

Corporate rights and responsibilities: restoring legal accountability

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The owners and directors of corporations must be made accountable in law for their actions. Owner-shareholders and top executives exercise immense power, both globally and locally, but are not responsible in law for their actions. This immunity is provided by the legal principle of limited liability.

Society needs successful businesses, but today business is taking over society. It is as if an over-indulged child had taken more and more liberties until it is entirely out of control. Everyone wants the child to do well, no boundaries are set, and before you know it the family is under the thumb of a teenager gone wild. The deep irony is that it is the unfettered rise of corporate power that presents the biggest threat to free markets, and to the ability of free markets to promote individual freedom, equality before the law and equitable prosperity.

The arguments in this article will be discussed at a conference on Corporate Accountability, Limited Liability and the Future of Globalisation [1] organised under the auspices of the Centre for International Studies and Diplomacy (CISD [2]) at the School of Oriental and African Studies (SOAS) in London on 20-21 July 2007

Also by Stephanie Blankenburg & Dan Plesch, a discussion paper for a meeting at the Royal Society of the Arts in London on 26 April 2007 on Limited Liability: essential protection or evasion of responsibility? [3]

The widespread concern over the impact of corporate power is expressed through efforts to achieve corporate social responsibility [4] (CSR). Sadly, CSR has not delivered on its expectation, mostly because it relies on voluntary action and lacks the legal teeth to change business behaviour. Corporations still have the rights of a person, but none of the responsibilities. They campaign to remove legal regulations they say impede their businesses, just not the one they benefit from. Now corporations are pressing for society to become totally organised on corporate lines as they take over community- and state-run services. This totalitarian momentum [5] is solidifying the "tyranny of the unaccountable few" as the new world order of the 21st century.

Today, fifty-one of the world's largest economies are corporations, and 80% of world industrial output is produced by only 1,000 corporations. Cross-border mergers and acquisitions by collective investment funds - a prime measure of the concentration of corporate power - are thirty times higher than at the end of the 1980s. At the same time, the share of wages [6] in the United States's gross domestic product (GDP) is the lowest on record (since 1947) while the share of corporate profits [7] is the highest since the 1960s. A similar picture emerges for all industrial economies, in particular leading European Union member-states.

A mantra of irresponsibility

Limited liability is at the heart of this rise of corporate power: it constitutes a blanket exemption of a special-interest group from accountability for the actions of their companies. While the mantra of "no rights without responsibilities" is used to regulate the behaviour of poor people who benefit from social-security payments, "the unaccountable few" enjoy feudal privileges. Owner-shareholders (and by extension manager-directors) are beyond the law to an extent not enjoyed by the central committees of communist parties, similar to the despotic monarchies, dictators and tribal leaders over which liberal western societies claim moral supremacy, and akin to the aristocracy in the *ancien régimes* of pre-enlightenment Europe

Adam Smith [8], the brilliant economist and guru of free-marketeers, was also a staunch opponent of limited liability. In 1776, he wrote: "To establish a joint stock company [shareholding corporation], however, for any undertaking, merely because such a company might be capable of managing it successfully; *or to exempt a particular set of dealers from some of the general laws which take place with regard to all their neighbours, merely because they might be capable of thriving if they had such an exemption, would certainly not be reasonable.*" Smith's objection - carefully omitted from the praise heaped on him by free-marketeers with no worries about corporate power - makes a simple but powerful point: a democratic and free society should not exempt some people from general laws simply because their business may thrive as a result.

If equality before the law is to have any meaning, it must apply to human beings, not fictitious persons, and organisations must not be handed blanket exemptions from accountability simply on the grounds that they can thrive through privilege. We cannot, on the one hand, treat corporations as if they were just any person, and on the other, invest them with unequal protection. Otherwise, we are guilty of a double blindness to power: disregarding it by setting human beings equal to powerful corporations before the law, and disregarding it again by granting special-interest protection to the powerful through limited liability.

Advocates of limited liability ignore these fundamental considerations and argue that limited liability is an ingenious device [9] to raise equity finance and thus to promote productivity growth that benefits everyone. It is implied that without it society as we know it would collapse.

This is simply wrong. Limited liability [10] was not a precondition of industrialisation anywhere in the world at any time. In the first industrial countries, notably Britain and the United States, it was one of its outcomes, promoted by already existing modern business interests (many of these very large). In 1900 only around 10% of British companies used limited liability. In follower-up countries, from Germany to Japan and South Korea, equity finance played a minor role in financing industrialisation. Limited liability and the shareholder mentality have only gained real ground over the past three decades with the rise of global financial deregulation and neo-liberalism. World growth has slowed at just the time that limited liability has become dominant. The growth-rates of world output almost halved from an annual average of 4.8% in 1960-80 to only 2.9% in 1980-2000. Similarly, the growth of labour productivity has slowed down from an annual 2.5% to 0.8% for the same periods, respectively. In addition, income inequalities across the world have escalated, and the world has suffered over seventy severe financial crises since 1980 (see Robert Wade, "Globalisation: emancipating or reinforcing?", 29 January 2007 [10]).

Worse, many of the fears voiced by opponents to the introduction of limited liability in Britain and the US in the 19th century - that it was likely to facilitate sluggish management and to encourage irresponsible risk-taking and speculation at the expense of society as a whole - have been more than borne out. Corporate fraud and corruption are rampant. Even as leading international organisations call on governments to ensure "good corporate governance" (for example, the OECD in its 2001 study *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* [11], and the European parliament's resolution of 13 March 2007), companies all

over the world scramble to take advantage of new legislation to facilitate access to limited liability in order to walk away from the damage they have caused or may cause in the future.

An August 2002 report on nuclear-power plants in the United States by the Stand for Truth about Radiation (Star Foundation) Riverkeepers [12], working in the Hudson River area of New York state, leaves few doubts: "Over the last ten years, the ownership of an increasing number of nuclear plants has been transferred to a relatively small number of very large corporations. These large corporations have adopted business structures that create separate limited liability subsidiaries for each nuclear plant, and in a number of instances, separate operating and ownership entities that provide additional liability buffers between the nuclear plant and its ultimate owners. The limited-liability structures being utilised are effective mechanisms for transferring profits to the parent/owner while avoiding tax payments. They also provide a financial shield for the parent/owner if an accident, equipment failure, safety upgrade, or unusual maintenance need at one particular plant creates a large, unanticipated cost. The parent/owner can walk away, by declaring bankruptcy for that separate unit, without jeopardizing its other nuclear and non-nuclear investments."

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The end of an illusion

Limited liability means "power without responsibility" and it is spreading fast. Originally a privilege only of publicly-quoted corporations, it has recently been extended to partnerships and to the professions in many countries. Many of the private-equity companies that are rapidly gaining themselves a reputation for asset-stripping and ruthless job-cutting [20], and many of the biggest accounting companies implicated in corporate scandals (such as Arthur Andersen in the Enron case [21]), are limited-liability partnerships. The winners are the big players - the

director-managers of large limited-liability companies speculating for the short-term "big buck" with impunity.

In 2006 alone, the top twenty-five hedge-fund managers took home a combined \$15 billion. The losers are the small creditors and shareholder-owners, and the employees of companies wrecked by short-term greed. When Farepak Ltd [22]- a British "Christmas club" in which mostly low-income families saved to buy seasonal gifts for their children - went bankrupt in November 2006 because of unreasonable management decisions by its parent company, the price was paid by its unsecured "creditors": 120,000 people lost £40 million savings. Meanwhile, majority shareholder Nicholas Gilodi-Johnson [23] received £62,000 a year, apart from his estimated share dividend [23] of almost £445,000. Of the other Farepak directors at the time of the disaster, Clive Thompson was paid an annual consultancy fee of £100,000 and chief executive William Rollason a £275,000 annual salary; their company pensions will be paid by the taxpayer under an insurance scheme.

Today's legal structures allow private companies to raise astronomical amounts of finance from the public in the time it takes to bat an eyelid and to employ these resources as they see fit behind an iron wall of secrecy and freedom from legal accountability. It is time to end the illusion that limited liability - and the profits it creates - is a natural good.

But it will do no good to threaten those who engage in innovative business activities with possible ruin when things go wrong by abolishing all recourse to covering for risks. At a minimum, a proper understanding of limited liability demonstrates the privilege that comes with wealth and provides an argument of redistributive and progressive policies based on the property rights of society as a whole rather than on morality and charity. The government regulation that protects shareholders must be balanced with protections for other parts [24] of society. Limited liability must be restricted so that it no longer shields criminal and otherwise fraudulent behaviour.

In the longer term, a common-sense approach would replace limited liability, as it stands, with an insurance system with clear and socially agreed criteria for the appropriate insurance of particular investment risks on the basis of scientific and societal debate and discussion. Shareholders would then have an incentive to create a race to the top, as the values espoused in the non-binding codes associated with corporate social responsibility would become criteria for low-insurance premiums.

To effect such change the debate needs to be prompt and global. Reforms should be considered through a range of institutions and processes: via provisions in the World Trade Organisation negotiations; in European Union [25] bodies in Brussels; in parliaments and state houses. In an atmosphere of renewed calls for deregulation our starting-point is to turn the argument around and say: if regulated protection is the problem, let us begin with the immunity given to shareholders.

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