The Corporation as Feudal Estate

Like a feudal estate, a corporation is considered a piece of property, not a human community, so it can be owned and sold by the propertied class.

BY MARJORIE KELLY

Stockholders are "owners" of corporations, we're often told–that's why their interests are paramount. It's why they alone have a vote for the board of directors, and why maximizing their returns is the purpose of the corporation. It's a kind of magical incantation, "own." It's deceptively small, and might be worth unpacking. Because stockholders "own" corporations, implicitly:

1) the corporation is an object that can be owned;
2) stockholders are sole masters of that object;
3) they can do as they like with "their" object.

It's an entire worldview in three letters. And as a result of this tiny incantation (like the "Shazam" that turns a boy into Captain Marvel), stockholders gain omnipotent powers: they can take massive corporations, break them apart, load them with debt, sell them, shut them down, and drive out human beings —while employees and communities remain powerless to stop them.

Power of this sort has an unmistakable feel of the ancient. Ownership—that bundle of concepts we also label "property rights"—is an antique tradition that comes down to us from the aristocratic era, when the landed class was the privileged class by virtue of its wealth in property. To own land was to be master. And in the master's view, what was owned was subordinate, as in the imperial presumption that India was a "possession" of the throne of England. Or the feudal presumption that lords could own serfs, like so much livestock.

Ownership, according to ancient British law, conferred upon the owner a right to "sole and despotic dominion." The phrase is from William Blackstone's eighteenth century *Commentaries on the Laws of England.* It is a phrase worth lingering over, for *dominion* shares the same root as "domination." And *despotic*, the *Oxford English Dictionary* tells us, means tyrannical rule of those who are non-free.

Blackstone's chilling phrase is one I encountered in a 1993 scholarly article by Teresa Michals, "'That Sole and Despotic Dominion': Slaves, Wives, and Game in Blackstone's *Commentaries*." It was a piece I stumbled on serendipitously, on a day I had abandoned myself to the random, as one does in antiques collecting. I rummaged upon this volume of the *Eighteenth Century Studies* journal in a used book store, and as I pulled up a chair there in the cluttered aisle, I sat transfixed as Michals described the ancient aristocratic mind: that antique perspective that saw virtually all relationships as varieties of ownership.

Eighteenth-century England, she wrote, was a world of "land-based hierarchy," in which social standing rested on ownership of land, or "real property." "Blackstone seems to assume that one either owns real property or becomes real property oneself," she wrote. "Although the common law did not support the buying and selling of persons, it did support the general principle that one person could own certain kinds of property in another."

There were, in effect, three categories of persons: the property owner with full rights, the slave as a piece of property with no rights, and in between a mixed category: "that of a right-bearing subject who is also the property of another." In this third category she noted that we might find a man's wife, or his servant, whom he owned though was not able to sell.

The element of ownership went one-way. The "inferior hath no kind of property in the company, care, or assistance of the superior," Blackstone wrote. And because ownership was one-way, loyalty was one-way. A servant owed loyalty to the master, but the master owed none to the servant. The husband could claim damages for trespass if his wife was abducted or seduced, but she had no reciprocal right. Curiously—or appallingly—the law of master and servant remains the law in employer-employee relationships today. Employees still owe a common-law duty of loyalty to the corporation, but as massive layoffs demonstrate, the corporation owes no loyalty to employees.

"Ownership" is an aristocratic notion, meaning what is owned is subordinate—as in the presumption India was a "possession" of the British Crown, or that lords could own serfs like livestock.

In Blackstone's era, those without property lacked voice in the legal process, much as employees today lack a vote for corporate boards of directors. Blackstone justified this by saying only those who owned property possessed an independent will, and since all others had "no will of their own," they were incapable of casting a valid vote.

In this ancient property-based world, a whole range of relationships were considered forms of "ownership." And this view made its way to America.

An excerpt from The Divine Right of Capital.

In colonial times, an advice manual stressed that "children are so much the goods, the possessions of their Parents, that they cannot without a kind of theft, give away themselves" without permission.

Even in *Two Treatises of Government* by John Locke, considered a founding document of democracy, God is conceived of as the Great Property Owner. Locke wrote:

> For Men being all the Workmanship of one Omnipotent, and infinitely wise Maker; All the Servants of one Sovereign Master, sent into the World by his order and about his business, they are his Property, whose Workmanship they are....

This notion of one sovereign master extended to the marriage relationship, where only men owned property. In early American law, a husband became owner of his wife's property upon marriage. He had sole right to administer it, claimed its profits, and was required to render his wife no accounting. In the 1764 case of *Hanlon v. Thayer*, a Massachusetts court said a husband owned even his wife's clothing—though she'd brought it with her at marriage. As Michals described the marital relationship:

Upon marriage, a woman once lost her ability to own property, becoming instead the property of her husband. If she was abducted, he could claim damages for trespass, but she had no reciprocal right.

> [A]t marriage a woman not only loses her property, which passes into her husband's possession; more fundamentally, she also loses her very ability to own property, becoming instead the property of her husband. Her consent to the loss of her property is taken to imply a free consent to the disappearance of her own legal personality into that of her husband....

Husband and wife were one legal person, and that person was the husband. Today, the corporation is considered one legal entity, and that entity is equated with stockholders. Like wives, employees "disappear" into the corporation. Corporate property is administered solely in the interests of stockholders, who like husbands claim the profits, and are required to render employees no accounting. We have thus a "corporate marriage" in which one party has sole dominion. The reason is property.

In the corporation, the "property" of stockholders is represented by two numbers. The first is the stream of income, called profit or earnings. Stockholders theoretically have a right to all of it, and in an earlier age did receive it all in direct payout. But today, stockholders get only a piece of earnings in dividends. The rest is retained for corporate use, and booked on the balance sheet as "stockholder equity." Still, profit does in a sense "belong" to stockholders, since earnings are often the basis of market value. That value, for example, can be expressed as a multiple of earnings, as in the price-earnings ratio.

So earnings are in a sense still stockholder property. The second part of their property is the value of the corporation itself—market value. Stockholders receive their portion of market value when they sell stock and pocket capital gains, if the stock has gone up. In analogy to a rooming house, you might say stockholders own the stream of rent coming in, and they own the house itself.

One way or another–through direct payout or increased firm value–the benefits of profit flow to shareholders. Attorney Jeff Gates in *The Ownership Solution* calls this the "closed loop" of wealth creation. Stockholders by definition are those who possess wealth. And in the design of the corporation, most new wealth flows to those owning old wealth, in a closed loop.

This loop functions in a literal way on the balance sheet. Equity represents the actual capital stockholders contributed when they purchased new shares. And the retained earnings portion of profits is added to equity each year. Thus by the magical closed loop of accounting, equity grows year after year. While stockholders never contribute another cent out of their pocket.

Ergo: Stockholders "create wealth" without lifting a finger. We call this "return on equity," or ROE. It is designed to continue into infinity.

It's a bit like the plant in "The Little Shop of Horrors," which ate everything in sight. The more equity grows, the more it demands to grow. Let's say equity is at $1 million and grows 15 percent a year for ten years (typical for large companies). The result is equity quadruples. So if a 15 percent return on equity initially means shoveling out $1 million of profits to satisfy shareholders, by the tenth year 15 percent requires a shovel four times as big, or $4 million. The company needs four times the profits, just to *stay in place* as far as stockholders are concerned—yielding the same ROE year after year.

It's like pushing a rock up a hill, and when you push nice and hard the rock gets bigger. There is no top of the hill. You must do this for eternity.

It's little wonder CEOs at public companies are desperate to boost profits however they can: sending jobs to sweatshops overseas, demanding corporate welfare, refusing to give raises, using temporary workers without benefits, wheedling tax breaks, downsizing staff. Institutional investors may occasionally call and demand increased profits–or boot out a CEO who fails to deliver–but the demand is also implicit in the financial statements. The closed loop of corporate accounting holds the demand in place forever.

One might ask whether this makes sense, that infinite payback must be made for a one-time hit of money. But let us sidestep that debate.

Let us assume, for the sake of argument, that all profits legitimately belong to stockholders. Let's assume they own all tangible corporate assets, so the book value of the corporation is theirs. (Book value means everything you own minus everything you owe.) Even granted this, stockholders are still running off with 75 percent of corporate value that's arguably not theirs.

Consider: At year-end 1995, book value of the S&P 500 accounted for only 26 percent of market value. "Intangibles" were worth three times the value of tangible assets.

Thus, even if S&P stockholders owned the companies' tangible assets, they got off scot-free with other airy stuff worth three times as much.

Included in intangibles are a lot of things, like discounted future value, patents, and reputation. But also included is a company's knowledge base, its living presence. Or to call it by a simpler name: employees.

In owning intangible value, stockholders essentially own employees—or at the very least, they have the right to sell them, which amounts to the same thing. Take the case of the Maryland company in Chapter 11 bankruptcy, which in 1997 sold itself to Space Applications Corp. (SAC) in Vienna, Va. The company's real assets were its 100 scientists. So it sold them. As Edward Swallow of SAC told the *Wall Street Journal*, "The company wasn't worth anything to us without the people."

"Human capital" acquisitions happen all the time. Through 1997, Cisco Systems Inc. in San Jose, Calif. had made nineteen of them—mostly acquisitions of small software companies with little revenue but 50 to 100 employees, for which it paid premium prices: up to $2 million per employee.

It's revealing when the accountants go to record such purchases on the balance sheet. If you pay $100 million for a company with, say, $25 million in tangible assets, what's the other $75 million of stuff you bought? How do you record it? Well, what you don't record is "100 scientists." In post-Civil War America, we recoil from the notion human beings might be bought and sold. So we say a company has purchased "goodwill." That's how it's booked: as a line item on the balance sheet called "goodwill."

The parallel to Blackstone is telling. Our law does not support the literal buying and selling of persons, but it does support the principle stockholders can own certain kinds of property in employees. We allow company owners to sell company assets, even when the primary assets are 100 scientists. This doesn't make these scientists property in the sense slaves were property, because the scientists are free to leave. But neither are they property owners, with a right to vote on the sale and a right to pocket the proceeds. Their status is akin to the third category Michals described: "that of a right-bearing subject who is also the property of another."

Through the lens of ownership, one either owns property or becomes property. There is nothing else. It's an attitude that says, if I own the assets of a firm, I own everything created on top of those assets. All new wealth flows to old wealth. This is inherently a feudal assumption — and we can see this more clearly, if we make analogy to land:

Say a landowner pays a tenant to farm some land, and the tenant builds a house there. Who owns the house? The landowner or the tenant?

In feudal England, the landowner legally claimed the house. But as legal scholar Morton Horwitz points out, American courts rejected this—

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beginning with the 1829 case, *Van Ness v. Pacard*, where Justice Story wrote: "what tenant could afford to erect fixtures of much expence or value, if he was to lose his whole interest therein by the very act of erection?" Under democratic law, the rule became that "the value of improvements should be left with the developer."

Refusing to bow to ancient property rights, democratic law articulated a new precedent: The house belongs to the person who built it. New wealth flows to those who create it.

In this tradition, employees who "build" atop the corporation (creating new products or new efficiencies) have a legal right to the value of their improvements. But in corporate law that isn't the case. Corporate law says stockholders own everything the corporation now has, and everything it will create into the perpetual future. Hence the increasing value of the corporation will flow forever to shareholders, though they won't lift a finger to create that value. The presumption is literally feudal.

Tied up with it is the notion that property owners *are* the corporation. Employees are incidental: Hire them today, get rid of them tomorrow, they're of no consequence. Sell the company, maybe employees will come along, maybe they won't. It doesn't matter. They're not on the balance sheet, so they don't exist in the tally of what matters.

Yes, well. We might puncture this fantasy with a simple question: What is a corporation worth *without* its employees?

This question was acted out, interestingly enough, in London, with the revolutionary birth of St. Luke's ad agency, which was formerly the London

office of Chiat/Day. In 1995, the owners of Chiat/Day decided to sell the company to Omnicon—which meant layoffs were looming—and Andy Law in the London office wanted none of it. He and his fellow employees decided to rebel. They phoned clients and found them happy to join the rebellion. And so at one blow, London employees and clients were leaving.

Thus arose a fascinating question: What exactly did the "owners" of the London office now own? A few desks and files? Without employees and clients, what was the London branch worth? One dollar, it turned out. That was the purchase price—plus a percentage of profits for seven years—when Omnicon sold the London branch to Law and his cohorts after the merger. They renamed it St. Luke's, and posted a sign in the hall: Profit Is Like Health. You Need It, But It Is Not What You Live For. All employees became equal owners. Ownership for St. Luke's is a right that is free, like the right to vote. Every year now the company is re-valued, with new shares awarded equally to all.

It's a house of cards, to believe outsiders can "own" a company that is a network of human relationships. Employees are the cards, holding the place together. But it's outsiders who run off with the wealth.

Thus we see how the presumptions of property hold up in the knowledge era: The fiction that outsiders can "own" a company, which is nothing but a network of human relationships, is a house of cards. Employees themselves are the cards, willingly holding the place together, even as stockholders walk off with the wealth that employees create.

How long this will be sustainable remains to be seen. But for the time being, employees remain hypnotized: believing themselves powerless, and accepting (shazam) that stockholders have sole and despotic dominion.

We accept this because we operate from the unconscious assumption that corporations are objects, not human communities. And if they're objects—akin to feudal estates—then they're something outsiders can own, and the humans working there are simply part of the property. Either you own property, or you become property: there is nothing else in a property-based world.

We're not aware we're holding such a picture of reality, until someone like Andy Law stands up to stockholders and says, I am not your property. Such gestures are reminiscent of the founding fathers standing up to Great Britain and saying, America is no longer your property. What seems solid melts under challenge. In the heat of confrontation, the notion of "owning" human beings slips away—like ice melting. Or like an incantation fading, once we have broken its spell.

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