sort of single, organic "Family" unit envisioned by Locke; often, they cannot even identify each other. Indeed, if anything, it seems as if the corporation, and not the shareholder, is the "Master," as it acquires the fruits of the shareholder's labor, codified as "stock," and directs its use.

But Locke's theory nevertheless provides some guidance as we consider the legitimate role of shareholders. In fact, the assignment of shareholders' "ownership" interest resembles more the impermissible conventional grant of political authority over

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<sup>65</sup> The point is not uncontroversial. However, Tully and Stevens, for example, reject the hypothesis that Locke's "Master" is a modern capitalist as we understand today, and accordingly reject the application of his thought to justify the wage relationship. Tully at 139-41; Stevens at 431-32. Henry suggests that the best contemporary examples of what Locke referred to are the "independent contractor" and the sole proprietorship with maybe a few employees. Henry, at 618-20. Otto von Gierke would go even further, calling the capitalist corporation akin to the "lordship group" endemic to the middle ages. Gierke, at 212.

<sup>66</sup> The passage reads as follows: "a Free-man makes himself a Servant to another by selling him for a certain time, the Service he undertakes to do, in exchange for Wages he is to receive: And though this commonly puts him in to the Family of his Master but a Temporary Power over him, and no greater, than what is contained in the Contract between 'em." Free consent to a master-servant relationship reflects the fundamental Lockean concepts of individual equality before God, proprietorship over one's own person, and natural liberty. It is on these grounds, after all, that Locke builds his political philosophy. Given the importance of such consent, if it is impossible to discern clearly, it should not be assumed.

both people and goods.<sup>67</sup> Certainly, the *Two Treatises* barely touched on social arrangements outside the state,<sup>68</sup> perhaps because, in Locke's time, no institution other than organized religion could challenge state authority.<sup>69</sup> Nevertheless, given Locke's aim to protect human liberty from nonconsensual invasions, it is not unreasonable to expect that he might examine our modern institutions as he did the state<sup>70</sup> -- especially as those institutions, in many instances, control more resources and impact the lives of more people than do governments.

A. *The Company as a Political Organization.*

When comparing Locke's description of legitimate government, the similarities between corporations and political society become apparent. In fact, during at least one

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<sup>67</sup> I do not mean to argue that the grant of authority given to others, *e.g.*, a board of directors or a CEO, is permissible or that, even if permissible, their authority is wielded in a legitimate manner. Such is a topic for another paper.

<sup>68</sup> *E.g.*, families, Master-Servant relations, and religion. However, it can be observed that while Locke insisted that the family is not a political society, he also acknowledged that it could grow to become one -- just as traditional family units became monarchical patriarchies. *See* II.105 and discussion *infra*.

<sup>69</sup> Stevens at 425 (in Locke's time, worries of exploitation did not involve protocapitalists, but governments, *e.g.*, the forced extraction of goods and money to fund wars waged by absolutist states.). It is not unreasonable to expect that Locke would critique a similar kind of "forced extraction" committed by a non-conventional state-like actor, had it existed during his time.

<sup>70</sup> That Locke failed to mention business enterprise as a form of social organization is not dispositive. Hayes, for example, argues that Locke had in mind pirates and privateers as an example of non-conventional, yet truly political, society. Hayes, at 462-65. Furthermore, "[t]he possibility that voluntary associations may have helped Locke to form his concept of democracy is strengthened by the fact that he had first hand knowledge of voluntary societies as a participant in venture capitalism." *Id.* at 474.

In further illustration, it is not unreasonable to expect that Locke would consider corporations differently than he did the merchants of his own time. Locke presumed, for example, that market participants could not act as price-setters. He therefore alleviated merchants from any obligation to charge lower prices for their goods, even if others would starve without such generosity. Such is not the case now, as increased consolidation and decreased competition gives business a lot of power to set prices and to determine which goods it will distribute. Berle & Means, at xlvi ("The corporate revolution has changed [competition theory] by creating centers of economic power on a scale never previously known. For the most part, competition is no loner among the many...The inflexibility of administered prices is itself evidence of market power and presents its problems."). Given such power over prices, Locke might change his analysis of a merchant's obligations to the poor during times of scarcity. It would not be unreasonable, therefore, to expect that Locke would change his analysis towards merchants in other ways, according to other changes in merchants' relative power and resources vis-a-vis the rest of society. For a good analysis of corporate power and its relative immunity from competitive markets, *see* Parkinson at 3-50.

point in modern discourse, theorists directly analogized Locke's state to "a joint-stock company whose shareholders were the men of property."<sup>71</sup> It is this similarity that allows us to examine shareholders according to standards associated with legitimate government rather than those associated with simple private ordering.<sup>72</sup>

1. The Corporation and the State of Nature.

First, the corporation, like political society, arises to resolve some dilemmas associated with a Lockean hypothetical state of nature. Locke explains that political organization itself is a result of a competitive society where man's productive activity leads to scarcity and thus to occasional conflict. It can be argued that the corporation is likewise an outgrowth of this conflict, whereby men find that they must cooperate and pool resources to remain competitive. Indeed, Locke's state of nature, where men can govern their actions and possessions as they see fit without asking leave or "depending on the Will of any other Man," (II.4) can easily be compared to a simple capitalistic society where small businessmen peaceably compete against each other in the marketplace. *See* II.14 (commerce, barter, and truck comes before political society). Such a community,

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<sup>71</sup> MacPherson at 195.

<sup>72</sup> I find no conceptual dissonance in an argument that purports to re-orient group governance away from the language of modern day corporate law. In doing so, I admit to a conception of corporation that is not purely juridical. In fact, modern corporate law understands itself to be simply a toolkit that enables private creativity in group formation and activity. Such is evidenced by the universal availability of general incorporation, as well as caselaw that permits incorporators to organize the company pretty much as they like, and a judiciary that gives deference to those incorporators' intentions when interpreting internal corporate rules.

I would also note that, throughout its history, the English law touching on associations of people – whether economic or otherwise – has only ever served as a frustratingly inchoate "hedge row" that did not, and was never meant to, delimit and define the inherent nature of those associations. As so cogently and elegantly argued by F.W. Maitland, in his *State, Trust, and Corporation*, all sorts of human group activity grew up around a simple property legal relation called "trust" – from churches to universities, to bar associations, to professional societies. People simply used the laws as tools to achieve certain group purposes, and went about their business – often completely unrelated to the subject of the law – in their pragmatic English fashion. Accordingly, I find no conceptual dissonance in an argument that purports to re-orient group governance away from the language of modern day corporate law. In fact, modern corporate law understands itself to be simply a toolkit that enables creativity in group formation.



like Locke's state of nature, is not a state of license, but one of rules; a state where one wins not with brute force but with ingenuity and invention. *See* II.6.

However, market competitors, just as men's natural passions, make for bad judges in their own disputes as they violate contracts, commit fraud, thief intellectual property, and snooker naive customers into bad deals. *See* II.13. Participants will therefore seek allies to both protect themselves and to seek retribution. Moreover, as resources grow scarcer and the competition fiercer, the potential for such disputes will grow. And even lawful competition will lead to devastating bankruptcies and therefore to conflict as the losers come to resent the winners. Eventually, as explained eloquently by Dunn, "[e]xternal conflict, arising from the land hunger caused by economic development and population growth, combines with internal conflict to make government essential for the maintenance of internal order and the direction to the best advantage of the external protective power of the society."<sup>73</sup>

2. The Power Wielded by the Corporation is Political.

The best direction to protect society and to enable industry, however, leads, in a market society, not just to government. Though Locke delegated to the state man's natural right to enforce the laws of nature, *viz*, the laws protecting property and liberty and enforcing contracts and fair play, today, it is the corporation, and not just the government, that fulfills these purposes. In-house corporate institutions, for example, establish and enforce the relationships between bosses and workers, creditors and debtors,

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<sup>73</sup> Dunn at 118. *See also* Laslett at 104: "For by their very industriousness and rationality these people created inconveniences for themselves and the rest of mankind, setting up relationships between men through their ever- more-complicated contact with material things which defeated the control of individuals acting as lone executors of the law of nature. Conscious, co-operative control was set up, therefore, under governments where 'the Laws regulate the right of property, and the possession of land is determined by positive constructions.'"

customers and suppliers -- all of whom would otherwise be competing amongst one another.<sup>74</sup> Like the state, the corporation protects its constituents from external competitors by, *e.g.*, promising them regular salaries, providing them with training programs and pensions, defending them in lawsuits and, of course, by developing products to trade for material resources.

Legitimate actions aside, corporations act a whole lot like states.<sup>75</sup> Like states, corporations wield real power over the lives and liberties of their citizens. They use collective assets to direct individuals' daily activities and to allocate the resources they might have otherwise used to preserve and enjoy their lives.<sup>76</sup> *See* II.3.<sup>77</sup> In many instances, as in a state, no appeal exists regarding the actions and judgment of corporate authority.<sup>78</sup> Moreover, although corporations do not possess a conventionally legitimate power to exercise capital punishment, their coercive power is nothing to sneeze at; the threat of exile, especially during times of economic hardship, is real and meaningful.<sup>79</sup>

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<sup>74</sup> *See* Blair and Stout (expositing a team theory of governance, such that an appointed legislative weighs the relative contributions and appropriate rents to team members according to their investments, whether in the form of capital or "human capital.").

<sup>75</sup> Even modern economists concede that corporations are command structures, formed as a result of transaction costs associated with markets negotiating the relationships of all corporate constituents. *See* Ronald Coase (1937), "The Nature of the Firm," *Economica* 4 (16): 386–405.

<sup>76</sup> McCall at 524.

<sup>77</sup> The section reads: "Political power then I take to be a right of making laws with penalties of death, and consequently all less penalties, for the regulating and preserving of property, and of employing the force of the community, in the execution of such laws, and in the defense of the Common-wealth from foreign injury, and all this only for the Publick Good."

<sup>78</sup> The great majority of corporate decision-making is protected by the infamous "business judgment rule," and is therefore subject to veto only if (1) it violates some governmental law and (2) that law is actually enforced by victims with legal standing or a governmental agency. Most corporate actions escape one or both of these conditions.

<sup>79</sup> Of course, history is replete with examples of corporations exerting deadly force against rebellious "citizens." The 1920 "Battle of Matewan" in the coal mines of West Virginia is a notorious U.S. example. More egregious acts are not uncommon in developing states, where local governments wield comparatively less power. It should be noted, too, that while many states do possess a legitimate right to effect a death

Corporate authorities, like states, hold a monopoly on this power; one worker cannot fire another without the blessing of management.<sup>80</sup> Finally, corporations, like states, exist within a state of nature as against other corporations, competing ruthlessly, committing espionage, poaching assets, and even swallowing each other through economic conquest.<sup>81</sup> Some of them even sign peace treaties, albeit in the form of non-compete agreements and joint ventures. It should therefore come as no surprise that much of the practice of corporate governance reflects an understanding of the corporation as a state-like command structure. For example, corporate leaders, like state officers, are expected to set aside personal interests and to govern as a fiduciary in the best interests of the corporate body.<sup>82</sup> *See* II.149. They monitor and protect against violations of Locke’s laws of nature using settled and public rules, “private” security forces and administrative “courts” to police theft committed against their constituents by both insiders and outsiders. *See* II.124-27. Many corporate leaders are even elected pursuant to voting rights under specific procedural rules.<sup>83</sup>

### 3. Government and Corporations Share (Some of) the Same Legitimate Ends.

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penalty, their exercise of that right is often rare. It is therefore a little too simple to state that a corporation is unlike a state because, *e.g.*, it does not (usually) have an army *per se*. -- though many boast “private security personnel” that puts local police forces to shame.

<sup>80</sup> *See* ASU at 24 (one difference between states and private institutions is a monopoly on the legitimate use of force).

<sup>81</sup> This state of nature is better couched as the Hobbesian type, rather than the tamer, more peaceable Lockean version. *See* MacPherson at 18-37 (describing Ch. 11, Leviathan, the Hobbesian state of nature as something identical to that faced by corporate competitors, where men seek greater and greater power over others in order to obtain some future good, where power exists only in so far as it is in excess of that possessed by others, and where power serves as an ability to command the services of other men).

<sup>82</sup> McCall at 537, 562. In fact, directors cannot make decisions that are undoubtedly in the best interests of the shareholders, as opposed to the corporation generally and to its other stakeholders, until the board has unequivocally determined to sell it. At that time, and only at that time, directors have a clear duty to maximize the price to be realized in the merger. *See Revlon, Inc. v. MacAndrews Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) and its progeny.

<sup>83</sup> Berle & Means, at xxviii.

Not only do corporations function like states, they also, like the Lockean state, encourage the industry required by God.<sup>84</sup> According to Locke, “the increase of lands and the right employing of them is the great art of government.” II.42. This is precisely what corporate leaders do when they, *e.g.*, ensure that corporate stakeholders cooperate successfully over time, resolving their disputes and enforcing rules of behavior -- just as states enforce contracts of joint venture, coordinate trade regulations, and monitor monetary policy. Similarly, corporations protect the “lives, liberties and estates” of its citizens by growing and protecting the collective resources to be distributed, eventually, to all members. *See* II.123. And corporations, like legitimate governments, preserve “property,” at least when properly understood as the necessary means to achieve human preservation and industry. *See* II.93 (Government has no other end but the preservation of property).

B. *Shareholders’ Political Authority is Not Legitimate.*

Given that corporations look and act like governments, one may properly critique the wielders of corporate power in accordance with Locke’s political principles. After all, just as in Locke’s time, “economy prosperity provides much greater incentive to the abuse of power. Given that corporate leaders “are just as much sinful men as are their subjects, this power is certain sooner or later to be abused.”<sup>85</sup>

Locke’s principles suggest that when shareholders exercise their limited control rights over a corporation, they resemble the feudal lords that he condemned as covetous,

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<sup>84</sup> Dunn at 123-24 (“the primary function of political society is to make it possible for people to execute their religious duties in an environment with as much widespread innocent delights as economic progress can make possible.”) McCall argues that the “end” of corporations is to efficiently produce economically useful products. McCall at 546.

<sup>85</sup> Dunn at 119.

quarrelsome, contentious and lazy.<sup>86</sup> See I.41. Accordingly, property in “shares” cannot be used to justify dominion over all corporate stakeholders. Neither contributing substantially to the corporation nor gaining the consent of those who do contribute, shareholders may nevertheless elect a corporation’s leaders and determine when the body should be dismantled. They exert their power, directly and indirectly, to extract rents at the expense of others and without their consent.<sup>87</sup> Moreover, for example, when shareholders involve themselves in hostile takeovers, they fail to fulfill their Lockean obligation “to secure every ones Property by providing against those three defects above-mentioned, that made the State of Nature so unsafe and uneasie.” II. 131.

In fact, shareholders’ status as company leaders reflects, like the patriarchal monarchies described by Locke, a historical consent to authority that no longer holds in current society. II. 106-11. Just like family patriarchs, it is logical to expect that at some point, shareholders were active and accepted authoritative figures in smaller business enterprises. Employees not only were hired and fired with shareholders’ supervision, they could also identify the shareholders and explicitly consent to their supervision. Yet shareholders relinquished their natural authority when corporations became the diverse, unwieldy, multinational, and public organizations we see today, just as patriarchy became outmoded and illegitimate as political bodies grew.<sup>88</sup> II.108. They relinquished their

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<sup>86</sup> Henry at 613 (Locke defends the property of the rational and industrious against feudal lords).

<sup>87</sup> For example, by compensating CEOs with stock options, shareholders encourage them to operate the entity with an eye towards short-term profits (*e.g.*, layoffs, accounting fraud, offshoring) that may mean doom for the corporation in the long run.

<sup>88</sup> Similarly, Locke points out that historically, paternal authority was common because men found it natural to consent to the rule of amiable, well-meaning fathers. Locke found it important to point out that, however, such rule derives not from the nature of fathers, but from the consent of those governed. Similarly, while shareholders may have had legitimate authority based on consent and legitimate property rights based on labor, their role, like that of fathers, is not immutable. See II.106-08; *also, e.g.*, Dunn at 117.

authority, just as kings did, when their interests failed to correlate with those of their corporate constituency, *i.e.*, when

Ambition and Luxury, in future Ages would retain and increase the Power without doing the Business, for which it was given, and aided by Flattery, taught Princes to have distinct and separate interests from their People, Men found it necessary to examine more carefully the Original and Rights of Government; and to find out ways to restrain the Exorbitances, and prevent the Abuses of that Power which they having intrusted in another's hands only for their own good, they found was made use of to hurt them.

I.111.

#### **IV. Implications for Corporate Governance.**

The Original and Rights of corporate government, by analogy, is a topic meriting its own treatment. Because if shareholders do not legitimately wield authority in the corporation, we must then ascertain what such legitimate authority might look like and to whom it might be entrusted. Despite the ambition of this task, I offer here a few thoughts as to what Locke's principles might suggest.

We know, foremost, that no political society can be legitimate unless its powers derive from the rights of its subjects.<sup>89</sup> Accordingly, governmental authority must arise from the consent of citizens who may only delegate and entrust their own individual powers. A similar consent must therefore be obtained from the corporate citizenry. The identity of the corporate citizenry, unfortunately, is somewhat nebulous. Locke suggests that only property owners can participate in the majority necessary to form a legislative.<sup>90</sup> Yet, as discussed above, because no one in the corporation can be said to own distinct, traceable products of corporate labor, we might therefore reasonably conclude that *any*

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<sup>89</sup> Dunn at 124; Forde at 446 (justice is not social, but individual).

<sup>90</sup> This point is controversial. *See* Stevens at 423-25 for an overview of the debate. For my purposes, however, it is moot; it is impossible to ascertain any specific individual "property" within a corporation. All the corporation's resources, as explained above, are owned by the corporation, not any individual within it.

stakeholder giving some minimum contribution to the corporation's produce should be included. Each contributes labor, or the products of earlier labor, to create collective corporate property which is used, in turn, to create items useful and necessary to human life. Each such corporate constituent thus satisfies Locke's consequentialist definition of property; each is thus the "rational" and "Industrious" that Locke commends; and each therefore merits inclusion. This population might consist of workers, investors, and even some major customers, creditors, suppliers, and taxpayers. Participation rights, moreover, might be prorated to reflect relative contributions, such that the consent of long-term employee on a stock purchase plan has more weight than that of a short-term customer.

Following the formation of the legislative, we might apply Locke's ideas regarding arbitrary power, property, taxation and consent when dividing up corporate profits and allocating corporate resources.<sup>91</sup> For example, because the natural property right arises before government and is impermeable to its actions, we might conclude that the majority cannot resolve to deprive a minority of its fair contribution without its consent. *See* II.221 (government may not arbitrarily dispose of property).<sup>92</sup> Thus, an executive contributing .1% to corporate product should not be permitted to usurp 15% of corporate profits without the consent of the majority.<sup>93</sup> We could furthermore resolve that a worker, having "sold" the labor that was hers to the company, must be

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<sup>91</sup> Berle and Means, as an illustration, describe the powers wielded by corporate executives as tyrannical and autocratic: "The recognition that industry has come to be dominated by these economic autocrats must bring with it a realization of the hollowness of the familiar statement that economic enterprise is America is a matter of individual initiatives. To the dozen or so men in control, there is room for such initiative. For them tens and even hundreds of thousands of workers and of owners in a single enterprise, individual initiative no longer exists." Berle & Means, at 116.

<sup>92</sup> *Cf.* Berle & Means at 219: "It is entirely possible...that the corporate profit stream in reality no longer is private property, and that claims on it must be adjusted by some test other than that of property right."

<sup>93</sup> Bebchuk offers a review of the empirical evidence regarding executive pay structures and a cohesive argument against runaway executive pay.

compensated at a rate at least equivalent to what she could earn in self-sufficient production.<sup>94</sup> Else her consent to corporate government could be questioned as the fruit of coercion. Associated institutions, like labor unions and customer protection boards, could be formed to ensure the enforcement of these rights and to assure the legitimacy of consent.

Similarly, the proper laws of internal corporate conduct should reflect Locke's constrained rationality, *i.e.*, "the direction of a free and intelligent agent to his proper Interest, and prescribe no farther than is for the general Good of those under that Law...that ill deserves the Name of Confinement which hedges us in only from Bogs and Precipices." II.57. Therefore, if everyone is better off if workers are required to show up every morning at 9:00am, employees cannot whine about lost liberties. And finally, because the Lockean legislature must govern so as to escape the uncertainties of the state of nature, so too must the corporate legislature publish and enforce clear rules, enforce established relationships and claims, and punish violators. II.136.

## **VI. Conclusion.**

Of course, the topic of legitimate corporate governance merits a much more thorough treatment than that offered here. Nevertheless, it is important to note that this treatment is not only possible, but also that it would not demand any significant social upheaval to meet its conclusions. In fact, much of corporate law and practice already reflects many of Locke's principles. For example, in continental Europe, worker and creditor representatives sit on boards, union representatives negotiate equitable, non-coercive wages, and authorities distribute the bulk of profits not to detached public

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<sup>94</sup> Henry at 613; Cohen at 307-08.



shareholders, but to other corporate stakeholders. Shaking off the yoke of the feudal shareholder, then, might just be a political revolution that we can undertake without fear of defeat or violence. And at the very least, it should convince us to take a second look at the neoliberal institutional reforms that demand that the developing world adopt the same kind of shareholder capitalism so far embraced by the U.S. and U.S. For if we laud the salvo against authoritarianism provided by privatization, we should beware substituting one form of hierarchy for another.

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