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The Constitution, Citizenship, and Corporations – A Critical look at *Citizens United v. FEC*

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Abstract

“Associations of citizens” is a phrase the US Supreme Court used in *Citizens United v. Federal Election Commission* (2010) to refer to corporations. This notion was, apparently, an important element in shaping the Supreme Court’s judgment that permitted corporations to participate in the democratic process through campaign funding. Presumably, the “citizens” the court had in mind are the shareholders of corporations. Treating corporations as citizens in the collective, the Supreme Court upheld their political rights, and there is evidence of disquiet with the decision in *Citizens United*.

This paper examines the Supreme Court’s characterization of corporations as associations of citizens and granting them “citizenship” rights. These have serious constitutional implications. The idea that corporations are groupings of citizens can be traced to the 19th century and in this paper, I question how far this conception is relevant to modern business corporations with their features such as centralized power structures, relative shareholder passivity, and widespread concerns about corporate power and influence. The characteristics of contemporary corporations leave little room for treating them as “associations of citizens.” My paper points out the need for greater clarity and realism in our understanding of corporations, particularly in the context of constitutional law. This can facilitate the development of more nuanced approaches to deal with the corporate phenomenon.

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A money-laundering threat assessment in 2005 by the federal government found that corporate anonymity offered by Delaware, Nevada and Wyoming rivalled that of familiar offshore financial centres.

~ The Economist (2009)1

I. Introduction

The decision of the US Supreme Court in Citizens United v. Federal Election Commission2 (2010) has been controversial.3 Overruling its earlier decision in Austin v. Michigan Chamber of Commerce (1990),4 the Supreme Court permitted corporations to participate in the political process through campaign funding. In a significant reference in Citizens United, the court described corporations as “associations of citizens.”5 It is apparent that this notion played a role in shaping the outcome in the case. The idea that corporations are association of citizens led the Supreme Court, quite logically, to rule that they have a right to participate in the democratic process through contribution of funds to political

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5 Clearly, the “citizens” referred to here are the shareholders of corporations. This is not explicitly recognized in the judgment, but the repeated references to shareholders make the meaning clear. See e.g. Citizens United, supra note 2 at 32 and 46, online version.
parties and electoral candidates. To curb corporations from doing so would, according to the ruling in *Citizens United*, violate the First Amendment to the American Constitution and its protections.6

In this paper, I examine the idea that corporations are associations of citizens and the implications of granting them “citizenship” rights based on this notion. I argue that the characterization applied by the Supreme Court in *Citizens United* does not pay sufficient attention to the key features of contemporary corporations which play an important role in modern societies. These qualities include centralization of power in the directors and managers, relative shareholder passivity and the constraints – legal and economic – under which corporate managements operate. Simply treating corporations as associations of citizens, without considering a host of issues involved, can lead to results opposite of what the Supreme Court apparently intended – namely, correcting the imbalances between powerful interests and less privileged groups, and making the political playfield less uneven.

To understand the “association of citizens” reasoning applied in *Citizens United*, it is necessary to go back to the emergence of the idea in the United States in the 19th century. This is also helpful in determining its relevance for modern business corporations. Arguably, the idea is archaic and outdated. The present need is for achieving greater clarity in our understanding of business corporations and their characteristics, specifically in constitutional law. This can help in developing more nuanced approaches that can help us in dealing better with the challenges of the present and the future.

The paper is divided into six parts. Part II outlines the key features of contemporary corporations. This is followed, in Part III, by a review of the issues with corporations raised in the public discourse about them. Part IV discusses *Citizens United* and its conceptualization of business corporations as associations of citizens. The discussion points out that the Supreme Court treated the issue almost as a

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6 The First Amendment, adopted in 1791, reads:

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.
fait accompli, and did not examine it in depth. Part V traces the origin of the “association of citizens” idea in the United States in the nineteenth century and questions the validity of the notion in the present age. Finally, Part VI points out the incongruities arising from the personification of corporations by the Supreme Court in Citizens United. It also advances an alternative conception that might be more appropriate for the present and better suited to deal with many of the issues experienced with corporations.7

II. Contemporary Corporations – An Outline of Features

In Citizens United, the Supreme Court interpreted corporations as citizens in the collective – an idea that dates back to the nineteenth century. The citizens, referred to by the court, are presumably the shareholders of corporations.8 The validity of this conception must be tested against the key features of modern corporations. This part outlines the features and characteristics of contemporary corporations, preparatory to testing the “association of citizens” thesis and its applicability to the corporations.

A. The Democratic Framework in Corporate Law

In speaking of corporations in Citizens United, the Supreme Court made a number of references to “aggregations of wealth”9 – a phrase that reflected the thinking underlying Austin.10 But in conception,

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7 This paper deals with the personification of corporations by the US Supreme Court in Citizens United, supra note 2. Its concerns are not the First Amendment and the freedom of expression protected by it. For a discussion of these issues and the application of the First Amendment to corporate press in the pre-Citizens United era, see David S. Allen, “The First Amendment and the doctrine of corporate personhood” (2001) 2(3) Journalism 255.
8 The corporation involved in Citizens United was a non-profit entity. However, the decision of the US Supreme Court applies to business corporations as well. A suggestion made by Justice Kennedy to restrict the judgment to non-profit corporations was declined by Solicitor General Kagan who referred to the possibility of business corporations using non-profit corporations as “conduits” to channel political contributions. Citizens United, supra note 1, oral argument transcripts, at 42. Transcripts available online: http://www.supremecourt.gov/oral_arguments/argument_transcripts/08-205%5BReargued%5D.pdf, accessed September 14, 2011. Justice Stevens has written a lengthy dissenting opinion for the majority in which he is critical of that the majority “manufactured a facial challenge” (Citizens United, supra note 2, dissenting opinion at 14, online version). This must be considered against the position taken by Solicitor General Kagan.
9 Citizens United, supra note 2, see e.g. at 31 and 35 (online version).
10 Supra note 4.
corporations are designed essentially on a democratic principle. The statutes under which they are organized are all about elections and meetings and reports.\textsuperscript{11}

In origin, corporations were vehicles for pooling the risk capital contributed by investors, or stockholders. Reflecting this origin, corporate law empowers stockholders to constitute control of the corporations by electing directors at annual meetings.\textsuperscript{12} The principle is similar to the political democracy as it has evolved in the English-speaking countries. Stockholders are assimilated to citizens and each unit of capital, called stock, carries a vote like individual citizens in the political democracy. The stockholders gather at annual meetings for electing the directors and the meeting is conceived as a forum for discussing the business and affairs of corporations. This is, again, similar to the political institutions of assemblies and debates on issues culminating in collective decisions.\textsuperscript{13} Before the “race to the bottom” in American corporate law began in the 1880s,\textsuperscript{14} the statutes also had fairly elaborate rules on reporting by the directors to the stockholders.\textsuperscript{15} Reporting was the instrument in law for promoting transparency and accountability in the functioning of business corporations.

The democratic structure in corporate law was, thus, complete. Stockholders who contributed the risk capital of corporations will meet every year and elect the directors who will control the capital and manage the business and affairs of the corporations. Directors will regularly submit reports to the stockholders on the developments in the corporations. The law also placed the directors under fiduciary

\textsuperscript{11} The reality has, however, turned out to be different. This is discussed a little later.
\textsuperscript{12} See e.g. Del. Code Ann. Title 8, General Corporation Law, §211.
\textsuperscript{13} On this, see generally Bruce Welling, \textit{Corporate Law in Canada: The Governing Principles} (Toronto: Butterworths, 1984).
\textsuperscript{14} See generally William Cary, “Federalism and Corporate Law: Reflections upon Delaware” (1974) 83 Yale L.J. 663 on the series of amendments to corporate statutes which resulted in the effective centralization of all corporate powers in the directors.
\textsuperscript{15} For a discussion on how the reporting rules were diluted to the point of meaninglessness from the 1880s, see E. Merrick Dodd, “Statutory Developments in Business Corporation Law, 1886-1936” (1936) 50 Harv. L. Rev. 27.
duties, to ensure that they acted in the corporations’ interests. While this is the model in the law book, the reality has been quite different.

**B. The Reality of Corporate Democracy**

It is not known if business corporations ever functioned according to the democratic ideal on which their law is based. In any event, the democratic model provided in law has not substantially defined the corporations or their workings in the recent times. The stock market developed rapidly since the closing decades of the nineteenth century, and rising share prices encouraged people to invest in corporate shares. The law of corporations, outlined earlier, implicitly placed the shareholders in a position of oversight and assigned a role for them in electing suitable candidates as directors and holding them to account. The retail shareholders who emerged in early twentieth century were hardly suited for the role conceived for them in corporate law. This genre of shareholders neither had the interest nor the capability to perform the functions that were expected of them in the corporate law framework.

On the contrary, the directors of corporations emerged as a powerful and autonomous group. The rise of a powerful class of corporate directors was the theme of the celebrated work of Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property*. Berle and Means bemoaned what they perceived as the decline of shareholders, understood as the owners of corporations, and a corresponding strengthening of the powers of directors who, in theory, were elected surrogates of the shareholders. The term “property” in the title of Berle and Means’ influential work clearly conveyed the

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16 The question about the beneficiaries of the fiduciary duties of directors has been contentious in corporate law. There is a school which asserts that directors owe their duties to the shareholders and interpret the relationship between the two groups in “principal-agent” terms. See e.g. Michael C. Jensen & William H. Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure” (1976) 3 J. Fin. Econ. 305. Another group of theorists argue that the directors owe their duties to the corporations which include all constituencies in them – namely, shareholders, suppliers, employees, and so on. For this broader version of directors’ duties, see Margaret M. Blair and Lynn A. Stout, “A Team Production Theory of Corporate Law” (1999) 85 Va. L. Rev. 247.


notions about the proprietary position of the shareholders. Berle and Means’ thesis about shareholders and directors, since termed “separation of ownership and control,” has been an enduring theme in the discourse on business corporations. Berle and Means found that the directors were not only powerful, but had also become a self-perpetuating agency that could determine its own successors.

We have empirical evidence of the truth in the findings of Berle and Means. A study carried out in 1976 found that in more than ninety-eight percent of the director elections held in the previous twenty years, corporate managements were able to get their nominees elected to the boards. This contradicts the principle of corporate democracy on which the law of corporations is based.

The inefficacy of shareholders has been common knowledge since Berle and Means published their work in 1932. In this milieu, the rise of institutional investors since the 1950s generated a great deal of optimism. These large investors that had sizable holdings and expert managers were expected to take care of most of the shortcomings identified with the retail investors of Berle and Means’ vintage. The thesis about more engaged shareholders is not supported by the results from a more recent survey of director elections. Cai, Garner, and Walking (2006) analyzed 1,741 elections of directors of public corporations and found that only three of them were contested. All the others were uncontested. This is no different from the results reported in the earlier survey. If we apply director elections as a test of

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19 See e.g. Margaret M. Blair, Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century (Washington, DC: Brookings Institution). The phrase “separation of ownership and control” is problematic for more than one reason. For one, use of the word “separation” suggests that the two were together at an earlier point and they moved apart later. This might not be accurate when we consider the origin of corporations as vehicles for pooling risk capital. In all probability, at no time did the contributors of capital also control the corporations. In other words, so-called ownership and control were probably never together. Another difficulty is with the word “ownership.” To be clear, this idea underlies the “association of citizens” approach of the Supreme Court in Citizens United. The proprietary rights generally attributed to shareholders is questionable, especially in the present age.


21 The title of the work of Peter F. Drucker, The Unseen Revolution: How Pension Fund Socialism Came to America (New York: HarperCollins, 1976) is indicative of the expectations associated with pension funds as institutional investors in company shares.

the functioning of the corporate democracy provided in law, it is quite obvious that shareholders play no meaningful role either in the choice of candidates or in their election as directors.\textsuperscript{23} The relative passivity and inefficacy of shareholders continues substantially. The recently-developed mechanism of nominating committees for selecting candidates for director positions adds a new dimension to the issue, and this is discussed a little later.

Takeovers provide another illustration of shareholders’ position in reality and the divergence that exists between corporate theory and practice. Entrenched and powerful managements and the inefficacy of shareholders in monitoring them led to the emergence of ideas such as “market for corporate control”\textsuperscript{24} and takeover battles.\textsuperscript{25} In corporate theory, the relationship between shareholders and managements resembles, at least in some respects, the principal-agent model. In this framework, if the agents were found to be inefficient or to engage in self-dealing, the principals would be expected to act. But this did not happen in reality. Instead, weak or inefficient managements were painted as targets for takeovers by outsiders and the 1980s witnessed a spate of messy takeovers in which shareholders did not play an active role. The outcome in the battles is decided largely by a combination of response to takeover bids from the stock market and from incumbent managements, and sometimes court interventions.\textsuperscript{26} This reality belies the simplistic conception of corporations as groupings of shareholders.

\textsuperscript{23} Robert A.G. Monks, a shareholder activist and corporate governance scholar, described the prohibitive cost of proxy circulars for shareholders to propose candidates director elections. See Monks’ statements in Ralph Walking, “US Corporate Governance: Accomplishments and Failings” (2008) 20 J. App. Corp. Fin. 28. The \textit{Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010} (Pub.L. 111-203, H.R. 4173) attempts to address this issue by requiring companies to include in their proxy circulars the details about candidates nominated by shareholders holding three percent or more of the outstanding shares. I point out a little later that this effort has been nullified, at least for now, as the rule framed by the Securities and Exchange Commission to implement the \textit{Dodd-Frank Act} proposal has been vacated. See \textit{infra} note 38.

\textsuperscript{24} See generally Henry Manne, “Mergers and the Market for Corporate Control” (1965) 73 J. Pol. Econ. 110.


\textsuperscript{26} Widely-dispersed shareholding characterizes listed US corporations, despite the rise of institutional shareholding in the recent decades. This feature is inherently opposed to concerted and meaningful shareholder activism. The issue is compounded by the absence of regulatory efforts to streamline corporate takeovers. On the lack of clarity
C. Management Power

The other side of the coin is the rise in the power and influence of corporate directors and managers. Indeed, directors have come under increasing focus in the corporate discourse and there is now greater appreciation of the powers vested in them by the statutes under which the corporations are organized.\(^{27}\) A number of factors combined to strengthen the position of the directors of business corporations since early twentieth century. Important among these were the rise of retail shareholders who did not actively exercise their rights, the success of business interests in procuring a number of legislative amendments to corporate statutes that strengthened the position of the directors \textit{vis-à-vis} the shareholders of corporations, increases in the size and complexity of business operations and the enhanced need for expert knowledge. The ingredients that strengthened corporate directors are shown in the figure below.

\(^{27}\) Blair & Stout, \textit{supra} note 15, developed their team production theory of corporate law around the directors and their powers and responsibilities. Stephen Bainbridge continued with the theme in his article, “

\textit{Director Primacy: The Means and Ends of Corporate Governance}” (2003) 97 Nw. U. L. Rev. 547. A difference is that according to Bainbridge, directors are under a duty to apply their powers for attaining the goal of shareholder wealth maximization.
In the prevailing situation, it was inevitable that full-time managers emerged as the centers of corporate power. Managerial power was true irrespective of the question whether the managers were also on the boards of the corporations. Given the dynamics of the situation and the top-down organization structures in corporations, power inevitably gravitated towards the full-time managers who had the requisite authority as well as inside knowledge of the business and operations.

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In tracing the evolution of managerial power in 20th century America, it is also significant that there was no large-scale wrongdoing by them in the business corporations. Berle and Means, despite their critical attitude towards corporate managements and the powers they held, did not seriously question managements’ integrity nor did they complain about self-dealing by the managers. A potential explanation for this is the fact that there were, at the time, no major governance failures or scandals – such as those seen in the financial sector during the Credit Crisis of 2008-09. Failures on this scale can call into question the validity of the entire corporate arrangement.

Beginning from Berle and Means (1932), the concern of the critics has essentially been about the principle of concentration of economic powers in corporate managements and its legitimacy. In a society founded on the ideal of liberty and a constitution based on division of powers, the presence of corporate managements as a powerful group that was also largely unaccountable was understandably irksome. High levels of executive pay were already an issue in the 1950s, and the debate on the subject indicated the sense of unease with the corporate arrangement.

Another important issue in the corporate framework is about the division of powers between the directors and the managers of business corporations. The legitimacy of the powers of directors, as pointed out earlier, is derived from their election by shareholders who contribute the risk capital. Corporate law also recognizes managers, termed “officers,” as delegates of the directors. The structure in corporate law is hierarchical with shareholders at the top, directors below them and officers at the bottom, as shown in the figure below.

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29 This idea is prominent in Anglo-American political thought. This was also carried into the economic sphere by John Kenneth Galbraith, who interpreted corporate economic power in terms of the countervailing power of other social, economic, and legal institutions. American Capitalism: The Concept of Countervailing Power (Boston: Houghton Mifflin, 1952).
Although shareholders were more or less irrelevant in the functioning of corporations, the directors held real powers at least until the 1950s. During this period, a large majority of the directors of corporations were full-time employees holding senior managerial positions. Only a minority were outside part-time directors. From the 1950s, however, there were significant changes. The ratio of inside directors began to fall and there was a matching rise in the number of outside directors on the boards of public corporations.\textsuperscript{32} Alongside, the emphasis on director independence increased. The development can be traced to criticisms against corporate insiders and complaints about the culture in boardrooms and cronyism.\textsuperscript{33}


The recent emphasis on director independence has resulted in a fall in the ratio of inside directors. But it is debatable whether this has made a material difference to the situation.\textsuperscript{34} The powerful position of corporate managements continues, more or less, as before – except that the percentage of managers on the boards has fallen in the recent decades. Reflecting the changes in board composition, outside directors who now dominate the boards are assigned the role of monitoring the managers.\textsuperscript{35} Independent directors are largely conceived as a check on managerial power, and now New York Stock Exchange Rules require that they should be the majority in boards.\textsuperscript{36} But is not clear how effective independent directors are in overseeing the managers and in enhancing the standard of corporate governance.\textsuperscript{37}

In the prevailing position, near-absolute corporate powers are vested in the directors,\textsuperscript{38} managers run the corporations, nominally under the oversight of the boards consisting of a majority of independent directors. Contrary to the principle of corporate law, shareholders do not in fact actively elect the directors. Instead, the board appoints a nomination committee consisting of a group of directors to select candidates for director positions. These candidates usually get elected without any effort or opposition.

The complaint of Berle and Means about self-perpetuating boards has not substantially been addressed. In a sense, the arrangement has been formalized through the mechanism of nominating

\textsuperscript{34} According to William Allen, former Chancellor of the Delaware court, CEOs are no longer as powerful as they used to be. “Modern Corporate Governance and the Erosion of the Business Judgement Rule in Delaware Corporate Law” (Osgoode Hall Law School, Comparative Research in Law and Political Economy (CLPE), Research Paper No. 06/2008), available online: \url{http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105591}, accessed October 18, 2011.


\textsuperscript{37} For a case-study of AIG’s board governance in the context of its credit derivatives business that almost destroyed the company, see P.M. Vasudev, “Default Swaps and Director Oversight: Lessons from AIG” (2010) 35 J. Corp. L. 757.

\textsuperscript{38} See e.g. Delaware General Corporation Law, §141(a).
committees. These are committees of outside directors, selected by the same outside directors, to choose candidates for board positions. Reflecting the criticisms leveled against director selection process, the focus now is on reducing the influence of managers in the selection of candidates. It is not about enhancing the role of shareholders in director elections – an idea implicit in the theory of corporate law. Corporate managers are protected by the business judgment rule which precludes challenges to the policies and decisions of managements, in the absence of serious fraud or self-dealing.

**D. Enter Economic Theory – Of Shareholder Value, Stock Options, Transaction Costs – and Executive Compensation**

The dominant features of contemporary corporations are significant. They project the image of large and powerful institutions with immense resources under the control of small groups of executives. The control groups in the corporations, whether they are just managers or directors or both, are not under serious structural constraints in ordering the business and affairs of corporations as they consider appropriate. In the prevailing picture the limited interest that shareholders, understood as the owners, have in the management of corporations is underscored.

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39 As I have pointed out earlier (supra note 23), the efforts of the Dodd-Frank Act to encourage shareholder participation in director elections have been stalled, at least for now. A rule framed by the Securities Exchange Commission to implement the statutory provision on proxy circulars for director-candidates nominated by shareholders has been vacated by the Court of Appeals. See Simpson Thacher Memorandum, “Proxy Access Rule Vacated by D.C. Circuit” July 29, 2011, available online: [http://www.stblaw.com/content/Publications/pub1245.pdf](http://www.stblaw.com/content/Publications/pub1245.pdf), accessed September 21, 2011.


41 For a recent application of this rule, see In re Citigroup Shareholders Derivative Litigation, 964 A.2d 106 (Del. Ch. 2009). The Delaware court rejected a complaint against the credit derivatives business of Citigroup, applying the business judgment rule. The outcome in this case has significant implications for the “association of citizens” conception applied by the US Supreme Court in Citizens United, and I discuss this in greater detail later in the paper.

42 There is a view that this position in law is quite appropriate, and that corporations, just like any other enterprise, are subject to a host of other regulations on safety, environment, consumer protection and so on. This variety of regulation is adequate and there is no need for any organic or structural regulation of business corporations. See
have in the corporations is confined more or less to the stream of revenue they derive from any dividends that might be paid by the corporations and potential capital gains from rise in share prices.

In this milieu of powerful managers and ineffective shareholders, economic theories about corporations became influential in the recent decades. Economic theorists advanced prescriptions such as “shareholder value” as the goal of corporate governance, grant of stock options to managers to align their interests with the shareholders and “transaction costs” as the decisive factor in determining corporate policy and business strategy. A large part of the developments in the recent decades in corporate America, indeed in the American economy at the macro level, can be explained in terms of economic theory and its tenets. Shareholder value, grant of stock options to managers, executive pay, and transaction costs are issues particularly relevant to the arguments advanced in this paper, and I discuss them below.

1. Shareholder Value as the Corporate Objective

The idea that shareholder value ought to be the corporate goal was stated by Michael Jensen and William Meckling in 1976. This prescription was advanced just before the boom in the stock market began in 1980. Constant rise in share prices occurred in a benign environment in which this was presented as the appropriate goal that corporations must attain. The market boom appeared to affirm the theory and made it even more persuasive and influential.

The ascendancy of the shareholder value idea is evident from the fact that in the 1990s, several companies had explicitly codified maximizing shareholder value, measured by current stock price, as the

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44 I have critiqued the economic prescriptions on corporate governance and in doing so, I have also traced the political economy in which they were developed. P.M. Vasudev, “Law, Economics, and Beyond: A Case for Re-theorizing the Business Corporation” (2010) 55 McGill L.J. 911.

45 Supra note 15.
This approach to corporate governance relied on another influential idea—the Efficient Markets Hypothesis (EMH). According to the Efficient Markets Hypothesis, the stock market will accurately reflect the information that is available about corporations and adjust share prices accordingly. To illustrate, companies pursuing growth opportunities will increase their revenues and profits, and as information about these developments become available it will trigger share price increases. In this framework, share prices were everything. The theory of corporate law and its democratic principle were of little consequence. It did not matter that shareholders were powerless and the principle of corporate democracy was dysfunctional. It was enough if shareholders gained from share price increases.

Enron and the events that led to its spectacular collapse in 2001 offered a powerful illustration of the perils of the shareholder value model of corporate governance. In any event, the bull phase in the stock market since 1980 appeared to vindicate the notions about shareholder value and efficient markets. They emerged as articles of faith in corporate governance. Several recent developments raise serious questions about the validity of the ideas. These include the numerous corporate scandals since the turn of the century, from Enron to AIG, the turbulence seen in the stock market since 2008 and the findings of behavioral finance scholars which question the fundamental assumptions in the Efficient Markets Hypothesis. In particular, the ongoing swings raise question about the stock market as a reliable store of value for pension and other savings.

2. Employee Stock Options


Michael Porter, supra note 46, has also pointed out the negative consequences of the shareholder value model.

The speculative element in financial markets and the potential for instability have been known for centuries (Stuart Banner, Anglo-American Securities Regulation, 1690-1860: Political and Cultural Roots (Cambridge, UK: Cambridge University Press, 1998)). But these were ignored in the recent times which saw arguments in favour of financial speculation from quarters such as the efficient market theorists. See generally Edward Chancellor, Devil Take the Hindmost: A History of Financial Speculation (New York: Farrar Strauss Giroux, 1999).
Stock options, as a phenomenon, are closely related to the shareholder value maxim. According to economic theory, grant of stock options to managers will align their interests to those of shareholders and encourage the managers to pursue shareholder value as this will benefit them equally. By making stock options a major element in managerial pay, a company could hope to promote shareholder value because stock options will incentivize its managers to strive for rise in share prices. These ideas, advanced by economic theorists, were warmly received. For a practical illustration of the consequences of this arrangement, we can again turn to Enron. Under the employment contract the company had with its CEO, Kenneth Lay, the performance bonus of Lay depended on Enron share price rising more than the Standard & Poor’s index. The events underlying the implosion of Enron are dubious evidence on the economic hypothesis about stock options and aligning the interests of managers and shareholders.

There are a number of other problems – practical and philosophical – with stock options. These are particularly significant for conceptualizing corporations in constitutional law and the democratic principle of corporate law. Firstly, current practice of stock options ignores the origin of shares as units of risk capital contributed by the stockholders and the foundation of their voting rights. On the contrary, it treats shares as commodities that corporations may emit at will. This undermines the democratic model in corporate law and the legitimacy of shares as economic instruments.

Secondly, it is implicit in the prevailing stock options model that companies can compensate their managers without actually incurring expenditure. The recipients of the options are expected to sell the stocks in the market and make their money – from investors in the market. In effect, this externalizes the cost of employing people in companies, and raises troubling ethical issues. Ever since the founding

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of the American republic, public interest has been an important justification for grant of incorporation.\textsuperscript{51} If companies are to reward managers through stock options and expect investors in the stock market to pay for them, this must be a concern for public policy.\textsuperscript{52} Even from a purely economic standpoint, there is no assurance that the price an investor in the market pays for the stock options sold by a manager will retain its value.\textsuperscript{53} The stock options model of compensation has also spawned unethical practices such as backdating of options.\textsuperscript{54}

3. **Executive Pay**

Stock options are a part of the larger issue about executive compensation. Concerns about the high levels of managerial pay have been voiced at least since the 1950s.\textsuperscript{55} From 140 times the pay of the average worker in 1991, the pay of corporate CEOs rose to about 500 times in 2003.\textsuperscript{56} This trend affirms the insight of economic theory about “agency costs” in corporations.\textsuperscript{57} The rise in the pay of senior managers in corporations must be tested against the trend in the median income of American middle classes. According to the latest data from the Census Bureau, the median household income in America


\textsuperscript{52} The American Constitution is not merely a document that lays down an administrative structure and demarcates powers among the branches of government. It also embodies important values of humanity. Combined with the Declaration of Independence, the Constitution is equally a moral document. It appears hardly an accident that Thomas Jefferson included the words “our sacred honor” in the Declaration of Independence. This stresses the ethical element in the constitution and the importance of applying ethical standards in determining constitutional issues. Declaration of Independence, online: [http://www.ushistory.org/declaration/document/](http://www.ushistory.org/declaration/document/), accessed September 28, 2011.

\textsuperscript{53} See e.g. the sale of shares by insiders during the Internet boom of the 1990s. Mark Gimein, “You Bought, They Sold” *Fortune* (2 Sep 2002).


\textsuperscript{55} A conversation in 1957 between Senator Kefauver and Homer, who then headed Bethlehem Steel Corporation, reveals both the concern about the level of managerial pay and the practice of managers determining their own pay structures. See J.K. Galbraith, *The New Industrial State* (Boston: Houghton Mifflin, 1967) at 84-85.


\textsuperscript{57} Having done so, it is ironical that economic theorists came out in support of higher levels of pay for senior corporate managers. See e.g. Michael C. Jensen & Kevin J. Murphy, “CEO Incentives – It’s Not How Much You Pay, But How” *Harvard Business Review* (May-June 1990) 138.
fell in the last decade – from $53,300 in 1999 to $49,500 last year, in 2010 dollars.\textsuperscript{58} The contrast between the trends in the incomes of senior corporate managers and average household incomes in the country present an apparently stark contrast, and this is an area for future research.

As I have pointed out earlier, historically an important justification for the grant of incorporation in the American republic is the advancement of public interest. It has been argued that the open structure of corporate law and the reluctance of legislatures to regulate them are justified by the ability of the corporations to generate wealth for large sections of the society.\textsuperscript{59} The general prosperity in America during most of 20\textsuperscript{th} century and American strength at the international level muffled the incentive for serious introspection. In the post-industrial, post-Credit Crisis recessionary America, there is a need for a more serious analysis of the issues about corporations, their power and their record in generating and distributing wealth.

\textbf{4. Transaction Cost Economics}

Transaction cost economics turn the focus of companies on costs and advocate cost reduction as a goal.\textsuperscript{60} This idea found its practical application in the large-scale shift of manufacturing operations and business processes to developing countries such as China and India, which happened in the 1980s and 1990s. These were meant to take advantage of the lower costs in those countries.\textsuperscript{61} To be sure, corporations became more competitive as well as more profitable.\textsuperscript{62} This translated into higher pay for a

\textsuperscript{58} An analysis of the Census Bureau data is provided by Jared Bernstein, “The Lost Decade for the Middle Class” The Christian Science Monitor (15 Sep 2011).
\textsuperscript{59} James Hurst, supra note 51.
\textsuperscript{61} In this sense, the globalization movement of the last few decades has been as parasitical as European colonization of Asia and Africa during the 18\textsuperscript{th} and 19\textsuperscript{th} centuries proved to be. In both these phenomena, one part of the world lived off another. As global integration and togetherness increase, a major challenge is to explore economic models that promote the principle of coexistence and the sustainable use of resources.
\textsuperscript{62} Apple and IBM, two iconic American corporations, are powerful representatives of this phenomenon. Apple gets its hardware manufactured in China and IBM now has very large operations in India for its information technology business. This means that these companies incur a large part of their costs in China and India, respectively, which
relatively small number of senior managers who were decision makers in companies and had control over the corporate resources. But the relocation of manufacturing operations and business processes from the US resulted in significant loss of middle and junior level corporate jobs in the country. This is, in turn, reflected in the stagnation/fall seen in median household incomes.

To be fair, transaction cost economics and similar ideas are valid at the microeconomic level. Few can deny this. It makes sense for a company that wants to be competitive and increase its profits to relocate its cost centers for achieving operational economies. But problems arise when this practice becomes widespread and is practiced on a significant scale. It then breeds conflict with macroeconomic interests, such as generation of employment and equitable distribution of resources. In situations like this, the corporate form of organization with its principle of central command can lead to lopsided advances that do not necessarily benefit the larger society. Data on corporate profits and median household incomes over the last thirty years, presented in the table below, are indicative of the potential consequences.

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reduces the level of employment and wealth in the US. At the same time, the corporations are able to increase their profits, which are then used as a justification for making higher payouts to senior managers. Economists call this result the “fallacy of composition,” which broadly means that something that is true and valid at the micro level might not be so from a macro level perspective.
Table 1

Corporate Profits and Median Household Incomes – Comparative Growth, 1981-2010

<table>
<thead>
<tr>
<th></th>
<th>1981</th>
<th>2010</th>
<th>Growth %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits of Fortune 500 US corporations</td>
<td>$81 billion</td>
<td>$391 billion</td>
<td>483</td>
</tr>
<tr>
<td>Median household income</td>
<td>$19,074</td>
<td>$49,445</td>
<td>259</td>
</tr>
</tbody>
</table>

Corporate profits have grown at almost double the rate of median household income in the last thirty years. This period was the era of globalization in which corporations relocated their cost centers and operations outside the US, resulting in loss of jobs in the US. It was again during this time that the gap between managerial pay and the salary of average workers climbed to new heights, as pointed out earlier.\(^65\)

To be fair, the macro data on corporate profits presented here do not capture the differences in the profitability levels of individual corporations, nor the variations occurring over a period of time. Yet the data clearly convey a sense of the larger economic trend over the thirty years. They point towards a degree of divergence between the benefit derived by corporate interests and that accruing to large sections of the society. If a major consideration for public policy to encourage corporations is their capacity to provide economic security and generate widespread prosperity in the society, a troubling

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\(^65\) Brett McDonnell, *supra* note 56.
question is about the continuing validity of the idea.\textsuperscript{66} In this paper, the issue I raise is how far the Supreme Court’s interpretation of the corporate character is sensitive to these dynamics in corporations and the adequacy of the understanding of contemporary corporations by the court.

\section{III. Corporations in the Contemporary Discourse – A Review}

The Supreme Court’s characterization of corporations in \textit{Citizens United} and its implications for constitutional law are important because corporations \textit{are} a key socioeconomic institution, and hold a special position in the nation’s psyche. A sense of opposition to corporations is as old as the American republic.\textsuperscript{67} Corporations are considered inimical to individual liberty and the principle of equality, which are ideals animating the US constitution – indeed, the American society. These are, apparently, at the root of the dissatisfaction with the Supreme Court’s decision in \textit{Citizens United} that enlarges the role of corporations in contemporary life.\textsuperscript{68}

This part of the paper outlines the issues that have been prominent in the recent discourse on business corporations. These include short-termism, the absence of a democratic culture in companies, high levels of pay for senior executives, and seemingly pathological pursuit of profits.\textsuperscript{69} The discussion in this part is, to some extent, in continuation of the references made in the previous part of the paper.

\subsection{A. Short-termism}

The goal of shareholder value bred myopia in business policies and practices. The preoccupation with share prices encouraged short-termism in policy and neglect of investments with potential for


\textsuperscript{68} A poll conducted shortly after the Supreme Court announced its decision in \textit{Citizens United} found that eight in ten respondents opposed the verdict. Dan Eggen, “Poll: Large majority opposes Supreme Court’s decision on campaign financing” \textit{The Washington Post} (17 February 2010), online: \url{http://www.washingtonpost.com/wp-dyn/content/article/2010/02/17/AR2010021701151.html}, accessed October 4, 2011.

\textsuperscript{69} On the pathological tendencies of corporations to pursue power and profits, see Joel Bakan, \textit{The Corporation: The Pathological Pursuit of Profit and Power} (New York: Free Books, 2004).
enhancing the capabilities of enterprises over the medium and terms.\textsuperscript{70} Lawrence E. Mitchell (2001) targeted the shareholder value mantra companies chanted in the closing decades of the last century and pointed out the negative consequences of this approach.\textsuperscript{71} The burst of the Internet bubble in the stock market in 2000-2001 provided a wakeup call on the risks inherent in the shareholder value maxim, and these have been reinforced by the ups and downs seen in the stock market since the onset of the Financial Crisis of 2008-09.

In the last few years, there has been greater sensitivity to the perils of corporate short-termism and the stock market centricity of corporate governance. Reflecting this, efforts have been made to promote more responsible governance policies and practices that focus on longer time horizons. In 2006, the Conference Board of New York published a research report critical of short-termism and it recognized the need for remedial action at three levels – namely, companies, investors and analysts.\textsuperscript{72} More recently in 2009 Aspen Institute, an independent think-tank based in New York, came out with a similar report that calls for a more responsible approach towards business and investment management.\textsuperscript{73} Among the long list of signatories to the report of the Aspen Institute are CEOs of leading companies, professional experts and scholars. They include Louis Gerstner (former chair of IBM), Martin Lipton (renowned corporate lawyer), and Ira Millstein and Lynn Stout (scholars in corporate governance and the capital markets).

There is now better realization of about the risks of short-termism – at the level of doctrine. But it is not clear if awareness on the issue has translated into meaningful action among companies. The results of a recent survey on incentives to managers are not very encouraging. The survey found that the

\textsuperscript{70} Michael Porter, \textit{supra} note 46.

\textsuperscript{71} Corporate Irresponsibility: America’s Newest Export (New Haven, CT: Yale University Press, 2001).


criteria applied for determining performance bonus payments to managers are still the ones developed in the shareholder value era – namely, Earnings per Share (EPS), revenue, operating income, net income and free cash flow. These are focused almost completely on the current year and do not provide significant incentive for managers to think long term. Research expenditure and investments are likely to make a long-term impact and including them also in the set of measures used for determining bonuses can retune the focus of managers towards the long term. But the survey shows that these are not among the criteria applied by companies. This is a pointer to the need for closing the gap between the emerging consciousness about corporate governance and actual practice.

B. Corporations and the Democratic Principle

Corporate law, as I have pointed out, is based on a democratic principle. In simple terms, it is about election of directors by shareholders and accountability of the directors. In the recent years, ideas about democracy as a principle and democratic institutions have seen significant development. The emerging democratic vision is more robust and expansive. Democracy is no longer merely about elections and majorities. It is not simply a numbers game. Greater sophistication informs the current thinking about the democratic process and what it should accomplish, as a normative ideal. Recent ideas stress the deliberative process that should precede decision-making, the consideration of the different interests involved and arriving at decisions that are informed by a sense of fairness and justice.

As an important socioeconomic institution, corporations are faced with the challenge of rising to the democratic values and aspirations of the present age. The shareholder value maxim, which has been the corporate goal in the recent times, is only concerned about shareholders, and it professes to curb managerial power in order to advance shareholder interests. The question is whether such limited ideas

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in corporate governance adequately reflect the rising democratic ideas of the present age and how far they are in tandem with the democratic foundation on which corporate theory rests.

There is a complaint that corporations and their style of governance do not live up to emerging democratic ideals. Voting rights in companies, which are now available only to shareholders, has come under attack and there are calls for enlarging the voting base in companies.\textsuperscript{76} A challenge for corporate theory is, therefore, to achieve greater convergence with nascent ideals and strengthen the democratic principle it already includes.

In corporate governance the stakeholder principle reflects, by and large, the broader and more nuanced ideas that increasingly animate the democratic discourse. The stakeholder vision has been developed as an alternative to the more narrow ideas about maximizing profit or value for the benefit of the shareholders. In the alternative stakeholder model, the interests of all the groups in companies, such as employees, suppliers, and communities, are understood as deserving consideration and fair treatment.\textsuperscript{77} In this framework, shareholders are just another group in a company and no proprietary notions are attributed to them. Nor are directors understood as the “agents” of shareholders. Shareholder interests coexist with those of the other groups in the corporations and do not override any others. Viewed from the emerging stakeholder lens, it is apparent that the Supreme Court’s conception of corporations as shareholders in the collective is dated and quite inadequate to handle the challenges and complexities of the present times.

C. Managerial Pay

I have referred earlier to the increasing disparity between the pay levels of senior managers and other employees at middle and lower levels in corporate organizations. The issue about managerial pay

\textsuperscript{76} See Allan C. Hutchinson, \textit{The Companies We Keep: Corporate Governance for Democratic Societies} (Toronto: Irwin Law, 2005). On the impact corporations have on democracy, see also Ted Nace, \textit{Gangs of America: The Rise of Corporate Power and the Disabling of Democracy} (San Francisco: Berrett-Koehler, 2005).

came to forefront during the Financial Crisis of 2008-09, in the context of the bonuses that had been paid to senior managers in banks and other financial companies for profits booked from speculative deals – that later turned sour and brought the companies to the brink of failure. Initial public policy responses included fixing ceilings for the pay of CEOs of companies that had received public assistance and the appointment of a Pay Czar. These measures were, understandably, *ad hoc* in character. They have since been replaced with a rule in the *Dodd Frank Wall Street Reform and Consumer Protection Act of 2010* that enables shareholders to cast a nonbinding vote on executive compensation – the so-called “say on pay.”

The say-on-pay rule reflects, at least in part, the proprietary ideas associated with shareholders. It can be explained, in another part, by the position of the shareholders as residual claimants in business corporations. As such, so goes the argument, shareholders are the appropriate group to safeguard the residue that will remain after payment is made to managers who are the custodians. This is another argument for empowering shareholders to oversee executive pay. Leaving aside the philosophy underlying the say-on-pay rule that favors shareholders, an important issue with the rule is that it hardly addresses the concerns about distributive justice within corporations and the function of managerial pay in promoting more responsible governance.

There is a longstanding complaint that shareholders are shortsighted and their concern seldom extends beyond share prices. If this is so, then it is questionable how far shareholders can be expected to be effective in regulating or overseeing managerial pay through nonbinding votes and the power of moral suasion. In any case, at the practical level there is no evidence of any significant questioning of executive pay by the shareholders. According a recent report, only in 40 out of 2,200 corporations which

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78 (Pub.L. 111-203, H.R. 4173), Section 951.
79 Martin Lipton is a famous advocate of this view. Delaware Supreme Court made a reference to this in *Moran v. Household International*, 500 A.2d 1346 (Del. 1985).
held a vote on executive pay, did the shareholders reject management plans.\textsuperscript{80} This is similar to the
evidence I have presented earlier on director elections.\textsuperscript{81} The results from the survey do not suggest
significant shareholder engagement in the issue of managerial pay. Like director elections, a risk is that
the say-on-pay becomes one more ritual among corporations with no substantive meaning.

In any event, the mechanism for nonbinding shareholder vote on managerial pay is unlikely to
address concerns about fairness and equity in the pay structure in corporate organizations.\textsuperscript{82} These
conscerns are now more pressing and urgent because of the persistent trend of gap between the pay of
senior managers and those at middle and lower levels. Viewed in this perspective, the inadequacy of the

The issue about executive pay has particular relevance for the Supreme Court’s characterization
of corporations as associations of citizens. The complaint is that controlling groups in corporations,
which are nominally elected by citizen-shareholders, appropriate for themselves a disproportionate
share of the corporate resources, causing prejudice to other groups in the corporations. Results from
the survey on say-on-pay, referred to earlier, the evidence is that citizen-shareholders do not hesitate to
endorse the action of the controlling groups.

IV. \textit{Citizens United, the First Amendment and Corporations as “Associations of Citizens”}

\textbf{Citizens United}, which is a corporation, invoked the First Amendment to assert its right to
broadcast a political documentary. This part examines how the Supreme Court dealt, in \textit{Citizens United},
with corporations and their position \textit{vis-à-vis} the First Amendment and the rights protected by it. The
review indicates that the Supreme Court’s interpretation that corporations are associations of citizens is

\textsuperscript{80} Dechert LLP, \textit{Defending Against Shareholder “Say-on-Pay” Suits} (September 2011), online:
http://www.dechert.com/files/Publication/5312a5d9-c3ac-4911-9b40-04007f14fe6e/Presentation/PublicationAttachment/bf7b8249-a2d7-4372-ba70-2e35b79d2785/C%26S_WCSL%20update_09-11_Defending_Against_Shareholder_Say-On-Pay%20Suits.pdf,
accessed September 29, 2011.
\textsuperscript{81} Supra note 21.
\textsuperscript{82} Compensation committees of the board, consisting of independent directors, have been developed in the recent
years with the goal of promoting greater objectivity in determining managerial pay. It is questionable how far
these committees have made a meaningful difference to the situation. See e.g. Eric Dash, “Outsize Severance
derived from historical notions. There are reasons to believe that the court did not examine, independently and in sufficient depth, the validity of the idea in the present circumstances.

The First Amendment is a bundle. Among other things, it protects freedom of expression and the right of peaceful assembly. Mr. Theodore Olson, who appeared for Citizens United, the appellant-corporation before the Supreme Court, made it clear at the beginning of his arguments that he relied on both these elements in the First Amendment. His plea was to uphold the right of free expression which was equally available to assemblies of citizens – such as the appellant.\textsuperscript{83} Obviously, one flows from the other. It is not just about freedom of expression but equally about availability of the freedom to groups of citizens or lawful assemblies of citizens. The effort was clearly to assimilate corporations to groupings of citizens.\textsuperscript{84} A majority of the judges of the US Supreme Court accepted the argument.

\textit{Citizens United v. Federal Election Commission} is hardly the first time the US Supreme Court extended First Amendment protections to corporations. In \textit{First National Bank of Boston v. Bellotti}\textsuperscript{85} (1978) the court relied on the First Amendment to uphold the right of business corporations to make political contributions.\textsuperscript{86} In \textit{Citizens United}, the majority judges were apparently influenced by rather ambiguous and somewhat archaic notions about the personhood of corporations \textit{and also} their identity with shareholders.\textsuperscript{87} The judgment in \textit{Citizens United} does not make significant efforts to explain why, indeed whether, corporations should be treated or understood as citizens in the collective. The examination of the issue is rather cursory in the opinion of the majority judges delivered by Justice Kennedy. The court simply took it as a fact that corporations are groups of citizens – disfavored groups,

\textsuperscript{83} \textit{Citizens United} oral arguments, supra note 7 at 5.

\textsuperscript{84} For this purpose, reliance was placed on cases such as \textit{New York Times v. Sullivan}, 376 U.S. 254 (1964) in which efforts to interfere with reporting on civil rights campaigns were under challenge.

\textsuperscript{85} 435 U.S. 765 (1978).

\textsuperscript{86} In the nineteenth century, the US Supreme Court accepted the contention that corporations were equivalent to natural persons. \textit{Santa Clara County v. South Pacific Railroad Company}, 118 U.S. 394 (1886), and \textit{Allgeyer v. Louisiana}, 165 U.S. 578 (1897).

\textsuperscript{87} There is an element of inconsistency in this. Logically, a corporation cannot be a person in itself \textit{and} a grouping of its shareholders. For a discussion of the issue, see P.M. Vasudev, \textit{supra} note 67 at 276-280.
at that.\textsuperscript{88} The logical consequences of this position followed automatically. The following extract from the majority opinion provides an indication of the court’s thinking on the issue:

"Yet certain disfavored associations of citizens – those that have taken on the corporate form – are penalized for engaging in the same political speech."\textsuperscript{89}

The idea was clearly imprinted in the minds of the majority that corporations were merely citizens in the collective and were automatically entitled to the liberties that citizens were guaranteed by the First Amendment. A reading of the court’s opinion suggests that it did not independently examine the issue whether corporations could be assimilated to citizens in the collective. As I have pointed out, the tendency of the majority of judges was to apply historical ideas that affirmed the position. It is significant that Chief Justice John Roberts, in his concurring judgment, described \textit{Austin}\textsuperscript{90} (a ruling that acknowledged “the unique legal and economic characteristics of corporations”\textsuperscript{91} and upheld restrictions on their participation in the electoral process) as “threaten[ing] to undermine our First Amendment jurisprudence and the nature of public discourse more broadly.”\textsuperscript{92}

The statement of Chief Justice Roberts needs unbundling. It assumes, \textit{a priori}, that corporations are groupings of citizen and then attacks what it perceives as efforts to deny them the liberties protected by the First Amendment. The reference to “First Amendment jurisprudence” is significant. This is an incomplete account of the issue. As I explain in the next section, another stream of

\textsuperscript{88} See e.g. the references at 33 and 38, \textit{Citizens United}, supra note 2.
\textsuperscript{89} \textit{Citizens United}, \textit{ibid}, at 40. It is ironic that in treating corporations as groupings of citizen, the US Supreme Court in fact attempted to reduce what it perceived as an imbalance in the political field – among large and small corporations, among wealthy and not-so-wealthy individuals, and so on. \textit{Ibid}.
\textsuperscript{90} \textit{Supra} note 4.
\textsuperscript{91} \textit{Ibid}. Para 9.
\textsuperscript{92} \textit{Citizens United}, supra note 2, concurring opinion at 11.
jurisprudence, both of nineteenth century vintage and more recent, treated corporations differently. The idea that they are no more than groupings of citizens was explicitly rejected.

V. Corporations and Their Perception – A Brief Survey

As I have pointed out, the Supreme Court’s characterization of corporations as associations of citizens can be traced to historical ideas about identity between them and their shareholders. However, this is not the only strand in the thought about corporations. There were also other ideas such as corporations as entities in themselves and corporations as devices designed for specific purposes or activities.\textsuperscript{93} In this part, I provide a brief survey of the facets of corporations in public opinion and the understanding of their character over the last two centuries.

1. Corporations as Entities

Until late nineteenth century, corporations were clearly understood as creatures of law. They were considered as entities or vehicles brought into existence by legislative charters for fulfilling the special purposes spelt out in the charters. Early evidence of this conception and the limited capacities of corporations is seen in Chief Justice Marshall’s famous description of a corporation as “a mere creature of law,” that “possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence.”\textsuperscript{94} This framework precluded any confusion between the corporate entity and its shareholders or members.

The position that corporations are entities in themselves is strengthened by the fact that America has no history of joint stock companies, unlike the United Kingdom. Joint stock companies in UK were often unincorporated associations created by private arrangement at common law.\textsuperscript{95} These companies were understood as groupings or agglomerations of their shareholders who contributed the risk

\textsuperscript{93} An account of the different perceptions is provided by Robert T. Sprouse, “Legal Concepts of the Corporation” (1958) 33 The Accounting Rev. 37.
\textsuperscript{94} Dartmouth College v. Woodward, 17 U.S. (4 Wheat) 518 (1819). Incidentally this case, like Citizens United, was about a non-profit corporation.
\textsuperscript{95} The Joint Stock Companies Registration and Regulation Act (7 & 8 Vict., c. 110) was enacted in UK in 1844 to regulate these unincorporated bodies and promote transparency in their organization and affairs.
capital. In their case, the identity of shareholders and companies is a given. To this day, modern companies’ legislation in the UK refers to shareholders in the collective as the “company.”

There were, however, no joint stock companies in the United States. Corporations were formed only through incorporation granted by the state – earlier by individual legislative charters and from mid-nineteenth century, by compliance with the procedure prescribed in general incorporation statutes. The legislative charters clearly defined the capacities and functions of the corporations and also spelt out their limitations. The detailed description of the corporate character, which was usually included in the legislative charters, stressed the “entity” concept. The structure provided little scope for any confusion between the shareholders who contributed the risk capital of the corporations and the corporate vehicle created under the special legislative charters. Similarly, the general incorporation statutes the states enacted from mid-nineteenth century also shaped the corporate vehicles by placing them under a number of restrictions. In this framework, a corporation could only be what the statutes permitted and it derived its character from the statute. As such, it was not possible to attribute the qualities and capabilities of natural persons to the corporations.

The entity or institutional vision of corporations is by no means archaic. There is evidence that it continues to the present. Delaware courts which handle a sizable volume of cases involving corporations have made references to the institutional character of corporations and the community of interests they represent. In *Unocal Corp. v. Mesa Petroleum Co.* (1985), the Delaware court referred to the “corporate enterprise which includes stockholders” and recognized the directors’ “fundamental duty and obligation to protect” the whole enterprise. This is a clear statement of the institutional vision of corporations. In a more explicit reference in *Credit Lyonnais Bank Nederland N.V. v. Pathe*

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97 See e.g. *Companies Act 2006* (c. 46) (UK), Section 168 on removal of directors.
98 On this, see generally, James Hurst, *supra* note 51.
99 493 A.2d 946 (Del. 1985)
Communications Corp. (1991), the court referred to “community of interests that sustained the corporation” and ruled that the directors had to “exercise judgment in an informed, good faith effort to maximize the corporation’s long term wealth creating capacity.”

Admittedly, the more recent crop of decisions moves away from the narrow conception that underpinned Chief Justice Marshall’s description of corporations in Dartmouth (1819). Yet there is considerable commonality of thought – that corporations are entities or institutions in themselves with special qualities and characteristics. The idea that corporations are not to be confused with any group comprised in them is explicitly stated in the decisions of the Delaware court in Unocal (1985) and Credit Lyonnais (1991). This represents continuity with the entity or institutional vision seen in Dartmouth (1819).

The Model Business Corporations Act, prepared by the American Bar Association and adopted by several states, also reflects the entity view. For instance, the Illinois Business Corporation Act of 1983 states that “[u]pon the filing of the articles of incorporation by the Secretary of State, the corporate existence shall begin.” This clarifies that a corporation comes into existence on compliance with the terms of the statute. The provision in the Illinois statute, based on the Model Business Corporations Act, resonates with Chief Justice Marshall’s description of corporations in Dartmouth (1819) as creatures of law, and leaves little room for confusing them with their shareholders or any other group. This is

101 Ibid. at 38 (**1156).
102 Supra note 94.
103 Supra note 99.
104 Supra note 100. This is not to deny another line of decisions from the Delaware court that are regularly cited to stress directors’ duty towards the shareholders of corporations. See e.g. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). These decisions, like the ones in Unocal (1985) and Credit Lyonnais (1991) were rendered in specific factual settings and their principles have limited application. This indicates the limitations inherent in judicial decisions rendered in limited factual contexts as inputs in developing corporate theory.
105 Supra note 94.
106 805 ILCS 5/, section 2.15.
107 Supra note 94.
further proof that the institutional vision of corporations is a living idea. However, this is not to deny the existence of other strands in the notions about them. I now turn to other views of corporations – as instruments or devices and as groupings of shareholders.

2. Corporations as Juristic Instruments or Devices

Another useful perspective of corporations is available in *Farmers’ Loan & Trust Co. v. Pierson* (1927). In this case, the New York State Supreme Court referred to a corporation as “more nearly a method than a thing,” and “as a useful name and a usual collection of jural relations.” The court stressed the need for ascertaining these relationships in individual cases and assigning them their proper place. This is a more open approach that recognizes the dynamics in corporate character and the need for analyzing them more thoroughly in every case.

The approach adopted in *Farmers’ Loan & Trust Co.* (1927) is likely more helpful in understanding the features of corporations and the individual motivations and power structures in each case. Its preference is for a case-by-case analysis that is fact-oriented and capable of producing better outcomes. The caution displayed by the New York Supreme Court in interpreting the corporate character offers an interesting comparison to the approach the US Supreme Court adopted in *Citizens United* in preferring to follow the precedent in *First National Bank v. Bellotti* (1978) rather than *Austin v. Michigan Chamber of Commerce* (1990) and applying the “association-of-citizens” label to corporations without substantive analysis of the implications of doing so.

3. Corporations as Shareholder Groupings

I have mentioned earlier that the distinctiveness of the corporate entity has been etched in American consciousness from early on. Efforts to import the British notion that they were nothing but their shareholders in the collective were rebuffed in the US, at least until mid-nineteenth century. In

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109 Supra note 85.
110 Supra note 4.
Bank of Augusta v. Earle (1839), the US Supreme Court rejected the submission that corporations ought to be treated as their shareholders in the collective. This is consistent with the institutional vision of corporations which has been described. In Bank of Augusta, the US Supreme Court specifically disagreed with the argument that “the members of a corporation were to be regarded as individuals carrying on business in their corporate name.”

A change in thinking occurred in the closing decades of the nineteenth century by when most states had enacted general incorporation statutes. Legislative charters were no longer necessary for incorporation. Individuals could now form corporations by preparing articles of incorporation and filing them with a public official, who would then grant incorporation. This development, it was argued, placed American corporations on par with the companies of UK and, therefore, corporations were no more than groupings of their shareholders – just as it was in UK. Alternatively or cumulatively, shareholders were also now imputed with ownership rights in the corporations.

The argument that corporations represented their shareholders in the collective was used mainly to whittle down the restrictions to which corporations were earlier subject in most American states. It was argued that the restrictions on corporations amounted to limiting the personal economic liberty of the individuals who were now operating in the corporate form, and could not be sustained. By and large, the argument was successful. The developments strengthened the ideas about identity among shareholders and corporations, or alternatively, affirmed the proprietary position of shareholders in corporations.

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111 38 U.S. (13 Pet.) 519 (1839).
112 Cited in Morton Horwitz, supra note 88 at 76.
Here again, two distinctive factors or features are jumbled together to produce a specific result—like it happened in *Citizens United* with the two issues of freedom of expression and the rights of assemblies of citizens. In the transition to general incorporation, it is one thing for incorporators to be permitted to prepare articles of incorporation and being able to obtain incorporation for the asking. This was, admittedly, different from the earlier times when incorporation needed legislative charters which were understood to be discretionary. To this extent, the transition towards general incorporation in the United States from mid-nineteenth century converged with a similar development in Britain. In both jurisdictions, it became possible to attain incorporation by complying with the terms of a statute.

But it is difficult to understand how the transition to general incorporation can also mean in the United States that the new genre of corporations were no more than shareholders in the collective. Such an inference is clearly refuted by the history of corporations in the United States, which is quite different from that of Britain. As I have already mentioned, US has no history of joint stock companies as private arrangements at common law, nor the notion that a company was exactly what its name implied—a group of individuals who had come together. Therefore, the inference from the transition to general incorporation and the recently-granted freedom to prepare articles of incorporation placed American corporations on par with the companies of Britain appears farfetched and inaccurate.

Yet the inference was drawn, and the tendency to equate corporations with their shareholders and understand shareholders as the owners became stronger as time passed.¹¹⁶ These ideas were clearly reflected in *Dodge v. Ford Motor Co*¹¹⁷ (1919) and the celebrated commentary of Berle and Means (1932). The following extract from Berle and Means is illustrative.

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¹¹⁶ For a detailed account of the development, see Morton Horwitz, *supra* note 114. Horwitz also pointed out the cursory manner in which the Supreme Court equated corporations with natural persons in *Santa Clara v. South Pacific Railroad* (1886), *supra* note 86. This is, perhaps, a true indication of the spirit of the age. An idea whose time has come just gets accepted; it hardly needs any persuasion.

Corporations were originally groups of investors pooling their individual contributions of risk capital to organize and carry on an enterprise. Since they had saved their earnings or gains and had risked them in the undertaking, they were assimilated to the owner of the land, who cleared and cultivated it, and sold its products.\textsuperscript{118}

Berle’s description clearly captures the theory of joint stock companies in UK, but it does not satisfactorily explain why corporations should be treated as the alter-ego of shareholders merely because there was a transition in the US to general incorporation. In my view, the two issues – namely, general incorporation and identity between shareholders and corporations are not directly related to each other. The development appears to be a historical accident which needs to be corrected. It is a serious matter if we permit this error of perception to cloud our thinking and we continue to apply the idea to the contemporary corporations. It would amount to a refusal to take note of several important features of corporations and respond to the needs and challenges of the present times.

VI. Corporations – Revisiting their Understanding in Constitutional Law

It is important that our understanding of corporations is informed by their current characteristics, rather than be shaped by outdated notions of questionable validity. This is the substance of the argument I advance in this paper. In this concluding part, I explain some of the perils in continuing with the “association-of-citizens” conception and advance an alternative model that is more instrumental and has greater validity for the present times. A better conceptualization of corporations, undoubtedly a vital socioeconomic institution, can help us make better use of their advantages and, at the same time, take care of some of the negatives we have experienced with them.\textsuperscript{119}


\textsuperscript{119} There is a curious, philosophical dimension to the American experiment with corporations. The sense of individualism, carried over from Britain, became more pronounced in the American republic. Alongside, the tendency for agglomeration, which is again an important trait of the Anglo-American societies, has remained
There is evidence of considerable disquiet with the Supreme Court’s ruling in *Citizens United*. Other than the exchange between President Obama and Chief Justice Roberts I have pointed out earlier, the results from a Washington Post-ABC News poll are revealing. The poll was held in February 2010, a month after the Supreme Court published its decision. In the poll, 80 percent of the participants were opposed to the ruling. Among them, 65 percent stated that they were “strongly opposed” to the decision. Significantly, opposition to the ruling cut across the party affiliations of individual participants in the poll. The level of opposition was 85 percent among democrats, 76 percent among republicans and 81 percent among independents. This is substantial evidence of the reservations and apprehensions about corporate power and influence that continue to animate the discourse. It is important to promote greater sensitivity to this issue among policymakers and the judiciary.

This part of the paper has two subparts. The first explains some practical implications of interpreting corporations as associations of citizens. In Subpart (B), I advance an alternative conception of corporations that is more sensitive to the criticism leveled against corporations and more capable of meeting the challenges and needs of the present times and the future.

A. Corporations as “Associations of Citizens” – Some Practical Difficulties

Historically in America, the efforts to equate corporations with groupings of citizens were used to advance arguments about liberty and to stress that the principle had equal applicability to corporations equally strong. We can interpret the “United” States, the “United” Kingdom and the confederation of Canada in terms of the agglomerating tendency. The corporation represents its economic expression. The continuing fascination with mergers and acquisitions and efforts to dominate through size can be viewed through the lens of the tendency for agglomeration. Individualism and agglomeration have co-existed in the Anglo-American despite their mutual inconsistency, perhaps proving the yin and yang concept in Oriental thought. In *Citizens United, supra* note 2, Justice Anton Scalia pointed out the paradox in the simultaneous dislike of corporations and the persistent trend of increase in their number and size (concurring opinion, at 2, online version). These opposites, oriental thought reminds us, are a feature of nature. They exist together and are evidence that the human mind, which is also a construct of nature, is not always logical. Nor can we forget the efforts made in the UK and UK during eighteenth and nineteenth centuries to curb corporations. They proved to be largely unsuccessful. In dealing with corporations, therefore, we must proceed on the basis that they will continue to exist and persist with efforts to smoothen the rough edges.

120 *Supra* note 3.
121 *Supra* note 68.
– because they were no more than citizens in the collective. Indeed, this reasoning underpins the verdict of the Supreme Court in *Citizens United*. In effect, the case is that corporations must not be placed under any shackles. The deregulation arguments made in the nineteenth century were couched in terms of liberty and constitutional protections, but more lately, they have been presented in the idiom of efficiency.\(^{122}\) The recent argument is that corporations have proven their ability to generate great wealth and distribute it among large sections of the society. Regulation will undermine their efficiency and consequently, general welfare. The “association-of-citizens” characterization applied by the Supreme Court in *Citizens United* is aligned to both these ideas. Below, I explore some of the practical consequences of this approach in dealing with corporations.

1. Executive Pay and Public Policy

Managerial pay offers a good illustration of the risks in the “association-of-citizens” idea. It makes it possible to impute citizen-shareholders with the right to approve managerial pay, at any level and in any amount. It is possible to read this notion into the “say-on-pay” rule recently introduced in the *Dodd-Frank Act*. The “association-of-citizens” reasoning can be used to justify or uphold the legitimacy – indeed, the right – of the shareholders to determine managerial pay through a tenuous link to the First Amendment.

Citizens have assembled in their corporate form, and they determine the compensation to be paid to the group that controls the resources that are understood to belong to the assembly.\(^ {123}\) If the government has no business to interfere with the assembly, it would be equally impermissible for it to interfere with the actions of the assembly, such as its approval of executive pay – except that in this case, these actions have consequences for several other citizens who are not a part of the assembly.


These other citizens include groups such as corporate employees, suppliers, and customers. In effect, the First Amendment argument can be used to defeat the rights of these other groups, which are equally entitled to the protection of the Constitution. This is an illustration of the weakness in the “association-of-citizens” characterization applied by the Supreme Court in Citizens United.

2. Citizen-Shareholders – Is this Factually Correct?

The quaint nineteenth-century notion about corporations as their shareholders in the collective is contradicted by a number of developments and prevailing realities. These include shareholding by other corporations, both domestic and overseas, and by foreign citizens, and the rise of institutional investors in the recent decades. These factors weaken plausible arguments that link corporations to their shareholders and carry overtones of citizenship and the rights of citizens. They must be reckoned with in any debate on corporations and their character.

To be fair, corporations in their origin had only individuals as shareholders. But way back in 1889, New Jersey permitted corporations to hold shares in other corporations. This was designed to facilitate the emergence of large corporations with business interests spreading across several states and to overcome the territorial restrictions applicable at the time to corporations formed in specific jurisdictions. Grant of the ability to hold shares in other corporations spawned holding corporations that held shares in other corporations, termed subsidiaries, and exercised control over them. A more recent mutant is corporations formed as “special purpose vehicles” for specific purposes. These special purpose vehicles shot into limelight in the Enron scandal in which they were used for shifting losses. The mechanism was also extensively used in the credit derivatives business which is largely considered

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124 See Part II, supra, on the issue of executive pay and rising disparities.


126 This practice was targeted by Berle and Means, supra note 17, who were critical of the facility it provided for the exercise of indirect control over corporations without actually holding shares in them and bypassing the principle of democracy on which the law of corporations is founded.

127 In the case of Enron, many of them were organized as limited partnerships rather than corporations.
responsible for the Financial Crisis of 2008-09.\textsuperscript{128} The “association-of-citizens” idea has little application to corporations of this variety where the shareholders are not individuals.

A related issue is about the global mobility of capital. This has become more common in the recent decades and it is now possible for foreign investors – natural persons or any other entity or organization – to participate in the US capital markets and hold shares in American corporations. When the shareholder is a foreign corporation or citizen, the question is whether the First Amendment protections can be extended to them.

Finally, and most importantly, we must reckon with the rise of institutional investors in the past few decades. The retail investors whose interests Berle and Means espoused in the 1930s are no longer as large a presence in the corporate shareholding landscape as they were back then. Institutional investors, which are mostly pension funds and mutual funds, have emerged as a major class of investors since the 1950s. They have reduced the importance of retail investor-shareholders and are considered more capable of playing the role that corporate law attributes to shareholders. Institutional investors, which invest the funds of other persons, hold large blocks of shares in listed corporations and are managed by professional experts. According to Conference Board data, the shareholding of institutional investors has remained above fifty percent since 2000, climbing steadily since 1950 when it was about six percent.\textsuperscript{129}

\textsuperscript{129} Based on data presented in \textit{The 2010 Institutional Investment Report} (New York: The Conference Board, 2010), Table 10 at 22.
Institutional investors are neither individuals nor citizens, and it would be difficult to bring them under the First Amendment. They are simply aggregations of financial capital managed by fiduciaries for the benefit of their constituents.\textsuperscript{130} It is, of course, possible to stretch the argument that pension funds are nothing but pools of the savings of individuals and represent their interests; therefore, they must be assimilated to citizens. But this will take us right back to the arguments I have earlier advanced about the foundational problems in treating corporations as shareholders in the collective.\textsuperscript{131} To clarify, the history of corporations in America and their contemporary features make it difficult to treat them as groupings of shareholders. Therefore, it little matters that institutional investors act for individuals, or that they are “representative-shareholders” acting for their constituents.

3. Shareholders and the Stock Market – Another Reason for Caution


\textsuperscript{131} Yet another reason for caution in dealing with potential arguments linking institutional investors with citizens is evidence about the focus of these investors on the stock market, rather than the corporations. I discuss this issue a little later.
I have explained earlier that it is possible to read in the law of corporations an implicit premise that shareholders will have a concern for the welfare of corporations and act in the larger corporate interests because this will be to their benefit and promote their own welfare. This notion is aligned with the proprietary rights attributed to shareholders and the complaint, voiced in the US since late nineteenth century, that restricting corporations amounted to restricting the individual shareholders who comprised the corporations. The corporations we have around us, however, hardly correspond to this vision.

The evidence is that shareholders are purely financial investors and this trend has only become stronger since 1940. A major incentive for the ineffective and passive retail investors, portrayed by Berle and Means, to purchase shares was the prospect of gain through trade in shares. The focus of these investors has, more or less, been riveted on the stock market. Their relative indifference to the larger interests of the corporations was understandable. To begin with, they did not purchase shares with any long or medium term commitment to their investment; nor did they have any plans to oversee the directors in their stewardship of the corporations. This trend also drew support from the law of corporations as it developed. It increasingly made the shareholders an insignificant constituency in corporate operations and policymaking. As a result, corporations came under the control of their managers while the shareholders watched from the sidelines to see how the price of their shares fared in the market. They were ready to sell their shares and leave – if the price was right.

The trend is reflected quite accurately in the progressive decline seen in the average shareholding period, which is a reasonable barometer of shareholders’ commitment to the corporations. There has been a consistent fall during 1940-2005 in the average shareholding periods for companies listed on the New York Stock Exchange. According to the chart below, the average shareholding period for NYSE-listed companies fell from over twelve years in 1940 to less than a year in 2005.

132 On this, see P.M. Vasudev, supra note 67.
There has been a consistent trend of decline in the average shareholding period over the fairly long span of sixty-five years. The fall has been particularly steep from the 1970s. This indicates the lack of serious commitment to companies by the shareholders, who are clearly financial investors, rather than the proprietors of corporations.\textsuperscript{134} It weakens the rationale for treating them either as owners or as

\textsuperscript{133} Taken from Andrew Haldane: Patience and finance, speech by Mr Andrew Haldane, Executive Director, Financial Stability, Bank of England, at the Oxford China Business Forum, Beijing, 9 September 2010, available online: http://www.bis.org/review/r100909e.pdf, accessed October 14, 2011.

\textsuperscript{134} Indeed, economic theorists such as Jensen & Meckling, supra note 15, tacitly encouraged such an attitude for the shareholders. It was termed “voting with the feet.” The influence of the idea is evident in the statement of Chief Justice Roberts during the oral arguments in Citizens United, supra note 8, when he implied that a shareholder who is unhappy with the decision of a corporation to make political contributions is free to leave the
the alter-ego of corporations. Indeed, it points to the perils in persisting with old ideas of dubious validity and not coming to grips with the prevailing realities.

It is significant that the fall in average shareholding period has happened along with the rise of institutional investors, who were expected to be more engaged and activist. Now there is greater realization that this class of shareholders is equally “market-oriented.”\textsuperscript{135} In other words, their practices also converge substantially with those of the retail shareholders whom they have supplanted to a considerable extent. In Canada, there is evidence that pension funds rely increasingly on trade in shares in the market, rather than dividend payments by corporations, for their revenue.\textsuperscript{136}

4. Shareholder Power and Its Inefficacy – Recent Evidence

Quite apart from shareholders’ willingness to act, there is equally the issue of their capability and legal power to act. The business judgment rule recognized by the courts effectively precludes challenges to most of the policy and operational decisions made by corporate managements. On one hand, legislative amendments made during 1880-1930 progressively weakened the position of shareholders and eliminated their participation in corporate decision-making. On the other, the doctrine of business judgment applied by the courts checks their power to question management decisions and actions, \textit{ex post}.\textsuperscript{137}

A recent and effective illustration of the business judgment rule and the protection it affords corporate managements was seen \textit{In re Citigroup Shareholders’ Derivative Action}\textsuperscript{138} (2009). The plaintiffs in the case challenged the decision of Citigroup management to engage in speculative credit derivatives business which inflicted heavy losses on the corporation during the Financial Crisis of 2008-09. Indeed,


\textsuperscript{137} See e.g. the description of the absolute powers of corporate managements by Frank Easterbrook & Daniel Fischel, \textit{supra} note 122 at 1417.

\textsuperscript{138} \textit{Supra} note 41.
the company survived only with the “bailout” provided by the US government. The Delaware court rejected the action at the threshold, proving once again the relative immunity of managements and the hospitality of Delaware as a corporate jurisdiction.139

Another, and more recent, development that undermines shareholders’ position is in relation to the efforts made in the *Dodd Frank Act* to enable shareholders to nominate board candidates. The rule introduced by the Securities and Exchange Commission (SEC) to implement the *Dodd Frank provision* was challenged by the US Chamber of Commerce and the Business Roundtable on the ground that it failed to consider issues of cost and efficiency. The DC Circuit Court, which heard the challenge, vacated the rule.140 This is another setback for shareholders whom *Citizens United* treated as a corporation’s alter-ego. To be clear, public apprehensions about corporate power are mostly inspired by their organized might exercised through trade associations and the like, as seen in the recent challenge to the SEC rule on shareholder nominations for director elections. Small incorporated enterprises operated by individuals or families or on a partnership basis are not a source of concern. The majority decision in *Citizens United*, however, fails to make the distinction and applied a broad-brush characterization to all corporations. Curiously, the decision purports to make the playing field even for all corporations – regardless of their size or resources.141

It is not merely that shareholders are, by and large, passive and unengaged. Equally, their chances of success are not very bright when they make efforts to challenge the managements. This is another factor we must consider in interpreting corporations and their character – in particular, in treating them

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139 For a critique of the decision, see Franklin A. Gevurtz, “The Role of Corporate Law in Preventing A Financial Crisis – Reflections on *In re Citigroup Inc Shareholder Derivative Litigation*” in P.M. Vasudev & Susan Watson, eds., *Corporate Governance after the Financial Crisis* (Cheltenham, UK: Edward Elgar, 2012) (Forthcoming).
141 See e.g. *Citizens United, supra* note 2, majority opinion at 40, online version.
as associations of citizen-shareholders. There are reasons to believe that citizen-shareholders are, in fact, disenfranchised within the corporations, and as such, it would not be appropriate to attribute corporate actions to this group.

B. Corporations and Their Character – A Case for a New Vision

Corporations contribute to general welfare through the creation and distribution of wealth in the society. This has been a principal argument in favor of corporations, but it is now weaker. A number of macroeconomic as well as microeconomic factors suggest this conclusion. These include the imbalance in the growth in corporate and family incomes, large-scale relocation of manufacturing operations and business processes outside the United States and consequent loss of employment in the country, the rising disparity between managerial pay and average worker pay. These warrant a reassessment of the role of business corporations in the socio-economy.

The issue is about divergence between business interests and the larger interests of the society. Corporations are reported to have built up sizable cash reserves. According to estimates provided by Moody’s, the total cash reserves of American non-financial companies were $1.2 trillion at the end of 2010. There are criticisms about the reluctance of the corporations to invest their cash in projects and create employment that promotes more broad-based prosperity. But corporations are reluctant to do so. At the same time, a high level of unemployment continues in the US.

The phenomenon raises the question whether corporate prosperity percolates into the society and the growth of corporate enterprises translates into general benefit. In other words, the question is whether what is good for the corporations is equally so for the society in which they function and do business. If this is not so, it undermines the validity of the other argument – that corporations should

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142 Sensitivity to the issue is seen in Justice Stevens’s observation that the framers of the constitution “had little trouble distinguishing corporations from human beings” (dissenting opinion, at 37, online version).
not be subjected to controls or restrictions because it would affect their ability to generate wealth and promote the general welfare.

Corporate enterprise is also credited with ability to create wealth in the stock market. For instance, Jensen and Meckling in the 1970s interpreted the shareholder value maxim for companies in terms of Pareto efficiency.\textsuperscript{144} It was argued that rise in share prices, \textit{ceteris paribus},\textsuperscript{145} will improve overall welfare. While it would make shareholders better off, no other group will suffer any harm on that account. This idea seemed to hold true until recently. Starting in 1980, the stock market witnessed a sustained rise in share prices for almost three decades, quickly recovering from the slides seen in 1987 and 2000-2001.

The story has been different since the onset of the Financial Crisis of 2008-08. From a peak of over 14,000 in July 2007, the Dow Jones Industrial Average index fell to under 7,000 in March 2009. There has been some recovery since then, but the market has experienced considerable instability. At this writing in October 2011, the Dow Jones index is hovering around 11,500. The ups and downs seen in the recent years raise questions about the market’s efficiency and its reliability as a store of value for public savings. It also raises questions about the impact of the shareholder value maxim on corporate culture and the perils of short-termism, which I have discussed earlier.

It is important that efforts to understand corporations and interpret their character are informed by a greater sensitivity to their key dimensions, some of which I have outlined here. Such an approach, based on greater holism, can facilitate the recalibration of the corporate mechanism to suit the needs of the present. Equally, the factors I have highlighted reveal the deficiencies in the “association-of-citizens” conception applied by the US Supreme Court in \textit{Citizens United}.

The need is for a new vision of corporations. The new vision must be sensitive to the realities and challenges of the present and the future, while learning from the past. In looking to the past, however, it

\textsuperscript{144} Jensen & Meckling, \textit{supra} note 15.
\textsuperscript{145} A Latin expression meaning, all other things remaining constant or unchanged.
is important not to get bogged down by older ideas developed in a different setting.\textsuperscript{146} For the present, a more instrumental view of corporations can be more appropriate. It would avoid the dogmas of the past and the narrow “contract-and-property” approaches that fail to account for most of the dominant features of modern corporations. The instrumental vision can affirm the advantages of joint enterprise and facilitate cooperation among individuals on a footing of greater equality, fairness, and reason – values which are more representative of the present age. To be fair, such ideas have already made some progress in corporate governance as evident from the rise of notions about stakeholders\textsuperscript{147} and the balanced scored card for companies.\textsuperscript{148}

The new vision, based on the instrumental approach, provides sufficient flexibility – both at the micro level for a corporation to devise its internal structures and at the macro level, for public policy to deal with changes as they occur in the larger social, political, and economic setting. It would be relatively untroubled by simplistic notions of liberty and property rights, and resist their inappropriate application to collective human endeavor for common economic benefit. The instrumental view was stated in 1918 by Gerard Henderson:

[The corporate device] is not an expression of any philosophic quality in the group – of any group will or group organism. It is no more than a convenient technical device . . . to achieve the practical results desired, of unity of action, continuity of policy [and] limited liability...\textsuperscript{149}

\textsuperscript{146} Decisions such as \textit{Citizens United} also raise questions about the institutional position of the Supreme Court in the constitutional framework. The debate is whether the Supreme Court ought to be a forum in which individuals possessed with intellectual vigor and maturity decide issues in nonpartisan ways, or should consist of groups owing loyalty to certain ideologies and political administrations, and pursuing their ideology depending on the availability of majorities. This is an issue for the world’s oldest democracy to grapple with, as newer and more sophisticated ideas about democracy and democratic institutions emerge. It may be time shed some of the older constructs.

\textsuperscript{147} See e.g. Post, Preston, & Sachs, \textit{supra} note 77.


The new vision must be equally sensitive to the public-private character of business corporations. The fact that corporations are brought into existence by state action is not in serious dispute.\textsuperscript{150} This much is affirmed, at least by implication, by the majority judges who delivered the verdict in \textit{Citizens United}.\textsuperscript{151} To be clear, corporations are organized under statutes which are laws enacted by elected legislatures in modern democratic societies. Corporate legislation, being statements of public policy on the subject, must ideally be made after deliberation, with due sensitivity to all interests involved and respecting them fairly. This approach would enable crafting of legislation that facilitates private enterprise and promotes economic welfare, while permitting public policy to make suitable interventions when they are considered necessary.\textsuperscript{152}

In any event, there is no justification for treating a corporation as an aggregation of individuals. This is a historical error that cries to be rectified. Persisting with the folly can have serious consequences for liberty, as the New York Supreme Court pointed out in 1890 in the Sugar Trust Case.\textsuperscript{153} Examining the argument about personification of corporations and with sensitivity to the fact that they are organized under legislative enactments, the court pointed out the consequences for individual liberty if corporate power is left unchecked by public policy. The court observed:

\begin{quote}
[F]or it is one thing for the state to respect the rights of ownership and protect them out of regard to the business freedom of the citizen, and quite another thing to add to that possibility a further extension of those consequences by creating artificial persons to aid in producing such aggregations. . . . the state, by the creation of the artificial persons constituting the elements of combination . . . becomes itself the responsible creator, the voluntary cause, of an aggregation of
\end{quote}

\textsuperscript{150} This fact contradicts arguments that stressed the private character of corporations, as social innovations. See e.g. Robert Hessen, \textit{In Defense of the Business Corporation} (Stanford, CA.: Hoover Institution Press, 1979). The inaccuracy of the argument is evident from the history of corporations in the Anglo-sphere as well as current, unchallenged practice – namely, the formation of corporations under statutes and their continued existence in terms of the statutes.

\textsuperscript{151} \textit{Supra} note 2, see the observations of Justice Scalia in his concurring opinion about the long history of grant of charters (at 2, online version).

\textsuperscript{152} The statement made here defines an ideal – a goal towards which we must move for realizing the democratic principle more fully.

\textsuperscript{153} \textit{New York v. North River Sugar Refinery}, 121 NY 582 (1890).
capital which it simply endures in the individual as the product of his free agency. What it may bear is one thing; what it should cause and create is quite another.  

The difficulty with the ruling of the Supreme Court in *Citizens United* is not limited to political contributions and potential influence on the democratic process. This is, however, not to belittle the importance of these implications. A broader issue is with the Supreme Court’s “association-of-citizens” interpretation and doing so without substantive examination either of the character of contemporary corporations or the implications of the interpretation it applied. The personification of corporations cannot be justified by referring to the features of the corporations and there are serious risks in adopting this approach in the efforts to understand corporate character.

At this writing in February 2012, there are signs of disquiet within the US Supreme Court regarding its decision in *Citizen United*. The court granted a stay of a Montana state court ruling that upheld a state anticorruption campaign finance law. While doing so, Justice Ruth Bader Ginsberg cited the observation in the majority opinion in *Citizens United* that “independent expenditures, including those made by corporations, do not give rise to corruption or the appearance of corruption,” and wrote that “Montana’s experience, and experience elsewhere since this court’s decision in *Citizens United v. Federal Election Commission* make it exceedingly difficult to maintain that there is no corrupting influence.”

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156 To be fair, the situation might have been less complicated if Solicitor-General Kagan had agreed that the Supreme Court could confine its ruling to non-profit corporations one of which, *Citizens United*, was actually before the court. See *supra* note 8.

157 *Citizens United*, *supra* note 2, at 42.