Agency between Shareholders and Companies

Description

This is more an academic thought than a practical tip.

I am reading the book “Agency, Partnership and the LLC” (2nd ed, West Nutshell Series) by J. Dennis Hynes in particular to find support for my personal understanding of the agency relationship between shareholders/members and the companies/corporations they invest.

In China, law scholars seldom shed lights on the nature and contents of the relationship between shareholders and companies. People tend to think that is something to be answered by the concept of “shareholder right” which has been considered as a new type of ‘civil right’ parallel with property right and creditor right in civil law systems. To me, that is wrong. There is a great degree of resemblance between the shareholder-company relationship and the typical agency relationship.

However, I didn’t find the support in this book, instead I noticed that under the sub-title “agency status of directors of a corporation”, the author said “although a board of directors is elected by the shareholders, the board is entitled to use its own business judgment in managing the affairs of the corporation, making the control by the shareholders too remote to constitute agency….. However, these duties are owed to the corporation itself rather than to the shareholders individually or collectively… An individual director has still less resemblance to an agent since he has no power on his own to act on the corporation’s behalf”.

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As to the cited opinions above, I have a few questions:

(1) “too remote a control” seems to me very arbitrary as it is almost impossible to accurately demarcate the degree of control to distinguish agency and non-agency. I am not familiar with American laws, under China Company Law, the shareholder meeting is still mandated with certain powers over the operation of the company. More or less, control does exist here. The amount of control does not seem a strong ground to deny the agency between shareholders (collectively) and the board of the directors (equally the company itself, as explained below).

In my opinion, unless the law deprives shareholders of all its powers or control over the company, predicated on shareholders’ ownership in corporate assets, shareholders are always entitled to some degree of control, for example, the shareholders may restrict the purpose of the companies, or put in place some other restrictions over the board such as merger or division etc.

(2) I apparently disagree with the statement “these duties are owed to the corporation itself”. Taking out the board of directors, a company or corporation is nothing at all.

This is about the nature of a legal person, a very abstract legal issue. Despite the mainstream view of real entity theory (opposite to the fiction theory) in China, I believe a company as a legal person is a personalized creature and in much the same way, a legal person has its own will as an individual does. The will of the legal person is nothing but the collective will of the board or in the absence of a board,

the will of the executive director (as provided in China Company Law) or the will of other organ of the company that makes the highest decision of and within the company. Without such a will, a company will be mystified as something undefinable.

The key in my understanding is the “Will”. As a personalized creature by law, the personalization foundation is “will”, making the will of the decision-making organ within the company the will of the company towards the outside.

The paradox of “owed to the corporation itself” is that nobody or nothing represents the corporation itself (the principal) when taking the board of directors as something separate from the company itself. Who will be enforcing the duties on behalf of the company then?

Based on the two doubts, I would embolden myself to say the author’s view may have serious flaw.

In the meantime, if we look at the other key factor of agency “on behalf of” or “for the benefit of”, we may be more confident to find agency out between shareholders and company. The company (here actually we refer to the board of directors) runs the company for the benefits of the shareholders. There is little dispute over the point that a company shall maximize the interests of its shareholders, which reflects exactly the “on behalf of” element in the agency relationship. After all, the fact that the company shall distribute its profits to its shareholders as dividend is of the same nature of an agent transferring to its principal interests derived from its agency acts.

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People who feel difficult in finding agency between shareholders and companies often get confused when the concept of limited liability is in the picture. Typically in a civil agency, principal is always fully and unlimitedly responsible for whatever consequences brought about by his or her agent. But in the case of a company or corporation, shareholders as principal (as a whole) are protected by the doctrine of limited liability. My explanation is: the change from “unlimited” to “limited” does not affect the very two fundamental elements in an agency relationship, and the change is the result of development of corporate law, a public policy aimed to promote the corporate activities in an economy. On the other hand, the rise of limited liability changes substantially the landscape of corporate law, because the corporate law has to develop more rules to strike the balance between shareholders (on one side) and creditors (on the other side), which see a substantial set of mandatory rules written into corporate law statutes. In turn, these mandatory rules make it more difficult to recognize agency between shareholders and companies. But, whatever changes in appearance, the fundamentals remain the same. Agency is still there.

I would like to have comments from law professors and other legal professionals from around the world.

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