Key points

- Theories about corporations law come from politics, sociology, economics and law.
- From politics we get ideas about:
  - little republics
  - constitutionalism
  - political critique
- From sociology we get:
  - theories of the company
  - structuralist: weber and marx
  - empirical studies
  - institutionalist economics
  - stakeholder theory
  - team production theory
  - liberalism
- From economics we get:
  - economic explanations
  - normative or welfare economics
- From law we get:
  - judges’ concepts and principle
  - legislation
- Being aware of the perspective from which theory operates can help you make sense of it.
- Various ways to categorise theoretical approaches include focusing on:
  - discipline
  - genealogy
  - calculated purpose
  - systemic focus
  - purpose, law and effect

Introduction

Why theory?

Ever since law began to regulate human beings, the nature and interior structure of corporations and their relations with the legal system have had to be explained. A multiplicity of concepts, principles and theories has developed inside the law and from other disciplinary perspectives. Because they represent ways of thinking about corporations, these theories are also deployed to explain or recommend what the law should be and to criticise the way it is or is going to be. And because corporations are the legal manifestation of firms within the economy and society, considerable cross-fertilisation of ideas occurs between disciplines concerned with economic and social analysis.
How to deal with theory

This section maps the terrain of corporate law theory.1 Most is set out in disciplinary terms—from within a categorisation based on the disciplinary perspectives relevant to corporations law. However, disciplinary perspectives inevitably compete and contradict one another, and their differences lead to considerable confusion if they are just set out and left to the reader to make sense of. The last part of this section, ‘Making theory work for you’, presents a way of coming to a more textured and subtle understanding of the various theories, concepts and principles that underpin the operation corporations law. This will assist you in the preparation of assignments and essay writing.

Politics

Little republics

Early justifications of incorporation by registration turned to political theory to explain what it was that was produced.2 Some nominated companies as ‘little republics’. In this way the self-regulating characteristic of a company could be explained as ‘constitutional’ and ‘law-making’. It also provided a way of thinking how those involved, the members, could be treated as a unity without prejudicing their characteristics as members of society at large. In this sense the traditional sources of the idea of the corporation—the self-regulating towns and guilds—were a model for the company, reinforced by the experience of the great quasi-state corporations of the East India Company and the Hudson’s Bay Company. A distinction could be drawn between the non-incorporated joint stock company, which had developed as a set of contractual or fiduciary relationships, and an organisation with inherent powers to make privately binding rules.

Constitutionalism

The idea that the corporation can be viewed as something more than the sum of its parts with some sort of inherent sovereignty resonates throughout law and legal writing. Early cases justify a policy of judicial non-interference in the internal affairs of a company by reference to the limits of jurisdiction of the Court—a clear recognition of the pluralism of multiple sovereignties.3 In various parts of the British Empire there were, and still are, experiments with the representation of tribes of peoples (usually indigenous) as companies.4 This approach reached a doctrinal high point with Automatic Self-Cleansing Filter Syndicate Co.

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3 See especially Pender v Lushington (1877) 6 Ch D 70.

where a delegation model of the internal structure of corporate governance was held to be merely an application of a constitutional understanding of the corporation. Yet just as this highwater mark was reached, a turn to liberalism occurred. Liberalism invented a contract law freed of substance, which refocused thinking on freedom rather than binding community ties. And the new conceptualisation of ‘society’, along with the social sciences of sociology and economics, reconstructed legal epistemology and its evaluation of law. Law retreated to doctrinal formalism.

Political critique

Although one of the glaring omissions in Marx’s thinking was his failure to account for the rise of the corporation, his legacy can be found in the writings of Berle and Means. In their famous study of the structure of US business, Berle and Means found a separation between ownership and control, and described management as a ‘self-appointed oligarchy’. Their findings formed the basis of half a century of critique, beginning with the famous debate conducted in the Harvard Law Review in 1932 between Berle and Dodds over the issue ‘For whom are corporate managers trustees?’

Less polemical political critique continued with the work of James Willard Hurst, who developed the idea of the legitimacy of the business corporation. This he measured using two criteria: utility and responsibility. Responsibility had a dual nature: the internal responsibility of those upon whom the corporate form conferred power and their responsibility to society. Legitimacy, more narrowly conceived, impelled a critique of the substance of the internal relations of companies by Stokes.

Out of this strain of thinking came the ‘corporate governance’ movement, which is concerned with the way power consolidated by corporations law is deployed and should be controlled. Hurst’s distinction between societal and internal responsibility is retained. An enormous number of studies focus on corporate governance, and most are descriptive of the systems set up within the law for the control of power, yet few have any coherent idea of the ideals for which their recommendations strive. ‘Bad things’ are identified from outside the province of the study. Many studies focus on the means by which power might be controlled, and hence focus on the techniques of law—on ‘soft law’ as opposed to command and control, or on ‘comply or explain’ approaches. Many take on board regulatory theory, especially in the form of Braithwaite’s regulatory pyramid. Even Teubner’s concept of ‘autopoietic law’ is deployed to redesign the nature of law on more ‘reflexive’ lines than the traditional ‘command and control’ model.

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5 Ltd. v Cunninghame. Where a delegation model of the internal structure of corporate governance was held to be merely an application of a constitutional understanding of the corporation. Yet just as this highwater mark was reached, a turn to liberalism occurred. Liberalism invented a contract law freed of substance, which refocused thinking on freedom rather than binding community ties. And the new conceptualisation of ‘society’, along with the social sciences of sociology and economics, reconstructed legal epistemology and its evaluation of law. Law retreated to doctrinal formalism.


7 (1931–2) 45 Harvard Law Review 1145 and 1365.


A very recent political approach can be found in Stephen Bottomley’s *The Constitutional Corporation: Rethinking Corporate Governance.* 13 Bottomley looks back to an appreciation of corporations law as constructing political institutions. A new constitutional appreciation of the corporate form would lead to three principles upon which corporations law should be founded. First, accountability through differentiation of the board of directors from the shareholders and a separation of powers between them; second, deliberation, in the sense that decisions should be the product of deliberative processes; and third, contestability of decisions.

**Sociology**

**Theories of the company** 14

Around the end of the nineteenth century incorporation became much more common. It was no longer confined to large businesses. Pressure built up for an explanation of just what it was that incorporation created. A number of explanations of the company ensued, each with implications for doctrines of law. These drew on an understanding of the components of a society structured by law.

The ‘corporation as fiction’ view has been on the scene since the *Case of Suttons Hospital* of 1612. 15 This theory arose by necessity from the idea that law regulates human beings. Representation of certain organisations as corporations was justified by accepting that although in reality they are not human beings, courts can treat them as if they were. The corollary is that there is no limit to the jurisdiction of courts and Parliament over laws as to corporations.

The ‘bracket’ theory was taken to be an alternative vision, although it is not essentially so. It envisages ‘corporation’ as a shorthand for a whole set of rules about the relations between human beings that is deployed to simplify those rules. Thus, for example, limited liability becomes a way of expressing an extraordinarily complicated set of terms in contracts.

The ‘concession’ theory switches focus to substance rather than form by acknowledging that incorporation confers advantages, whether or not in the form of default terms in implicit contracts. It directs attention to the bargain that the incorporating authority can offer in return for the advantages in incorporation regulation that can be imposed. It recognises that if the costs of regulation outweigh the benefits, firms will not be incorporated bodies.

The ‘realist theory’—unlike the previous three, which are all versions of much the same thing—denies that society is comprised only of human beings. The subjects of law include those institutions with the capacity to will; these, states the theory, are what incorporation recognises. The theory thus places limits on the capacity of law to regulate by constructing an irreducible minimum of corporateness. Deriving from German sociology of the 1890s, it was received into common law jurisprudence only in translated form, but it had the profound effect of facilitating an anthropomorphic approach to acceptance of the corporate form into areas of law designed for human beings. Hence Lord Denning in particular referred to the company as having a ‘head’ and ‘brains’ when formulating reasons why it might have an intention for the purpose of intentional torts and crimes. 16

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15 10 Co Rep 23a.

16 *H.L Bolton (Engineering) Co Ltd v T.J Graham and Sons Ltd* [1957] 1QB 159 at 172.
These theories assume that persons, even group persons, are the basic unit in society and are concerned with their legitimacy as such. Law then regulates legitimate, or ‘legal’, persons. Given the assumptions of each theory, implications flow for that law. The law of legal persons is not otherwise explained. Moreover, the implications for each theory sometimes do not match existing or potential legal doctrine: they are disproven, if you like. Yet further, the explanations are limited; for example, they tell us little of how internal relations in corporations are to be regulated. Description is useless if it is simply wrong or incomplete.17

**Structuralist sociology**

Sociology is the study which endeavours to describe the development of human society. Scanning through sociology texts reveals that remarkably little is said about corporations law. There is material on the economic system and firms, much about Weber’s adumbrations on bureaucracy, and much about laws in general, especially criminal laws, but little about corporations.

Sutton and Wild18 combine the worldviews of Weber and Marx, although with much greater emphasis on the former. They provide a description of the development of corporations law, identifying the ideas which in their opinion have special bearing on the attempt to control capitalist enterprise through corporations legislation, and provide some indication of how change is to be evaluated.19 Paddy Ireland20 and Sally Wheeler21 further explore this terrain, yet it remains a substantially incomplete project.

**The empirical tradition**22

A lively empirical tradition has been seen in corporations law, especially over the last twenty years or so. This includes an explosion in the numbers of empirical investigations into the workings of firms where the concern is to ‘map the contours of corporate Australia’.23 The earliest empirical work was on interlocking directorships and cross-shareholdings; in many ways this work explored aspects of the Berle and Means theses.24 On specific topics, there has been more recent work on insider trading,25 institutional investors,26 board structure and

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17 For a devastating, if unfair, critique, see M Wolff, ‘On the Nature of Legal Persons’ (1938) *Law Quarterly Review* 494
See also H L A Hart, ‘Definition and Theory in Jurisprudence’ (1954) 70 *LQR* 37.


24 Ibid.

corporate governance and corporate accountability. The preferred technique for these studies is to interview members of corporate Australia and report what they say. In many respects these become ‘gap studies’, to use the terminology adopted in Bottomley et al., following in the footsteps of Stewart Macaulay’s seminal study. Even more recently there have been studies of the use of various provisions of the Corporations Act. These include of the oppression remedy in sec 232 and enforcement of statutory duties.

Institutionalist economics

By a side wind, sociology from the start of the twentieth century has again become relevant. Ferdinant Tönnies distinguished between ‘gemeinschaft’ and ‘gesellschaft’, between community sustained by bonds of feeling and groups sustained by an instrumental goal. The corporation is perhaps the paradigm example of the instrumental. In his exploration of these ideas, Tönnies distinguished between types of community, including agreement and organisation. Taxonomies of the characteristics of each have become critical in the ‘institutionalist’ approach to law and economics. These theorists combine the descriptive approach of Tönnies with the transaction cost economics of Coase to propose that the reason one form of organisation is chosen over the other is expense: it costs less to use one than the other in the particular circumstances. Tönnies’ descriptive categories become lists of relevant transaction costs, generally organised in one way or another.

Stakeholder (or enterprise) theory

Legitimacy was raised as an evaluative criterion for corporations law by the work, categorised above as ‘political’, of Hurst. Some time earlier, the American Realists had identified the

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33 Ferdinand Tönnies, Community and Society, Charles P Loomis (tr. and ed.), Harper & Row, New York, 1957.


effect of laws on ‘interest groups’ as a key tool in evaluating law. Reacting to the narrow focus of the economics of corporations law, many US theorists combined the views of Hurst and the Realists for concepts and principles to serve the interests of those affected by corporations law as the key evaluative methodology.  

These ideas have become allied with the doctrines of civil law jurisdictions and the corporate governance movement to produce a set of theories known as ‘communitarian’ approaches—ironically reflecting Tönnies’ ‘gemeinschaft’ model. The communitarian approach is that the corporation represents an arrangement between key interest groups, and the role of management is to negotiate between them. The latest in a long line of such communitarian approaches is ‘team production theory’, highlighting the contribution of the contributors of inputs into the enterprise represented by the corporation. The corporation, with its appurtenant governance structure and distinction between the inside of its regulatory coverage and its contractual outside is a means of mediating the interests of the various team members.

Stakeholder theory is problematic because it presumes what it is designed to solve: the identity of the stakeholders, the homogeneity and solidarity of their interests, and the processes—beyond begging its own question by nominating them as ‘balancing’—by which competing interests are to be resolved. The stakeholder approach also often fails to perceive the limitations of legal discourse, sometimes even to the point of conflating the organisational or economic idea of the firm with the legal concept of corporation.

Some Australian authors argue that corporations law is limited in its ability to serve the interests of those who are adversely affected. In other words, corporate conduct cannot be controlled through corporations law. Thus, for example, Ayres and Braithwaite think that it may be controlled through the application of organisation theory. Blair and Stout’s ‘team production model’ is directed at this very point, arguing that corporations law is simply an element in the facilitation of enterprise.

Liberalism

At each point in time certain perpectives or prevailing ways of thinking can be said to be paradigmatic. These have been variously identified, particularly by post-modern social theorists. Whatever you might think of the arguments themselves, liberalism heavily influenced political philosophy of the nineteenth century; state welfarism was very influential in the mid twentieth century; and neo-liberalism is the prevailing political orthodoxy.

Liberalism focuses on the individual, emphasising their freedom subject only to their duties, from which personal liability flows. The stress on the individual can admit ethical criteria, especially through utilitarianism and hence economics. Corporations law developed

into its present form during the nineteenth century. Thus it is often argued that liberalism pervades the field. Yet a paradox is revealed. How does liberalism accommodate the essential idea of the corporation as a group enterprise?44

The tension within corporations law between its context—a legal system founded in liberalism—and its nature—recognising and encouraging productive collective enterprise, runs the argument—leads to the conceptualisation of the nature of corporate law as addressing three fundamental questions:

- To what extent and by what concepts is the collectivity to be recognised rather than the individuals who comprise it?
- What does ‘recognition’ mean within the legal system as a whole?
- Given that liberalism is about freedom from the fetters of state regulation, how and to what extent does that apply to corporations?

Liberalism posits a particular ethical framework, one articulated most clearly in welfare economics. In seeking efficiency we start with the preferences of individuals. This leads to a strong critique. The social is relegated to being part of the preference set of individuals.45 Yet that the social exists apart from individuals, or that individuality is constructed, are equally viable points of view not accommodated by liberalism.46 To be sure, we can adopt the ethical precepts from which liberalism is derived, but in doing so we choose those precepts from equally valid alternatives.47 This choice is implicated in the political issues resulting from the challenge to liberalism by group enterprise, and should thus be contemplated within a theory of corporations law. This argument is made most vigorously by feminist writers, who would also argue that even if one accepts an individualist ethos, as conceived in law the individual is a man, so the female is marginalised.48

Economics

Economic explanations

Many economists have attempted to explain the firm as a part of the economy. Famously, the originator of modern economics, Adam Smith, thought the joint stock company a contradiction in terms.49 Why would the directors and trustees not simply run off with the money? But as the theorems of economics became refined, towards the end of the nineteenth century the discipline focused on the rational actor as the unit of analysis. This left the dynamics of the way firms worked in the supply side of a market (apart from being assumed to profit-maximise) somewhat less than obvious. Coase made an attempt at explanation in 1937 with ‘The Nature of the Firm’, drawing on transaction costs: in many circumstances it is more expensive, he said, for people to associate together by contract than in firms.50 As was explained under ‘institutionalist economics’ above, this was later associated with Tönnies’

taxonomical project to apply the transaction costs approach to the structure of productive relations.

In the 1970s the expansion in economic reasoning reached law with Posner’s seminal study, *Law and Economics*. Economic reasoning was applied to firms towards the end of that decade to produce a theory of the firm. This theory reduced the relations involved in production in firms to a series of transactions, important among which were the relations between shareholders (or ‘stockholders’ in US parlance) and management. For this reason it is often called the ‘contract theory of the firm (or corporation)’. Those transactions were analysed as setting up relations of agency, hence the theory is often alternatively called ‘agency theory’.

The transactions shareholders make hand wealth to managers to deal with in the interests of the shareholders. It is supposed that rational actor managers in this situation would look after their own interests rather than the interests of the shareholders. Hence a series of ‘agency’ problems present themselves. The theory then proposes that these are dealt with in a number of ways, starting from the arrangements between those involved. Law intervenes to modify or provide those arrangements. Markets also discipline management through the threat of corporate failure in the product market and through threat to the jobs of management resulting from the operation of the market for corporate control. The market for management positions provides incentives for managers to be honest and work hard, goes the theory.

The agency theory has been developed in a multiplicity of ways to account for many of the features of corporations law. Legal personality, fiduciary duties, the vote and so forth all received multiple detailed coverages. In Australia, most of these developments were simply reported as given, even though the legal context of corporations law is very different here.

**Normative or welfare economics**

Economics writers did not stop at description. The point of Adam Smith’s writings in the middle of the eighteenth century had been to recommend an alternative to mercantilism—the hoarding of wealth by nations. His recommendation was that trade and specialisation made possible by markets was a far better proposition. Economists have not stopped recommending since then. By the turn of the twentieth century Eduardo Pareto had convincingly formulated efficiency as a criterion of welfare and asserted that it was produced by competitive markets. Exactly how markets worked was comprehensively studied during the twentieth century and recommendations as to how efficiency might best be achieved within firms followed soon after the agency theory was developed.

Most of the recommendations from the contract theory were simply that regulation in the form of corporations law could be stripped away. In particular, the recommendations favoured shareholder primacy—that shareholders should be left to determine what the best contracting structure was for the firm and that the law should, if anything, favour the idea that managers should look after the interests of shareholders alone. The main function of law was to proffer terms to shareholders, which they could accept or reject as they saw fit. Oddly enough, as we shall see, this is indeed the core structure of Australian corporations law.


52 The principal actors in the development of this school of thought were E Fama, M C Jensen and W Meckling. The seminal article is, perhaps, M C Jensen and W Meckling, ‘Theory of the Firm, Managerial Behaviour, Agency Costs, and Ownership Structure’ (1976) 3 *Journal of Financial Economics* 305.


Nevertheless, in an exercise of extreme cultural cringe, Australian academics and law reformers have espoused and emulated the structure of US law simply in order to reform it in the direction recommended—ironically, towards what is was in the first place. An example is the idea of replaceable rules instead of Articles of Association.

The normative validity of the contract theory was challenged when US economists eventually realised that their picture of corporations law and firm structure was not representative of all jurisdictions. In particular, civil law countries did not adhere to the shareholder primacy model at all. This realisation produced three responses. The first felt satisfyingly hegemonic: that despite appearances, globalisation was forcing all corporate structures into the shareholder primacy model.\(^{55}\) The second accepted difference and asked, ‘What made it happen?’ Bebchuk and Roe drew on a chaos theory analogy to talk of path dependency and sensitivity to initial conditions and hence to raise to the fore cultural differences.\(^{56}\) The last accepted difference but said the US model was better because it produced deeper and stronger capital markets and hence cheaper capital. What mattered, these studies said, was well-defined property rights, including minority protection, and enforcement of securities laws.\(^{57}\) When measures of share value between US and other systems were compared, US shares were valued higher simply because they were within the US system. The result is that capital is cheaper in the US. Naturally, from this flows a good deal of advice for other systems.\(^ {58}\)

**Law**

**Judges**

Judges as theorists are in the unfortunate position that they are required to produce an answer to the problems they face. Academics can put a matter aside until a solution seems viable, and tend not to feel the least bit guilty if what they say proves to be quite wrong. Judges swear an oath not to avoid deciding and they know that if, in deciding, they get it wrong they cause damage. Thus they tend to avoid theorising, relying on the doctrine of precedent to produce systemic adaptations to change within society. Despite this, judges are creatures of their time and their thinking falls within the contemporaneous discursive formations. Moreover, precedent produces path-dependent legal thinking. Consequently certain concepts and principles are etched within the structures of any field of law. Corporations law is no exception.

Important principles now enshrined in the law to regulate the internal relations of corporations are: encouraging strong central control of business enterprise; allowing managers to get it wrong, provided they make a business judgment; majority rule; the share and its incidents as property rights; prevention of abuse of power; and minority protection. Less obvious now is the idea of the purpose or object of incorporating.\(^ {59}\)

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59 For a strong analysis of corporate law (albeit Canadian) in terms of these principles, see B Welling, *Corporate Law in Canada: the Governing Principles*, Butterworths, Toronto, 1991.
These ideas are unexceptionable. Some authors find more policies, principles and concepts within judgments and argue for them. Bottomley finds political structures, Whincop found contracts and I found associations and membership.

Parliament

It would be a mistake to think that law, whether judge-made or in legislation, is consistent or coherent. While the system of precedent does provide pressure on related doctrines to maintain some degree of consistency, this is not the case for legislation. The political process and procedures of interpretation are as far as pressures to conform go. Accordingly, legislative change as the product of policy development is subject to the whims of the time. These may be clearly identifiable, or they may be part of a discursive paradigm as outlined below.

In the last fifteen years or so, two policy ‘Programs’ have been instituted. Both have resulted in a great deal of legislative change. The first was ‘simplification’ under the rubric of the Corporations Law Simplification (CLS) Program. The program was about the expression of rules and not about the larger issues, especially what comprises a good system of corporations law. It was to simplify pre-existing rules and policies within a context of legislation as something to be understood by ‘users’.

The objective of CLS

To simplify the Corporations Law [now the Corporations Act 2001] and make it capable of being understood so that users can act on their rights and carry out their responsibilities


Despite its expressed objective, CLS effected one of the most far-reaching substantial changes in corporations law for many years—the abolition of par value. It was not a controversial change; there was hardly an argument against it. On the other hand, where controversy was apparent, the Task Force implementing the Program steered well away. Examples are the introduction of the business judgment rule in directors’ duties and of the derivative action in shareholders’ remedies. The former would have antagonised shareholder groups and was thought by academics to be unnecessary, and the latter was a worry to business groups. Both were introduced by the successor program, the Corporate Law Economic Reform Program (CLERP).

CLERP, the second ‘Program’, was put in place on the accession to government of the Liberal–National Coalition in 1996. The carriage of legislative change in corporations law was transferred from the Attorney-General’s Department to Treasury and the change was clearly nominated to be ‘economic’.

The objective of CLERP

The aim of the Corporate Law Economic Reform Program will be to ensure that Australia’s corporate law is consistent with promoting a strong and vibrant economy. This will involve delivering a corporate regulatory regime which:

- takes full account of the Government’s economic objectives;
- encourages companies to fulfil their basic role of facilitating investment, employment and wealth creation; and

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protects investors and maintains confidence in the business environment (Business Law Division, 1997:2).

This objective indicates that:

- the program is meant to be an instrument of government economic policy; and
- the government accepts the economics view of the role of corporations.

Whether or not the legislative outcome of the Program adhered to these strictures is open to debate.

A feature of both was consultation, with ‘users’ in the first instance and the business community in the second.

Prior to both Programs, and to some extent contemporaneously, a variety of legislative interventions occurred in corporations law. These are founded in a great diversity of policies and ideas, best dealt with in their substantive law context.

A way of ordering the theories

A real problem facing a student of corporations law is how to grasp its extraordinary panoply of theory without descending into a simple list replete with vague and inconsistent language or worse, conflicting discourses.

Disciplinary origin

The material presented in this section can be ordered in a number of ways. As it happens, it is ordered here in a disciplinary way: according to the ways of thinking in which the theories, concepts or principles originated. Yet within that crude classification reference is made to other ways the material may be analysed. It is useful to think of them as defining the dimensions of a province for the theory, concept or principle. What, then, are these dimensions?

Genealogy

Time provides the sequence of development and enables us to tie ways of thinking into the context they inhabited. Thus, for example, we might ask whether a legal change is out of nineteenth century liberalism, or how law reformers conceptualised the problems they saw arising from the scams of the 1980s. This is called a ‘genealogical’ approach.

Calculated purpose

Taking a small step, from abstraction towards particularity, the next ordering principle is to locate items in our list of theories in terms of their disciplinary context. This is, indeed, the primary one adopted above. Noticeable, however, is the way the theories cross borders into other disciplinary perspectives: Toennies’ sociology turns up in institutionalist economics, for example. Hence the disciplinary categorisation can inhibit understanding of the role the material within it plays. A way out of this methodological trap, and a variety of others, is to concentrate on what a particular theory, concept or principle is taken to do—what is its ‘calculated purpose’. Is a text, for example, reformulating economic ideas of the firm, or perhaps explaining the relationships which make up the internal structure of a company? This approach allows us to think in terms of political, economic, doctrinal or even sociological ideas (as genealogy also tends to do) without confining a theory, concept or principle to its origin. Hence a sociological idea of the company as a real entity can found a theory of corporate liability.
Systemic focus

Next we can focus on the place on which the theory, principle or concept is acting within the legal system. Is it a matter of policy for legislative reform, or a metaphor used in judicial reasoning? The ‘contract theory of the corporation’ is taken to be both of these, even though they are very different ideas.

Purpose, law and effect

Finally and most particularly, how does this theory, principle or concept play out against a certain rule, and its purpose and effect? It may simply be a description of the law, or indicate what its purpose should be taken to be. It may even provide measures of effect or even effectiveness. We are concentrating here on the function of the theory, principle or concept within law as doctrine. Taking the contract theory of the corporation again as our example, we may say that in its economic sense this theory indicates that the legal idea of a constitution for a company is one which allows for free negotiation of the contracts through which a company exists, and that the effectiveness of such a rule should be measured by the transaction costs involved in forming companies.