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# A New Social Contract: Corporate Personality Theory and the Death of the Firm

Stefan Padfield

**Response**

# A New Social Contract: Corporate Personality Theory and the Death of the Firm

**Stefan J. Padfield**[†]



In their Article *The Death of the Firm*, Professors June Carbone and Nancy Levit argue that "the firm as entity is disappearing as a unit of legal analysis."[1] More specifically, they argue that by dismissing the corporation as a mere legal fiction[2] and equating the rights of this legal fiction with the rights of its

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1. June Carbone & Nancy Levit, *The Death of the Firm*, 101 MINN. L. REV. 963 (2017).

2. *Cf. id.* at 965 n.9 ("The firm is not, however, a complete fiction as it is an entity chartered by law with the power to enter into contracts and perform other binding acts.").

owners, cases like *Hobby Lobby*[3] "erode the status of the corporation as an entity that imposes *institutional* constraints on executive freedom of action, has *institutional* obligations to its employees, or can be held *institutionally* accountable as a community citizen."[4] In other words, the firm that has died is the one that "provided security and stability and advanced interests greater than the sum of its parts."[5] In light of this, Carbone and Levit conclude that "*Hobby Lobby*, in describing the corporation as no more than a vehicle to advance [the interests of its owners], changes the assumptions on which public-private partnerships are based."[6] Owners no longer have any "obligation, morally or legally, to consider the interests of their employees,"[7] and thus employee dependence on firms for things like health insurance becomes problematic.[8] Therefore, "the ul-

3. Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751 (2014); *see also id.* at 2768 ("[I]t is important to keep in mind that the purpose of this fiction is to provide protection for human beings. . . . Corporations, 'separate and apart from' the human beings who own, run, and are employed by them, cannot do anything at all."). *But see id.* at 2794 (Ginsburg, J., dissenting) ("[T]he exercise of religion is characteristic of natural persons, not artificial legal entities.").

4. Carbone & Levit, *supra* note 1, at 964.

5. *Id.* at 992.

6. *Id.* at 968.

7. *Id.* at 1022. This observation implicates the shareholder wealth maximization norm in corporate law. However, discussion of that norm is for the most part outside the scope of this paper. *Compare* Lynn A. Stout et al., The Modern Corporation Statement on Company Law (Oct. 6, 2016) (unpublished manuscript at 2), https://ssrn.com/abstract=2848833 (asserting that "corporate directors generally are not under a legal obligation to maximise profits for their shareholders"), *with* Honorable Leo E. Strine, Jr., *The Dangers of Denial: The Need for A Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 763 (2015) ("[A]dvocates for corporate social responsibility *pretend* that directors do not have to make stockholder welfare the sole end of corporate governance . . . .") (emphasis added); *see also* Stefan J. Padfield, *An Updated Draft of "Corporate Social Responsibility & Concession Theory" and Some Further Thoughts on* Hobby Lobby, BUS. L. PROF BLOG (July 27, 2014), http://lawprofessors.typepad.com/business_law/2014/07/an-updated-draft-of-corporate-social-responsibility-concession-theory-and-some-further-thoughts-on-hobby-lobby.html (arguing that *Hobby Lobby* doesn't change the existing shareholder wealth maximization norm). *Cf.* Hugh Christopher Willmott et al., *The Modern Corporation Statement on Management* 1 (Humanistic Mgmt. Network, Research Paper No. 51/16, 2016), https://ssrn.com/abstract=2863077 ("Firms with a strong focus on maximizing shareholder value tend to . . . reduce the quality of employment . . . when it is not outsourced, offshored, etc.").

8. *Cf.* Jeff Mordock, *DuPont to End Pension Contribution for Active Employees*, USA TODAY (Nov. 18, 2016), http://www.usatoday.com/story/money/nation-now/2016/11/18/dupont-end-pension-contribution-active-employees/

timate goal of health care reform should be to eliminate the employer role altogether."[9]

Right up front, I want to note that a similar type of what may be called an "unintended-consequences" argument was made post-*Citizens United v. FEC*.[10] Specifically, David Yosifon argues that "corporate law should depart from the shareholder primacy norm which presently dominates American corporate governance."[11] His rationale proceeds as follows:

> I begin by highlighting shareholder primacy theory's reliance on the availability of external government regulation to curb corporate exploitation of non-shareholding stakeholders in corporate enterprise, including workers, consumers, and communities. I then argue that the shareholder primacy norm itself engenders a public choice problem that makes reliance on such external regulation implausible. Profit-seeking corporations work to undermine the development of the very regulation that shareholder primacy theory charges with curbing corporate operations. Because of their capital concentration, limited liability, singular focus, and relatively small numbers compared to other interest groups, corporations can routinely best other constituencies in the competition for regulatory favor. This public choice problem is well recognized within regulatory theory generally, but it is under-theorized in corporate law. When forced to confront this public choice problem, shareholder primacists usually prescribe greater regulation of corporate political activity in order to insulate the political process from corporate influence. But the Supreme Court's recent decision in *Citizens United v. Federal Elections Commission* makes clear that the First Amendment precludes such a response. Confronting this analytic dead end, this Article concludes that the only viable response to the public choice problem in corporate law is to alter corporate governance law so that firms are not managed in the exclusive

94061148 ("The company . . . eliminated retirement health benefits, including dental and life insurance for all employees under the age of 50 . . . . [in] an attempt to align with industry trends . . . .").

9. Carbone & Levit, *supra* note 1, at 968.

10. 558 U.S. 310 (2010). *But cf.* David Rosenberg, The Corporate Paradox of *Citizens United* and *Hobby Lobby* (Nov. 7, 2016) (unpublished manuscript at 2), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2865966 (noting "irreconcilable visions" of corporations embodied in the *Citizens United* and *Hobby Lobby* decisions).

11. David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility After* Citizens United, 89 N.C. L. REV. 1197, 1198 (2011). Yosifon may be better understood as referring here to the shareholder wealth maximization norm, which constitutes an end or goal of corporate governance, as opposed to shareholder primacy, which is generally understood to locate the decision-making power in the shareholders (as opposed to, for example, the board) independent of what goal is pursued. *Cf.* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 551 (2003) ("[T]he director primacy theory embraces the shareholder wealth maximization norm even as it rejects the theory of shareholder primacy.").

> interests of shareholders, but instead operate under a multi-stakeholder regime which requires directors to attend directly to the interests of multiple stakeholders at the level of firm governance.[12]

Thus, we should consider adding Yosifon's *Citizens United*-driven multi-stakeholder regime[13] to Carbone and Levit's *Hobby Lobby*-driven separation of health care and employment as part of the response to "The Need for a New Social Contract" identified by Carbone and Levit in *The Death of the Firm*.[14] However, I will also argue that to the extent both these responses are viewed as accepting a new normal in terms of the power of corporations vis-à-vis the state, any response intended to re-assert some measure of the corporate accountability lost along the way will likely fail to achieve optimal results unless the view of corporations as discrete entities that exist at least in part on the basis of state-granted concessions remains viable (or is rehabilitated)[15] for at least some purposes.

This Response Essay proceeds as follows: Following this Introduction, I will briefly review the path Carbone and Levit chart to reach their conclusion, particularly focusing on the changes in economic and legal analysis that accompanied the shift from the "managerial firm" of the mid-twentieth century to the more modern contractarian view of the firm. I will then provide some hopefully useful commentary on how *The Death of the Firm* might look when viewed through the lens of corporate personality theory. This will be followed by a brief review of some likely criticisms of relying on corporate personality theory

12. Yosifon, *supra* note 11, at 1198–99.

13. *See* Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335 (2015) ("*Citizens United* . . . undercuts conservative corporate theory's reliance upon regulation as an answer to corporate externality risk, and strengthens the argument of its rival theory that corporate managers must consider the best interests of employees, consumers, communities, the environment, and society—and not just stockholders—when making business decisions."); Stephen M. Bainbridge, *Corporate Social Responsibility in the Night-Watchman State*, 115 COLUM. L. REV. SIDEBAR 39 (2015) (responding to Strine & Walter); David G. Yosifon, *The* Citizens United *Gambit in Corporate Theory: A Reply to Bainbridge on Strine and Walter* (Santa Clara Univ. Legal Studies, Research Paper No. 4-14, 2014), https://ssrn.com/abstract=2510967.

14. Carbone & Levit, *supra* note 1, at 1027 (including in the new social contract (1) making education more affordable, (2) increasing re-training and other support for the unemployed, and (3) having the government serve as the employer of last resort).

15. *See* Stefan J. Padfield, *Rehabilitating Concession Theory*, 66 OKLA. L. REV. 327 (2014).

in general, and artificial entity/concession theory in particular, to address the issues discussed herein. Finally, I will provide some concluding remarks.

## I. A SUMMARY OF CARBONE & LEVIT'S *THE DEATH OF THE FIRM*

Carbone and Levit provide an interesting overview of the evolution of the theory of the firm,[16] including the works of Ronald Coase,[17] Adolph Berle and Gardiner Means,[18] John Kenneth Galbraith,[19] Armen Alchian and Harold Demsetz,[20] and Michael Jensen and William Meckling.[21] I will briefly summarize this part of *The Death of the Firm* in the following two sub-parts.

### A. THE MANAGERIAL FIRM

Carbone and Levit describe the managerial firm of the mid-twentieth century as "the Coasean, Berlean, Galbraithian firm."[22] We will take each of these adjectives in turn.

Ronald Coase (1910–2013) received the Nobel Prize in Economics in 1991 "for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy."[23] The work we

16. Carbone & Levit, *supra* note 1, at 963. Carbone and Levit note that:

> We use the term "firm" in this article in the sense that Ronald Coase did to describe a form of business organization that orders the production of goods and services through use of a system internal to the enterprise rather than through the use of independent contractors. The term "corporation," in contrast, refers to a particular type of business organization with a corporate charter. Thus, while all corporations are in some sense "firms," not all firms are corporations.

*Id.* at 963 n.2.

17. *See, e.g.*, Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

18. ADOLPH BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

19. *See, e.g.*, JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE (1967) [hereinafter THE NEW INDUSTRIAL STATE]; JOHN KENNETH GALBRAITH, AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER (1952) [hereinafter AMERICAN CAPITALISM].

20. Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972).

21. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

22. Carbone & Levit, *supra* note 1, at 1006.

23. Press Release, The Royal Swedish Academy of Sciences, The Prize in

are most interested in here is Coase's 1937 piece, "The Nature of the Firm."[24] For Carbone and Levit, Coase's critical observation was that "the distinguishing mark of the firm is the supersession of the price mechanism."[25] In other words, the transaction costs of hiring personnel on an as-needed basis on the open market may be so high that it makes more sense to form a firm and hire employees on a more permanent basis and at wages that do not fluctuate daily with market supply and demand. As Carbone and Levit see it, "[t]he value of Coase's insight . . . is the . . . startling conclusion, at least for an economist, that . . . non-market organization may be superior."[26] Thus, "Coase's conclusion suggested that the firm as an entity might have some importance."[27]

In 1932, Adolph Berle (1895–1971) and Gardiner Means (1896–1988) published their classic book, *The Modern Corporation and Private Property*.[28] As Carbone and Levit put it, in that book Berle and Means "emphasized the problems stemming from the separation of ownership and control," which "have defined the corporate governance debate ever since."[29] More specifically:

> Berle and Means argued that, by the Great Depression, the corporation as entity had taken on a significance that made it something more than the tools of its owners . . . . Taking together the corporation's impact on its shareholders, employees, and the communities it affected, Berle and Means concluded that corporations had become "quasi-public" entities . . . .[30]

Finally, John Kenneth Galbraith (1908–2006) helped explain both what made firms unique entities and how these unique entities became part of an alliance with labor and the

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Economics 1991 (Oct. 15, 1991), http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1991/press.html.

24. Coase, *supra* note 17.

25. *Id.* at 389.

26. Carbone & Levit, *supra* note 1, at 974–75.

27. *Id.*

28. BERLE & MEANS, *supra* note 18.

29. Carbone & Levit, *supra* note 1, at 985. *Cf.* Jason Scott Johnston, *The Influence of the Nature of the Firm on the Theory of Corporate Law*, 18 J. CORP. L. 213 (1993) ("Berle and Means describe the separation of ownership from control . . . in terms of the 'surrender' of control, the transformation of the owner from an 'active' agent . . . to a state of passivity in which the owner 'is practically powerless through his own efforts to affect the underlying property.'").

30. *Id.* at 982.

state. First, Galbraith "believed in 'identity economics' and found the firm as entity central to the creation of identity."[31]

> Galbraith found that the principal problem for any organization is how to coordinate the activities of members. Doing so requires addressing the issue of motivation. [H]e found that neither compulsion nor pecuniary incentives were enough. Instead, the most effective motivation comes from employees who identify with the goals of the firm and derive tremendous satisfaction from achieving them . . . .[32]

Second, Galbraith identified "countervailing powers"[33] as part of the process that ultimately led to corporations becoming "important to the vindication of public purposes."[34] Carbone and Levit note that "[i]n both of these ways, the idea of the firm as greater than the individuals who comprised it contributed to the coordination of relationships within the firm, and the relationships between firm, state, and community interests."[35]

Thus, all three theorists provided support for the corporate firm as distinct and somehow greater than the sum of its parts. This, in turn, provided support for relying on these distinct entities as part of the government's social safety net.

### B. THE DEATH OF THE MANAGERIAL FIRM

Carbone and Levit argue that "[i]f the first seven decades of the twentieth century marked the rise of the firm as an institution greater than the sum of its parts, the last part of the twentieth century has marked its dismantling."[36] They note that "an ideological shift rejected mid-twentieth century managerialism, which had treated firms as more than the sum of their parts, and replaced it with agency-cost theory that treated the firm as a mere nexus of contracts."[37] Furthermore,

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31. *Id.* at 977.

32. *Id.* at 976–77 (citing THE NEW INDUSTRIAL STATE, *supra* note 19, at 140–58, 166–78 (1967)).

33. *See* AMERICAN CAPITALISM, *supra* note 19, at 196–200.

34. Carbone & Levit, *supra* note 1, at 21.

35. *Id.* at 992.

36. *Id.*

37. *Id.* at 966. *Cf.* John C. Coffee, Jr., *Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation*, 100 COLUM. L. REV. 370, 376 n.15 (2000) (citing Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) for the standard definition of "agency costs": "the sum of the preventive costs taken by firms to limit misappropriation by their agents, the bonding cost undertaken by agents themselves, and the irreducible minimum of losses from agent misconduct that it is not efficient to prevent"); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the*

"the attack did not reject the seminal insights of Coase or Berle and Means. Instead, it embraced and reinterpreted them."[38]

Carbone and Levit identify the economists Armen Alchian (1914–2013) and Harold Demsetz (1930–present) as providing "the initial reconstruction."[39] Specifically:

> Coase's insight had been that . . . firms managed the coordination involved in . . . more complex organizations through something other than price; Alchian and Demsetz objected that the problems of coordination involved something more than simply the substitution of employer direction for contract terms. Instead, they observed that what the firm did was to assemble teams of workers who needed to work together to produce the desired output and production teams inevitably produced shirking . . . . Alchian and Demsetz argued that firms solved the problem through the entrepreneur's role as a "residual claimant."[40]

Carbone and Levit note that this analysis "validated the entrepreneur/owner's dominant position in the firm. Most fundamentally, however, it eliminated the developments of the preceding forty years."[41]

> The idea of firm identity providing motivation for employee efforts disappeared from consideration. So, too, did the notion that relationships within a firm depend on something different from relationships outside it. Alchian and Demsetz took Coase's idea of suppression of the price mechanism, which opened the door to consideration of alternative forms of human motivation, and used it to validate narrow self-interest. The result presented a fundamental challenge to the importance of the firm itself.[42]

Carbone and Levit next identify the economists Michael Jensen (1939–present) and William Meckling (1922–1998) as firing off "an influential salvo in this effort soon after Alchian and Demsetz."[43] Specifically, Jensen and Mecklng "seconded

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*Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1754 (2001) ("Corporate production typically requires the combined efforts and contributions of a wide range of groups and individuals, including shareholders, employees, and managers. The nexus of contracts theory of the firm holds that these efforts and contributions are coordinated primarily through a web of express and implied contractual agreements.").

38. *Id.* at 993.

39. *Id.* (citing Alchian & Demsetz, *supra* note 20, at 777).

40. *Id.* at 994–95.

41. *Id.* at 995.

42. *Id.*

43. *Id.* at 998; *see also* Elias Pete George, *Using Game Theory and Contractarianism to Reform Corporate Governance: Why Shareholders Should Seek Disincentive Schemes in Executive Compensation Plans*, 42 GOLDEN GATE U. L. REV. 349 (2012) ("While Coase, Alchian, and Demsetz laid the ground-

Alchian and Demsetz's findings that the separation of ownership and control created monitoring problems, which they termed 'agency costs.'"[44] Furthermore, "Jensen and Meckling went to great lengths to emphasize that the corporation as entity was not in any way special."[45]

Carbone and Levit then proceed to argue that, in addition to the foregoing, "[t]he agency-cost theorists needed to rewrite Berle as fundamentally as they had reinterpreted Coase—and they did"[46]:

> When the corporate governance debate resumed in the seventies, the corporation no longer symbolized the concentration of unaccountable power in the hands of a few. Instead, the new concern was complacency. . . . The new generation of corporate theorists again saw this . . . problem as arising from the separation of ownership and control. The solution, however, was not to reinforce Berle and Means' call for greater judicial or government oversight. Instead, their solutions would be to bring back the price mechanism both within the firm and without. To do so, they did not just inveigh against the corporation as a fiction that could and should be ignored. They ultimately sought to reduce the entity to no more than a vehicle to facilitate market exchanges.[47]

Carbone and Levit conclude in relevant part by noting that "'at bottom the nexus-of-contracts conception is not a theory of the firm: It is a theory of why there are no firms'; a conclusion that conflicts with Coase, Berle and Means, and 'reality as it is normally understood.'"[48]

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work for contractarianism, Michael Jensen and William Meckling are credited with fathering the nexus-of-contracts theory . . . .").

44. *Id.*

45. *Id.*

46. *Id.* at 996.

47. *Id.* at 996–97. "Legal scholars embraced the nexus-of-contracts approach to argue that all that was necessary was to get the law out of the way so that the market could perform its magic." *Id.* at 999. *Cf.* Joseph F. Morrissey, *A Contractarian Defense of Corporate Regulation*, 11 TRANSACTIONS: TENN. J. BUS. L. 135, 138 (2009) ("The most problematic portion of the nexus-of-contracts framework for me has been the normative claim that many proponents of the framework have proffered: that, because the corporation can be viewed as this bundle of privately ordered contracts, regulation is largely unnecessary and undesirable.").

48. Carbone & Levit, *supra* note 1, at 1000 (quoting Melvin A. Eisenberg, *The Conception That the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 832 (1999)). *Cf.* William W. Bratton, *The Separation of Corporate Law and Social Welfare*, 74 WASH. & LEE L. REV. (forthcoming 2017) (manuscript at 1), https://ssrn.com/abstract=2927150 ("It is now clear that the market side really won the battle of the 1980s, succeeding in entering a wedge between corporate law and social welfare.").

Having thus summarized Carbone and Levit's description of the rise and fall of the managerial firm, including its replacement by the contractarian firm, we shall now examine what added insights we might derive from viewing this process through the lens of corporate personality theory. It is my hope that this exercise will provide some additional insight into both the nature of the problems and the concomitant solutions proposed by Carbone and Levit.

## II. CORPORATE PERSONALITY THEORY AND *THE DEATH OF THE FIRM*

Theories of corporate personality attempt to describe the nature of corporations in ways that can hopefully assist legislatures, judges, and society in general determine the proper role for corporations in society, as well as the proper scope of regulations to be applied to corporations. Much of my recent scholarship has focused on the role of corporations in society, specifically focusing on the lessons to be learned by utilizing the lens of corporate personality theory.[49] Accordingly, much of the following overview is taken directly from that scholarship. The subsequent application of this theoretical framework to Carbone and Levit's Article will constitute the primary substance of my response here.

49. *See* Stefan J. Padfield, Citizens United *and the Nexus-of-Contracts Presumption*, 1 HARV. BUS. L. REV. ONLINE 25 (2011), http://www.hblr.org/2011/01/citizens-united-and-the-nexus-of-contracts-presumption (arguing that in *Citizens United*, "adoption of . . . competing theories of the firm was in some meaningful way dispositive"); Stefan J. Padfield, *The Dodd-Frank Corporation: More Than a Nexus-of-Contracts*, 114 W. VA. L. REV. 209 (2011) (arguing that "Dodd-Frank adds a new weight to the concession theory side of the scale by codifying too-big-to-fail"); Stefan J. Padfield, *The Silent Role of Corporate Theory in the Supreme Court's Campaign Finance Cases*, 15 U. PA. J. CONST. L. 831 (2013) [hereinafter *The Silent Role of Corporate Theory*] ("In this Article, I examine the key Supreme Court cases leading up to *Citizens United* to see whether a . . . silent corporate theory debate is evident . . . I find that there is . . . and proceed to argue that . . . the Justices should make their views regarding the proper theory of the corporation express."); Padfield, *Rehabilitating Concession Theory*, *supra* note 15 (arguing that "reports of concession theory's demise have been greatly exaggerated and that there remains a serious role for the theory in discussions concerning the place of corporations in society"); Stefan J. Padfield, *Corporate Social Responsibility & Concession Theory*, 6 WM. & MARY BUS. L. REV. 1, 34 (2015) (arguing that "[c]orporate personality theory, specifically concession theory, can be a meaningful source of leverage in advancing mandatory [corporate social responsibility]").

### A. AN OVERVIEW OF CORPORATE PERSONALITY THEORY

The three primary theories of corporate personality are: (1) artificial entity theory (also known as concession theory); (2) aggregate theory; and (3) real entity theory. At the risk of oversimplifying, real entity theory and aggregate theory arguably presume corporations stand in the shoes of natural persons (the board of directors in the former case, and the shareholders in the latter), and thus have available to them many of the rights of natural persons when it comes resisting government regulation. Concession theory, on the other hand, views the corporation as a state creation, and presumes the state may regulate its creation as it sees fit.

#### 1. Concession Theory / Artificial Entity Theory

In the 1819 Supreme Court case of *Trustees of Dartmouth College v. Woodward*, Chief Justice John Marshall famously stated:

> A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created . . . . The objects for which a corporation is created are universally such as the government wishes to promote. They are deemed beneficial to the country; and this benefit constitutes the consideration, and in most cases, the sole consideration of the grant.[50]

This formulation has commonly been associated with concession theory, also known as artificial entity theory. As I have stated elsewhere, "of the three traditional theories of the corporation under constitutional law . . . concession theory is the only one that legitimizes presumptive deference to state regulation."[51]

#### 2. Aggregate Theory

In the 1886 Supreme Court case of *Santa Clara County v. Southern Pacific Railroad Co.*, the Court notoriously asserted that:

> The court does not wish to hear argument on the question whether the provision in the Fourteenth Amendment to the Constitution, which forbids a State to deny to any person within its jurisdiction the

50. Tr.'s of Dartmouth Coll. v. Woodward, 17 U.S. 518, 637 (1819).
51. Padfield, *Rehabilitating Concession Theory*, *supra* note 15, at 329.

> equal protection of the laws, applies to these corporations. We are all of opinion that it does.[52]

I have previously noted that "Morton Horwitz has convincingly argued that [*Santa Clara*] represented a shift to the aggregate view of the corporation."[53] The aggregate view rejected the fiction of the corporation as an artificial entity, which had been promoted by concession theory, and instead focused on the property rights of the underlying shareholders to conceive of the corporation as simply an association of individuals.

3. Real Entity Theory

As I have previously written elsewhere:

> The problem with aggregate theory is that the primary theoretical justification for limited liability is the separation of ownership from control by way of the statutorily designated overseers of corporate activity – the board of directors. If one ignores this separation and boils the corporation down to its shareholder owners, then one is essentially back to a form of general partnership where all the owners are personally liable for the debts of the business. Thus, the need arose for another theory, and real/natural entity theory filled that need by aligning the corporation with the board of directors.[54]

As opposed to aggregate theory, which essentially boils the corporation down to an association of shareholders, real entity theory (also known as natural entity theory) essentially places the board of directors at the control center of the corporation.[55]

Having thus briefly reviewed the basic forms of corporate personality theory, we can now try to assess whether their application to *The Death of the Firm* may be useful.

## B. APPLYING THE CORPORATE PERSONALITY THEORY LENS TO *THE DEATH OF THE FIRM*

One might view the story of the death of the firm presented by Carbone and Levit as a play in three acts. The first act might be characterized as describing the rise of the firm using the analysis of Coase, Galbraith, and Berle & Means to highlight the role of the firm as something more than simply the

52. 118 U.S. 394, 396 (1886).

53. Padfield, *Rehabilitating Concession Theory*, *supra* note 15, at 336 (citing MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1870-1960: THE CRISIS OF LEGAL ORTHODOXY 67 (1992)).

54. *Id.* at 337.

55. *Cf.* Bainbridge, *supra* note 11, at 560 ("[T]o the limited extent to which the corporation is properly understood as a real entity, it is the board of directors that personifies the corporate entity.").

sum of its parts and more than a pure creature of the market.[56] In this act, big business is aligned with labor and the state in a very meaningful way, and government regulation plays an important role in maximizing the benefits of the corporate form. The second act would focus on the analysis of Alchian & Demsetz, and Jensen & Meckling, and the deconstruction of the firm as nothing more than the sum of its parts; purely the efficient response to certain market pressures. Here, labor is relegated to employment contracts, government regulation is seen as an impediment to growth, and corporate governance is focused on aligning the interests of management and shareholders via various incentive schemes. Finally, the third act portrays the rise of the "new elite," as upper-level management aligns with powerful shareholders to focus on short-term share-price gains, and the allegiance of this group is to profit and each other rather than to the firm as valuable in its own right and worth stewarding for the long-term benefit of all stakeholders.[57]

If one translates the foregoing three acts into the language of corporate personality theory, one may align the Coase/Galbraith/Berle firm with the concession or artificial entity theory of the firm, at least to the extent they describe the firm as insulated from the market and aligned with, and dependent upon, an active state in some meaningful way. The second act arguably aligns well with aggregate theory, particular-

56. *Cf.* Grant M. Hayden & Matthew T. Bodie, *The Uncorporation and the Unraveling of "Nexus of Contracts" Theory*, 109 MICH. L. REV. 1127, 1130 (2011) ("Corporations are not creatures of contract. One cannot contract to form a corporation. The individuals involved must apply to a state for permission to create such an entity. The fact that this permission is readily granted . . . does not change the fact that permission is required."); Richard N. Langlois, The Corporation is Not a Nexus of Contracts. It's an iPhone (July 20, 2016) (unpublished manuscript at 1), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2856631 ("[T]he corporation cannot be constructed solely out of voluntary contract . . . .").

57. *Compare* Carbone & Levit, *supra* note 1, at 992 ("[T]he managerial inclination to promote broader interests may also have come from greater elite unity in the postwar era (management and state were inclined to see their interests as aligned to a greater degree than today) . . . ."), *with id.* at 993 ("The intellectual cohesiveness of American elites in the immediate postwar era that contributed to the greater alignment of management and labor, public and private interests gave way to renewed ideological division.") *and id.* at 1015 (identifying a modern "management elite that views the company from without, as part of a group of directors, managers and shareholders likely to see the company as a means to produce profits rather than as an entity of importance in itself").

ly to the extent the firm is there described as a nexus of contracts wherein solving the agency problem is paramount.[58] Finally, one may equate the new elite of the third act with real entity theory.[59] This last characterization is likely particularly apt to the extent one aligns shareholder primacy with aggregate theory, and thus distinguishes it from what may be loosely described as a form of director primacy accompanied by a shareholder wealth maximization norm.[60]

The reason this exercise matters is because to the extent part of the appropriate response to the death of the firm is a reduction of the corporate subsidies previously conferred in exchange for a more community-oriented firm,[61] corporate personality theory is a useful, and perhaps even necessary, part of such a project. This is because decisions like *Hobby Lobby* and *Citizens United*,[62] among other factors, are essentially increasing corporate subsidies by strengthening corporate rights against state regulation.[63] A corporate personality theory analysis can explain how the Supreme Court is justifying these decisions, while at the same time exposing serious flaws in the

58. *See* Reuven S. Avi-Yonah, Citizens United *and the Corporate Form*, 2010 WIS. L. REV. 999, 1025 n.142 ("The point that the nexus of contracts theory is a reinvention of the aggregate view has been made repeatedly.").

59. *Cf. id.* at 1040 ("What is remarkable about *Citizens United* . . . is that both the majority and the dissent adopted the real entity view of the corporation . . . ."); *but cf.* Padfield, *The Dodd-Frank Corporation: More Than A Nexus-of-Contracts*, *supra* note 49, at 225–26 (2011) ("Where Avi-Yonah sees coherence, I see a battle between the concession and contractarian views of the corporation.").

60. *See* Bainbridge, *supra* note 11, at 551 ("[T]he director primacy theory embraces the shareholder wealth maximization norm even as it rejects the theory of shareholder primacy.").

61. *Cf.* Carbone & Levit, *supra* note 1, at 968 ("The recognition of the rights of owners to impose idiosyncratic limits on employee access to state benefits raises the issue of whether the state should subsidize employer benefits at all."); *id.* at 1029 ("[T]he price for leaner firms, which have jettisoned public obligations, ought to be fewer public subsidies with more explicit strings attached for those that remain.").

62. *Cf.* Sloan G. Speck, *The Social Boundaries of Corporate Taxation*, 84 FORDHAM L. REV. 2583, 2592–93 (2016) (identifying "recent renaissance in judicial, academic, and popular engagement with the nature of corporate personality" and noting that "[a]t the heart of this recent renaissance lie two well-known Supreme Court decisions—*Citizens United v. FEC* and *Burwell v. Hobby Lobby Stores, Inc.*").

63. *Cf.* Carbone & Levit, *supra* note 1, at 1020 ("[I]n acting through corporate form, the Hobby Lobby owners can insist on a First Amendment right to claim the . . . competitive advantages of government subsidized health care for their employees *and* still pick and choose among the provisions included in the plans on the basis of their individual, idiosyncratic preferences.").

analysis.[64] Furthermore, because corporate personality theory "fits" as a lens through which to view the death of the firm as described by Carbone and Levit, it can form a useful bridge from the problem described to the solution proposed therein. Finally, because corporate personality theory utilizes a powerfully evocative narrative that can elicit a strong voter response,[65] there is a real risk in ignoring corporate personality theory and allowing the "new elite" to capture that narrative just like they arguably captured the analysis of Coase and Berle.[66] In sum, and as alluded to earlier, it may be necessary to revitalize and rehabilitate both corporate personality theory generally and artificial entity/concession theory in particular in order to effectively respond to the death of the firm as discussed herein.

## III. CRITICISMS

There are likely numerous reasonable challenges that can be brought against the assertions and proposals in both Carbone and Levit's *The Death of the Firm*, as well as my response thereto. While I acknowledge the former, I plan to only address some of the latter here. Essentially, the audience I have in mind for this Essay consists primarily of readers who have

64. *See The Silent Role of Corporate Theory*, *supra* note 49 at 833–34 (2013) (arguing that a close reading of *Citizens United* "reveals that both the majority and dissent not only adopted diverging theories of the corporation, but that those theories were likely dispositive," and that corporate personality theory "played the same silent and dispositive role" in many of the cases leading up to *Citizens United*). *Cf.* Heather M. Kolinsky, *Situating the Corporation Within the Vulnerability Paradigm: What Impact Does Corporate Personhood Have on Vulnerability, Dependency, and Resilience*, 25 AM. U. J. GENDER SOC. POL'Y & L. 51, 54 (2017) ("Th[e] evolution of corporation as person . . . highlights the problem of providing resilience to vulnerable subjects whose competing vulnerabilities are situated in the same corporate environment. Addressing this issue is of critical importance where employment has become the conduit for the responsive state to provide resilience to so many subjects . . . .").

65. *Cf.* Ernest A. Canning, *California Voters Afforded Opportunity This November to Weigh-in on "Corporate Personhood,"* TRUTHOUT (July 23, 2014), http://www.truth-out.org/news/item/25110-california-voters-afforded -opportunity-this-november-to-weigh-in-on-corporate-personhood ("According to state Sen. Ted Lieu (D-Torrance), the author of SB 1272, the measure is intended to send 'a message to Congress' that we 'should not equate money with free speech and corporations are not people.'").

66. *Cf.* Tamara R. Piety, *Why Personhood Matters*, 30 CONST. COMMENT. 361, 386 (2015) ("Calling upon the legal fiction of personhood seems a deliberate part of the litigating strategy by those . . . who push for expansive rights for corporations . . . .").

found some or all of the major points in *The Death of the Firm* at least defensible, and who are considering to what extent, if any, they should incorporate the perspective I develop herein into their understanding of those points. Thus, I leave debating the substantive merits of *The Death of the Firm* to other fora, though I obviously would not be writing this response if I did not believe the points made therein at least worthy of serious consideration and comment.

In my article, *Rehabilitating Concession Theory*,[67] I address a number of arguments commonly raised against relying on corporate personality theory generally, and concession theory in particular, as a basis for determining the rights and responsibilities of corporations, including: (1) "The Argument That Corporate Theory Is Excessively Malleable";[68] (2) "The Argument That Concession Theory Died Along with Special Charters";[69] (3) "The Argument That Listeners' Rights Trump Corporate Theory";[70] (4) "The Argument That the Unconstitutional Conditions Doctrine Trumps Concession Theory."[71] Rather than rehash those arguments here, I will leave the interested reader to review that piece. However, I will add a few points that I may not have made previously.

67. Padfield, *Rehabilitating Concession Theory*, *supra* note 15.

68. *Id.* at 343 (arguing that "while corporate theory may not be able to precisely predict outcomes in all cases, it is nonetheless meaningful in terms of eliminating certain conclusions and allocating burdens," and that "a purely functional analysis may either be incomplete without corporate theory or merely overlap with corporate theory"). *Cf.* Margaret M. Blair & Elizabeth Pollman, *The Derivative Nature of Corporate Constitutional Rights*, 56 WM. & MARY L. REV. 1673, 1743 (2015) ("If a corporate right is premised on being derivative in nature, then it would seem imperative that the Court be able to identify the group of persons from whom the right is derived. Some corporations can be appropriately characterized as a group of identifiable persons, while others cannot.").

69. Padfield, *Rehabilitating Concession Theory*, *supra* note 15, at 347 (2014) ("[T]he fact that government permission is required to incorporate supports the legitimacy of state regulation, regardless of how freely such permission is granted.").

70. *Id.* at 349 ("[E]ven if one understands the *Citizens United* opinion to be fundamentally about listeners' rights, there remains the question whether there is something about corporations that would justify including them in the line of cases carving out exceptions for particular identity-based restrictions on speech.").

71. *Id.* at 354 ("Were the Court to directly confront the issue, there are at least five good reasons to conclude that the unconstitutional conditions doctrine would not constitute an insurmountable obstacle to the viability of concession theory.").

To the extent that I am not only advocating for a role for corporate personality theory in determining the rights and responsibilities of corporations, but am further arguing that of the three theories discussed herein it is concession theory that holds the most promise for enabling the state to effectively address the concerns raised by Carbone and Levit, and that, finally, concession theory can in fact bear the weight I propose be placed on it, another criticism relates generally to the superiority of relying on the market to provide appropriate corrective measures.[72] Relatedly, empowering the state via the application of concession theory may actually exacerbate the problems identified by Carbone and Levit due to regulatory capture and other aspects of crony capitalism.[73] Of course, this debate has been raging for years and will certainly not be resolved here. I merely note that I accept that these criticisms have merit, but that there is likely enough reason to be skeptical to warrant continuing to advocate for a strong role for the state in ensuring the vulnerable portions of our society aren't simply left to fend for themselves amidst the vagaries of the market.[74]

## CONCLUSION

Before proceeding to my concluding remarks, I feel compelled to comment briefly on Carbone and Levit's reference to economic inequality as another consequence of the death of the firm. Carbone and Levit note that:

> If we compare skilled and unskilled workers, firms today contract out (that is, they use market contracts) to secure an increasing percentage of the unskilled labor they need . . . . Corporations remain more likely to bring employees in-house to perform more sophisticated

72. *Cf.* Noah Smith, *IPOs Are Going Out of Style*, BLOOMBERG (Sept. 16, 2015), https://www.bloomberg.com/view/articles/2015-09-16/taking-companies-public-is-going-out-of-style ("Whatever the cause of the U.S. turn away from publicly listed companies, the important question is: Is this a bad thing? Many investors . . . say that public markets force managers to think only in the short term, while private companies are able to think long-term.").

73. *Cf.* Peter Martin Jaworski, *Blame the Politicians: A Government Failure Approach to Political Ethics*, 12 GEO. J.L. & PUB. POL'Y 521 (2014) (citing rent-seeking, regulatory capture, and crony capitalism as "predictable causes of government failure").

74. *Cf.* Barbara J. Fick, *Corporate Social Responsibility, Free Trade and the Trans-Pacific Partnership*, CLS BLUE SKY BLOG (June 29, 2015), http://clsbluesky.law.columbia.edu/2015/06/29/corporate-social-responsibility-free-trade-and-the-trans-pacific-partnership ("Experience with . . . [voluntary corporate] codes [of conduct] over the past twenty years indicates serious shortcomings in their ability to effectively protect workers from abusive labor conditions.").

> tasks, such as engineering or product design, that are harder to specify, to supervise, or to divide into discrete parts. Companies, of course, are also more likely to bring employees in-house where the skills are valuable, firm specific, and/or hard to find. This dynamic contributes to the growing inequality in American wages and it recreates a form of class structure within American firms.[75]

One interesting proposal for addressing economic inequality that may also implicate the nature of the firm is what I will call "Inclusive Capitalism."[76] "Inclusive Capitalism" refers to a scheme of corporate finance that rests on a broader distribution of capital.[77] As Robert Ashford, Ralph P. Hall, and Nicholas A. Ashford describe it in their article, "Broadening Capital Acquisition with the Earnings of Capital as a Means of Sustainable Growth and Environmental Sustainability":

> In general, earning capacity can be enhanced by some combination of two contributions; (1) wages earned through employment and (2) money earned through the ownership of productive capital. The latter includes ordinary investment from wage savings that people might make through the purchasing of stocks, bonds, and property; changing ownership structures of businesses, employee stock ownership plans (ESOPs), and extending effective market opportunities to poor and middle-class people so that they can acquire capital with the earnings of capital based on principles of binary economics. This article focuses on the binary economic approach and explains how this approach can enhance not only their capital earning capacity but also the demand for employment and the prospects for achieving environmental sustainability. The binary economic approach envisions an implementation of an ownership-broadening system of corporate finance that would require no taxes, redistribution, or government command. Corporations would be free to continue to meet their capi-

75. Carbone & Levit, *supra* note 1, at 1011.

76. *See* Robert Ashford, *Why Working but Poor? The Need for Inclusive Capitalism*, 49 AKRON L. REV. 507 (2016) ("[W]e must establish a more inclusive capitalism . . . .").

77. *Cf.* David Singh Grewal, *Closing Remarks: Law and Inequality After the Crisis*, 35 YALE L. & POL'Y REV. 337, 339 (2016) ("[I]nequality . . . signals a preponderance of capital over labor in the generation and distribution of income and wealth . . . ."); Leo E. Strine, *Who Bleeds When the Wolves Bite? A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. (forthcoming 2017) (manuscript at 9), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2921901 ("For the middle and upper-middle class . . . wages comprise 70% or more of income."); Amy Westbrook & David A. Westbrook, Unicorns, Guardians, and the Concentration of the U.S. Equity Markets (Mar. 3, 2017) (unpublished manuscript at 7), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2928949 ("While Berle and Means were worried about the republican consequences of dispersed capital and concentrated management, in recent years, *both* capital and management have become concentrated.").

> tal requirements as before, but they would have an additional, potentially more profitable, market means to do so.[78]

Thus, we may expand further on the new social contract discussed in an earlier part of this Essay by adding a role for "Inclusive Capitalism" in the "new partnerships" Carbone and Levit identify as necessary responses to the death of the firm[79]:

> As firms change from entities with stable identities, investments in long-term employees, and community-based commitments to ever-shifting networks designed to maximize the interests of the transient few, the opportunities they offer for public-private partnerships change. The new partnerships should be based on flexibility rather than stability, and they should promote individual resilience rather than assume that employment alone will address long-term worker needs.[80]

In *The Death of the Firm*, Carbone and Levit argue that "[t]he firm *is* dead. That is, the nearly century-long arc that saw the rise of the large American corporation, its dominance within American communities, and its emergence as a co-equal partner with Big Government and Big Labor has reached its end."[81] Accordingly, "[e]mployer-provided health care has become an anachronism,"[82] and "the price for leaner firms, which have jettisoned public obligations, ought to be fewer public subsidies with more explicit strings attached for those that remain."[83] In this Essay, I argue that the project Carbone and Levit advocate for would benefit greatly from, and perhaps even be dependent upon, a reinvigoration of corporate personality theory—particularly concession theory.

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78. Robert Ashford, Ralph P. Hall & Nicholas A. Ashford, *Broadening Capital Acquisition with the Earnings of Capital as a Means of Sustainable Growth and Environmental Sustainability*, EUR. FIN. (Oct. 2, 2013), http://www.europeanfinancialreview.com/?p=1321.

79. *See* Stefan J. Padfield, *The Inclusive Capitalism Shareholder Proposal*, 17 UC DAVIS BUS. L.J. (forthcoming 2017).

80. Carbone & Levit, *supra* note 1, at 969.

81. *Id.* at 1005.

82. *Id.* at 968. *Cf.* Kristian Stout, *Sharing the Wealth: Gig Economy Moves Toward a Portable Safety Net*, TRUTH ON THE MARKET (November 10, 2015), https://truthonthemarket.com/2015/11/10/sharing-the-wealth-gig-economy-moves-toward-a-portable-safety-net ("[T]hirty-nine different companies and policy experts . . . signed a letter urging lawmakers to create a 'portable benefits' platform . . . .").

83. Carbone & Levit, *supra* note 1, at 1029.