

A BALANCING APPROACH TO CORPORATE RIGHTS AND DUTIES

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MARTIN PETRIN

I. Introduction

Despite its age, the longstanding debate surrounding corporate rights and duties remains unresolved. Until today, the type and scope of corporate rights and duties, as well as the manner by which they are assigned, are both contested and evolving. The questions at stake are manifold. For instance, should we view corporations as aggregates of individuals, which would suggest that the corporate entity should be given the rights that their shareholders or other controlling individuals possess? Should corporations be criminally liable, and if so, does it matter whether misconduct can be attributed to individuals at a certain hierarchical level? Or, are corporations capable of bearing social or ‘moral’ responsibility for societal issues, namely in the form of corporate social responsibility?

In order to elucidate these and similar issues, this chapter will in Part II first trace the roots of the corporate rights and duties debate. It will survey traditional theories that explain the nature of legal entities and, turning to contemporary corporate law, discuss the nexus of contracts approach, focusing in particular on these theories’ implications for corporate rights and duties. The chapter will then, in Part III, move on to demonstrate how traditional and modern corporate theories influence the law and academic discussion on the rights and duties of corporate entities, highlighting also how this has led to various problems.

Finally, Part IV will outline an alternative approach to conceptualizing corporations, which aims to provide a more useful and transparent method by which to ascertain corporate rights and duties. In short, the chapter will argue that instead of relying on the theories of the firm that are currently used – old and new – a better way going forward is to engage in a balancing approach, which seeks to assign rights and duties by reference to corporations’ social and economic function, purpose, and effects.

II. Theory of the Firm and Corporate Rights and Duties

Legal scholars have long attempted to explain, in theoretical terms, the precise nature of legal entities. The resulting theories have often been tied to the question of how and to what extent legal entities should be given rights and duties. Today, this debate continues and is in significant parts still based on ancient conceptions of the firm, which remain very much alive. Thus, for a deeper understanding of current law and jurisprudence that govern what corporations are allowed and required to do, knowledge of the relevant theories is paramount. Against this background, the following sections will provide an overview of the most influential theories of the firm, emphasizing their treatment of rights and duties.

A. Fiction Theory and Aggregate Theory

During the nineteenth century a growing number of legal scholars became consumed by the idea that the nature of ‘juristic persons’ and their status within the broader legal framework could be ‘scientifically’ explained, which in turn would clarify which rights and duties these entities could bear.¹ One of the most important theories to emerge from this period was the Roman law inspired ‘fiction theory’, which emphasized the artificial character of legal entities such as states, municipalities, and corporate entities.

The fiction theory dominated English and American corporate law for the first part of the nineteenth century.² For example, in the landmark decision of *Trustees of Dartmouth College v. Woodward*, US Supreme Court Chief Justice Marshall characterized the corporation as an ‘artificial being, invisible, intangible, and existing only in contemplation of law.’³ Emphasizing the state’s role in the formation of corporations, he also noted that these entities only possess those properties that they are conferred upon by their charter.

¹ See, e.g., R. Harris, ‘The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business’ (2006) 63 *Washington & Lee Law Review* 1421 at 1422–1423.

² See W.W. Bratton, ‘The New Economic Theory of the Firm: Critical Perspectives from History’ (1989) 41 *Stanford Law Review* 1471 at 1502–1506; M.J. Horwitz, ‘Santa Clara Revisited: The Development of Corporate Theory’ (1985) 88 *West Virginia Law Review* 173 at 184. In Anglo-American law, the fiction theory was also known as the ‘grant theory’ or ‘concession theory,’ although it is worth noting that some scholars have distinguished the latter theory from the traditional fiction theory.

³ *Trustees of Dartmouth College v. Woodward*, 17 US (1 Wheat.) 518 at 636 (1819).

In Germany, jurist Friedrich Carl von Savigny played the most prominent role in helping to further develop and popularize the fiction theory.⁴ His account of the fiction theory is particularly illuminating. Along with other fiction theorists, he argued that legal persons only have recognized rights and duties as a consequence of an act of the state,⁵ which meant that they were purely artificial or fictitious in nature.⁶ Further exploring the fiction theory's implications for rights and duties of legal entities, Savigny contended that given their artificial personality, these entities could only bear a limited set of rights and duties, which mostly related to property.⁷ Furthermore, apart from instances of strict liability, legal entities – in contrast to the individuals acting for them – could not incur civil or criminal liability. Given their artificial nature, they were perceived as being incapable of developing the requisite state of mind, such as negligence or intent.⁸

During this period, the fiction theory also competed with the 'aggregate' or 'contractualist' theory, which was particularly popular in nineteenth century England⁹ and emerged more clearly and became dominant in the United States during the latter half of the same century.¹⁰ This theory asserted that corporations and other legal entities were aggregations of human individuals whose relationships were structured by way of mutual agreements.¹¹ As such, both a legal entity's legal rights and duties were often seen, in an indirect or derivative manner, as simply those of its shareholders or other individuals that made up the entity. In other words, under the aggregate theory, rights and obligations held by individuals could be construed to reflect upon the legal entity itself.¹²

⁴ The central work is F.C. von Savigny, *System des heutigen römischen Rechts* (Berlin: Bei Deit und Comp, 1840), vol. II.

⁵ *Ibid.* at 275.

⁶ *Ibid.* at 236.

⁷ *Ibid.* at 238-239, 314.

⁸ *Ibid.* at 317.

⁹ N.H.D. Foster, 'Company Law Theory in Comparative Perspective: England and France' (2000) 48 *American Journal of Comparative Law* 573 at 585.

¹⁰ See J.C. Coates, 'State Takeover Statutes and Corporate Theory: The Revival of an Old Debate' (1989) 64 *New York University Law Review* 806 at 815–818.

¹¹ See, e.g., Bratton, above n 2 at 1489.

¹² For example, in *San Mateo v. Southern Pacific Railroad*, 13 F 722 (C.C.D. Cal. 1882) the court stated that the beneficiaries of constitutional and other legal rights would always be the individuals behind a corporation, never the entity itself. As will be shown later in this chapter, this theory has recently once more risen to prominence through two landmark US Supreme Court decisions.

B. Real Entity Theory

The practical shortcomings of the fiction theory (with its limits on corporate liability, which proved increasingly difficult to reconcile with the needs of modern society) led to the development of the Germanic ‘real entity theory’ in the late nineteenth century.¹³ The real entity theory (or ‘organic theory’) was based on a very different premise. Legal entities were not seen as fictions, but rather as ‘real’ beings that represented ‘social organisms with heads and extremities’.¹⁴ Although it was admitted that legal entities technically gained their personality through acts of the state, the theory’s proponents argued that juristic personality formed and existed independently or ‘naturally’, and that therefore the law simply confirmed a pre-existing reality already in place by its own virtue.¹⁵

The real entity theory included two important features. First, in contrast to the fiction theory, it was ‘pro-liability’.¹⁶ Higher-ranking officials or executive bodies, referred to as ‘organs’, could commit torts and crimes in their official capacities. These acts would be imputed to the legal entity, resulting in both the entity’s and the responsible individual’s liability to third parties.¹⁷ Importantly, therefore, entity liability depended on the seniority of the person within the entity committing the offense. Second, because of its understanding of legal entities as non-artificial, organic beings, the real entity theory contended that these entities could have any right that they were capable of exercising, which was usually defined in the negative as rights that did not require human qualities.¹⁸

In the early twentieth century, the real entity theory, together with the discourse over its clash with the fiction theory, was ‘transplanted’ from Germany to England and the United States, where it gained traction, challenging both the fiction and aggregate theories.¹⁹ The real entity theory was not as successful in the common law as in the civil law, where it defeated the fiction theory for the most part and was even elevated to statutory law. Nevertheless, from

¹³ One of the leading proponents was German scholar Otto von Gierke. See O. von Gierke, *Die Genossenschaftstheorie und die deutsche Rechtsprechung* (Berlin: Weidmann, 1887). For a helpful discussion of the theory’s broader background and impact, see Harris, above n 1 at 1427-1430; M. Gelter, ‘Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light’ (2011) 7 *New York University Journal of Law & Business* 641 at 665-666.

¹⁴ O. von Gierke, *Deutsches Privatrecht* (Leipzig: Duncker & Humboldt, 1895), vol. I, pp. 470, 472.

¹⁵ Gierke, above n 13 at 611; Harris, above n 1 at 1424.

¹⁶ M.M. Hager, ‘Bodies Politic: The Progressive History of Organizational “Real Entity” Theory’ (1989) 50 *University of Pittsburgh Law Review* 575 at 588.

¹⁷ Gierke, above n 13 at 743-760.

¹⁸ For example, legal entities were thought to be incapable of assuming parenthood.

¹⁹ Harris, above n 1 at 1435.

the early twentieth century onwards, the real entity theory also increasingly influenced courts and gained considerable prominence in the common law. Among others, the theory's rejection of the notion of corporate artificiality can be credited with the recognition of corporate tortious liability and certain aspects of corporate law, including the decline of *ultra vires* theory and a strengthened limited liability principle.²⁰

C. Nexus of Contracts

Despite the reality-fiction-aggregate debate and its persistent presence in both the common law and civil law, some scholars began to argue that theories of the firm should emphasize economic aspects rather than only the *nature* of legal entities. The American legal realist movement that blossomed around the 1920s and similar movements in Europe²¹ paved the way to new academic theories of the firm, beginning from around the 1970s, that placed their focus on functional aspects of the corporate form.

The most notable development to emerge from this period is the nexus of contracts theory of corporations, now in some jurisdictions regarded as the dominant corporate law theory.²² The nexus of contracts model, however, still contains elements of both the traditional aggregate and fiction theories. This becomes evident in the theory's portrayal of the firm as a construct of various explicit and implicit contracts between a firm's constituencies²³ and its characterization as an 'aggregate of various inputs acting together to produce goods or services'.²⁴ Additionally, the theory also embraces the view that firms are legal fictions, with the fiction forming the nexus that is at the center of a complex web of explicit and implicit contracts.²⁵

²⁰ See Horwitz, above n 2 at 186-188; R.S. Avi-Yonah, 'Citizens United and the Corporate Form' (2010) *Wisconsin Law Review* 999 at 1018-1019; see also Avi-Yonah's chapter in this book, 'The Four Transformations of the Corporate Form'.

²¹ See K. Grechenig and M. Gelter, 'The Transatlantic Divergence in Legal Thought: American Law and Economics vs. German Doctrinalism' (2008) 31 *Hastings International & Comparative Law Review* 295 at 348-353.

²² The theory is often traced back to R. Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386. In addition, other scholars with notable pioneering works in this area include Oliver Williamson, Armen Alchian, Harold Demsetz, Michael Jensen, and William Meckling.

²³ See, e.g., S.M. Bainbridge, *The New Corporate Governance in Theory and Practice* (Oxford University Press, 2008), p. 28; F.H. Easterbrook and D.R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991), p. 12.

²⁴ Bainbridge, above n 23 at 28.

²⁵ S.M. Bainbridge, 'Abolishing Veil Piercing' (2001) 26 *Journal of Corporation Law* 479 at 485.

Modern theories of the firm are almost exclusively preoccupied with the corporate governance problems that arise between shareholders and corporate managers and assume that non-corporate laws will regulate corporate responsibility vis-à-vis non-shareholder third parties. Therefore, perhaps surprisingly, the nexus of contracts theory – and contemporary corporate law and theory generally – have little to say about corporations’ rights and duties.²⁶ One notable exception is the nexus of contracts theory’s stance on the question for whose benefit corporations operate. According to this aspect of the theory, shareholders are the primary beneficiaries of corporate activities and, consequently, managers should normally – and unless shareholders direct them otherwise – maximize shareholders’ wealth without regard to other stakeholders’ interests.²⁷ Contractarians also tend to deny the firm’s ability to bear social or moral duties and responsibilities based on its fictional character, which they see as precluding the firm from assuming such obligations.

If the nexus of contracts model would be used without any adjustments to define which rights and duties legal entities should have, it would lead to untenable results. Taken literally, the nexus itself as a mere web of contractually connected individuals could not bear any rights or be liable. Indeed, the atomistic nexus model would demand that rights and duties are those of the various individuals or constituencies that act for or as part of the nexus. In this sense, the contractarian model’s partial proximity to the old aggregate and fiction theories becomes once more apparent.

III. Impact on Corporate Rights and Duties

Focusing on constitutional law, tort and criminal law, and corporate social responsibility, this part of the chapter will highlight how the corporate theories discussed above influence today’s theory and practice of corporate rights and duties. As it turns out, the traditional fiction, reality, and aggregate theories retain a strong presence and influence the law in a number of ways.²⁸ The nexus of contracts theory, outside of the academic realm, does not

²⁶ As one scholar recently observed, ‘orthodox corporate theory ... has relatively little to say about the corporation itself and even less to say about corporate responsibility’. L. Johnson, ‘Law and Legal Theory in the History of Corporate Responsibility: Corporate Personhood’ (2012) 35 *Seattle University Law Review* 1135 at 1163.

²⁷ See, e.g., S.M. Bainbridge, ‘Director Primacy: The Means and Ends of Corporate Governance’ (2003) 97 *Northwestern University Law Review* 547 at 548.

²⁸ In addition to the following sections of this chapter, the continuing effect of traditional theories on corporate theory and practice is noted for example in V. Harper Ho, ‘Theories of Corporate Groups: Corporate Identity Reconceived’ (2012) 42 *Seton Hall Law Review* 879 at 896; J.M. Krannich, ‘The

appear to have directly shaped the law governing corporate rights and duties. However, it is an important point of reference and basis for those that oppose corporate social responsibility-type obligations of businesses, which also makes it important for the purposes of this chapter.

A. Constitutional and Statutory Rights

The real entity theory and its counterparts, the fiction and aggregate theories, have made their mark on constitutional law. This is particularly pronounced in the United States. Over the course of the nineteenth and twentieth centuries, a number of Supreme Court cases held that a corporation was akin to a real person and therefore entitled to constitutional rights such as commercial speech, protections against unreasonable searches and seizures, and freedom of the press, among others. Conversely, in other cases decided during this period, the firm's fictional nature prevailed.²⁹ It is also worth noting that apart from the constitutional arena, questions surrounding corporate rights have arisen in the statutory context, where – as in the case of constitutional law – it may be equally unclear whether specific rights or duties, such as privacy, apply to a legal entity or not.³⁰

Recently, two landmark cases have once more shown the effect of corporate theories on corporate rights. In *Citizens United v. Federal Election Commission*, the Supreme Court struck down statutory provisions limiting corporate election contributions based on the real entity and aggregate theories.³¹ *Citizens United* raised the question as to whether corporations should be granted political speech rights, thus allowing them to use their general treasury funds to influence election campaigns.³² The Court was asked to decide whether, from a

Corporate “Person”: A New Analytical Approach to a Flawed Method of Constitutional Interpretation’ (2005) 37 *Loyola University of Chicago Law Journal* 61 at 61, 67, 84, 90. See also M. Petrin, ‘From Nature to Function: Reconceptualizing the Theory of the Firm’ (2013) 118 *Penn State Law Review* 1, which explored this section’s topic and the theme of this chapter from a pre-*Hobby Lobby* perspective (on said case, see below text accompanying notes 37-40).

²⁹ For an overview of the case law, see P.I. Blumberg, ‘The Corporate Entity in an Era of Multinational Corporations’ (1990) 15 *Delaware Journal of Corporate Law* 283 at 299-318; Krannich, above n 28 at 90–100.

³⁰ In *FCC v. AT&T, Inc.*, 131 S. Ct 1177 (2011), for example, the Supreme Court held that a corporation as an artificial entity could not claim a statutory ‘personal privacy’ interest in law enforcement records.

³¹ *Citizens United v. FEC*, 558 US 310 (2010).

³² The case arose when non-profit corporation Citizens United sought to confirm certain portions of a law that regulates financing of political campaigns that were unconstitutional as applied to its documentary on then-Senator Hillary Clinton.

constitutional standpoint, corporate political speech differed from that of individual political speech such that the former should be more limited. The majority opinion suggested that, for the most part, there was no difference between humans and corporations in this regard. While the Court did not expressly state that corporations are real persons or that they solely represent their shareholders – thus warranting First Amendment rights given to individuals – the decision’s wording suggests and was widely read as relying on the aggregate and real entity theories.³³ The Court analogized corporations with ‘associations of individuals’³⁴ and appeared to generally treat the corporation as being on the same or similar footing as individuals. Conversely, the dissenting opinion argued that corporations are vastly different from natural persons and should generally not be given political speech rights. The dissent noted that corporations are ‘legal fiction[s]’ that ‘have no consciences, no beliefs, no feelings, no thoughts, no desires.’³⁵ By doing so, the dissent invoked the core idea of nineteenth century fiction theory, even using language that is strikingly similar to eighteenth-century fiction theory proponent Edward Thurlow’s famed observation that corporations have no ‘conscience ... no soul to be damned, and no body to be kicked’.³⁶

In the 2014 decision in *Burwell v. Hobby Lobby Stores, Inc.*,³⁷ the US Supreme Court once again returned to corporate rights. This time, the Court was faced with determining the scope of corporations’ religious rights, based on a statute that specifies the constitutional right to free exercise of religion. In particular, the Court had to address whether a corporation could choose not to provide health-insurance coverage for certain methods of contraception – despite a governmental requirement mandating otherwise – in order to preserve the company’s controlling shareholders’ religious beliefs.

In its characterization of the corporate form, the Supreme Court returned to some of the familiar reasoning previously seen in *Citizens United*, although it now relied most heavily

³³ See, e.g., Avi-Yonah, above note 20 at 1040-1042; Harper Ho, above note 28 at 922-923; D.A.H Miller, ‘Guns, Inc.: Citizens United, McDonald, and the Future of Corporate Constitutional Rights’ (2011) 86 *New York University Law Review* 887 at 930; J. MacLeod Heminway, ‘Thoughts on the Corporation as a Person for Purposes of Corporate Criminal Liability’ (2011) 41 *Stetson Law Review* 137 at 138; A. Tucker, ‘Flawed Assumptions: A Corporate Law Analysis of Free Speech and Corporate Personhood in Citizens United’ (2010) 61 *Case Western Reserve Law Review* 497 at 505, 515.

³⁴ *Citizens United*, above n 31 (Scalia J. concurring).

³⁵ *Ibid.* at 466 (Stevens J., concurring in part and dissenting in part).

³⁶ J.C. Coffee, ‘No Soul to Damn: No Body to Kick’: An Unscandalized Inquiry into the Problem of Corporate Punishment’ (1981) 79 *Michigan Law Review* 386 at 386 (quoting Baron Thurlow).

³⁷ *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct 2751 (2014). On this decision, see generally L. Johnson and D. Millon, ‘Corporate Law after Hobby Lobby’ (2014) 70 *Business Lawyer* 1.

on the aggregate theory. It referred to corporations as ‘legal fictions,’ but noting that ‘the purpose of this fiction is to provide protection for human beings’.³⁸ On this basis, the Court found that a ‘corporation is simply a form of organization used by human beings to achieve desired ends’.³⁹ Consequently, it concluded that ‘[w]hen rights, whether constitutional or statutory, are extended to corporations, the purpose is to protect the rights of these people’.⁴⁰ Based on this assessment, the majority held that the purpose of extending constitutional and statutory rights to corporations was to protect the rights of individuals that are associated with such entities, including shareholders, officers, and employees. Consequently, the Court concluded that protecting corporations’ free-exercise rights was necessary in order to protect the religious liberty of the humans who own and control them.

Unfortunately, *Hobby Lobby* leads to more questions than it answers. For instance, on a fundamental level, it is not clear why the Court found that the established separation between the legal entity and individuals should not apply when it comes to corporate rights. More importantly, particularly for businesses, it is also unclear from the Court’s reasoning why its holding should not apply to corporate duties as well. On this understanding, however, the legal obligations of corporations could in future cases also be imputed to those who control them, meaning that shareholders (or directors, officers, employees) could become liable for their firm’s debts and other obligations. Given this potential flipside to the Court’s conception of incorporate entities, *Hobby Lobby* may turn out to be only a pyrrhic victory for businesses and their owners.

B. Tort and Criminal Law

Tort law and criminal law are further areas that reflect the influence of legal entity theories, here in the shape of corporate duties in the form of liability. In Continental Europe, tort law as applied to legal entities remains almost wholly captured by the real entity theory. In the case of corporations, normally, only torts committed by the company’s higher-ranking officials can incur the company’s liability. Although vicarious liability for lower-level employees is recognized, establishing the legal entity’s responsibility in several jurisdictions

³⁸ *Hobby Lobby*, above n 37 at 2768.

³⁹ *Ibid.*

⁴⁰ *Ibid.*

still requires, at least in theory, that a higher-level ‘organ’ acting for the entity was negligent in exercising her duties in selecting, supervising, or monitoring such employees.⁴¹

The real entity theory’s effects are also visible in Anglo-American law. In the United Kingdom, the organic approach still retains ‘a lingering grip’ on the civil liability of corporations⁴² and governs, among others, the attribution of knowledge and conduct to legal entities through the theory of the ‘directing mind’.⁴³ In the United States, the distinction between a legal entity’s senior officials and lower-level employees, although of lesser importance for tort law overall, manifests itself in the area of punitive damages. The law in some states rejects pure corporate vicarious liability for punitive damages and, instead, provides that punitive damages can only be awarded upon a showing of involvement by certain higher-level corporate officials – such as directors, officers, or ‘managing agents’ – that control and represent the corporation itself.⁴⁴ As one court has explained, by confining liability to situations involving individuals that are seen as the corporation’s alter ego, the law aims to punish a corporation for misbehavior that reflects ‘the corporate “state of mind” or the intentions of corporate leaders’.⁴⁵ This conception is reminiscent of the real entity theory’s idea that only misconduct by ‘organs’ can be attributed to a company.

Criminal liability of legal entities, on the other hand, is under the influence of both the real entity and fiction theory. Courts and scholars in many jurisdictions have long adhered to the traditional axiom that legal entities lacked the capability of incurring mens rea and could not be criminally liable. Instead, only individuals acting on behalf of a company could be subject to criminal punishment.⁴⁶ Still today, many civil law countries typically do not recognize general corporate criminal liability, with the narrow exception of certain statutory liabilities.⁴⁷ Conversely, in the United Kingdom, a corporation’s criminal liability is often

⁴¹ This is true, for example, under German, Swiss, and Austrian law. See M. Petrin, ‘The Curious Case of Directors’ and Officers’ Liability for Supervision and Management: Exploring the Intersection of Corporate and Tort Law’ (2010) 59 *American University Law Review* 1661 at 1690, footnote 151.

⁴² B. Hannigan, *Company Law* (Oxford University Press, 2012), p. 77.

⁴³ *Stone & Rolls Ltd. v. Moore Stephens* [2008] EWCA (Civ) 644, [2009] 1 AC 1391.

⁴⁴ See C.R. Green, ‘Punishing Corporations: The Food-Chain Schizophrenia in Punitive Damages and Criminal Law’ (2008) 87 *Nebraska Law Review* 197 at 200.

⁴⁵ *Cruz v. Homepage*, 99 Cal Rptr 2d 435 at 439 (Cal. Ct. App. 2000).

⁴⁶ See G. Geis and J.F.C. DiMento, ‘Empirical Evidence and the Legal Doctrine of Corporate Criminal Liability’ (2002) 29 *American Journal of Criminal Law* 341 at 342–348; V.S. Khanna, ‘Corporate Criminal Liability: What Purpose Does It Serve?’ (1996) 109 *Harvard Law Review* 1477 at 1490.

⁴⁷ See, e.g., G.O.W. Mueller, ‘Mens Rea and the Corporation: A Study of the Model Penal Code Position on Corporate Criminal Liability’ (1957) 19 *University of Pittsburgh Law Review* 21 at 28–

premised on the principles of the real entity theory. According to the classic ‘directing mind’ or ‘identification’ theory, which was adopted in the House of Lords’ *Lennard’s case*⁴⁸ and corresponds to the real entity theory, only criminal offences committed by individuals that can be regarded as physical embodiments of the company can be attributed to the company.⁴⁹ Although the introduction of the UK’s Corporate Manslaughter and Corporate Homicide Act has mitigated some of the harsh effects of the identification doctrine, the Act’s provisions still require a breach of duty on the part of senior management and remain reminiscent of the real entity theory.⁵⁰

Under US law, a mixed picture of corporate criminal liability emerges. While corporations’ vicarious liability for criminal conduct is broadly recognized for strict liability offenses, there are splits amongst both jurisdictions and legal scholars when it comes to offenses requiring mens rea.⁵¹ On the one hand, federal courts hold that corporations may become vicariously liable for criminal acts committed by employees of any hierarchical level. Under this approach, criminal liability does not require any involvement by senior corporate officials. On the other hand, a considerable number of states follow the approach incorporated in the American Law Institute’s Model Penal Code (MPC). The MPC’s rules generally provide that a corporation may incur criminal liability if ‘the commission of the offense was authorized, requested, commanded, performed or recklessly tolerated by the board of directors or by a high managerial agent acting on behalf of the corporation within

32; P.S. Abril and A. Morales Olazábal, ‘The Locus of Corporate Scierter’ (2006) *Columbia Business Law Review* 81 at 106.

⁴⁸ *Lennard’s Carrying Co. v. Asiatic Petroleum Co.* [1915] AC 705. Another notable case is *H.L. Bolton (Engineering) Co. Ltd v. T.J. Graham & Sons Ltd.* [1957] 1 QB 159, in which Lord Justice Denning used the reality theory’s organic approach in establishing corporate liability. Although a civil case, other courts have often relied on *Bolton* in the criminal context.

⁴⁹ The individuals triggering corporate liability are normally directors, officers, or other senior employees. *Tesco Supermarkets Ltd. v. Nattrass* [1972] AC 153. A broader definition of which persons can represent the corporation in this context was suggested in *Meridian Global Funds Management Asia Ltd. v. Securities Commission* [1995] 2 AC 500 (PC).

⁵⁰ The Act may impose criminal liability on organizations if the management or organization of their activities causes a person’s death and the conduct of senior management is a substantial element in the breach of their duties in this respect. Corporate Manslaughter and Corporate Homicide Act 2007, s. 1. Although the UK Law Commission has recently considered law reform to abolish the identification doctrine, it was ultimately decided not to move forward with proposals on corporate criminal liability.

⁵¹ See P.I. Blumberg, *et al.*, *Blumberg on Corporate Groups* (New York: Aspen Publishers, 2005), vol. III, pp. 106-107 and footnote 6; Green, above n 44 at 200; B. Thompson and A. Yong, ‘Corporate Criminal Liability’ (2012) 49 *American Criminal Law Review* 489 at 494–495; MacLeod Heminway, above n 33 at 141-142.

the scope of his office or employment'.⁵² The MPC's approach represents a variation of the English identification theory and as such continues to embody an outflow of traditional real entity theory.⁵³

The real entity theory and the fiction theory's application in tort and criminal law yields unfortunate results. The real entity theory – as used in various contexts in both tort and criminal law – and its application mean that a corporation can only be liable if the injured party can show that someone akin to an 'organ' of the company committed or was otherwise involved in the offense. Especially in larger and decentralized organizations, this tends to be difficult to prove for outsiders. Conversely, insofar as the fiction theory is still adhered to (in the criminal law context), its application has the effect that corporate liability is impossible or severely restricted. In sum, in both instances, corporations' exposure to civil and criminal liability may be limited, resulting in equally limited recourse by third parties injured by corporate activities.

C. Corporate Social Responsibility

A final example of the impact of corporate theory on rights and duties can be found in the area of Corporate Social Responsibility (CSR), which focuses on the imposition of corporate duties to stakeholders other than shareholders, such as employees, communities, or governments.⁵⁴ The question to what degree corporate directors and managers can or should engage in acts that depart from shareholder wealth – and indeed the broader questions of the corporate purpose – remains controversial. US corporate law, perhaps apart from corporate constituency statutes,⁵⁵ fails to provide clear guidance on this point.⁵⁶ In the UK, the

⁵² Model Penal Code § 2.07(1)(c) (Proposed Official Draft 1962). According to the MPC's definition in § 2.07(4)(c), a 'high managerial agent' is an officer or agent that has 'duties of such responsibility that his conduct may fairly be assumed to represent the policy of the corporation'.

⁵³ See E. Colvin, 'Corporate Personality and Criminal Liability' (1995) 6 *Criminal Law Forum* 1 at 9-11.

⁵⁴ On the (potential) differences between CSR and stakeholder theory, see generally J.M. Conley and C.A. Williams, 'Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement' (2005) 31 *Journal of Corporation Law* 1; D. Millon, 'Two Models of Corporate Social Responsibility' (2011) 46 *Wake Forest Law Review* 523.

⁵⁵ These statutes generally allow or require directors of public corporations to consider the welfare and other interests of non-shareholder groups in the course of making corporate decisions. However, they are regarded as largely ineffective in practice.

⁵⁶ See, e.g., C.M. Bruner, 'The Enduring Ambivalence of Corporate Law' (2008) 59 *Alabama Law Review* 1385; B. Choudhury, 'Serving Two Masters: Incorporating Social Responsibility into the Corporate Paradigm' (2009) 11 *University of Pennsylvania Journal of Business Law* 631 at 633. One

Companies Act 2006 now includes a statutory duty of directors to ‘promote the success of the company’, which includes an obligation to have regard to the impact of the company’s operations on employees, the community, and the environment.⁵⁷ Nevertheless, this language still leaves room for varying interpretations and lacks a degree of clarity that would put the corporate purpose debate to rest.

Given the law’s ambiguities, scholars have frequently attempted to solve the controversy by developing arguments that draw from theories of the firm. Merrick Dodd’s classic account of corporate citizenship and CSR rejected the fiction theory’s implications and was already inspired by real entity theory.⁵⁸ ‘If the unity of the corporate body is real’, Dodd theorized, ‘then there is reality and not simply legal fiction in the proposition that the managers of the unit are fiduciaries for it and not merely for its individual members, that they are ... trustees for an institution rather than attorneys for the stockholders’.⁵⁹ Thus, with corporations viewed this way, businesses and corporate managers can pursue societal interests and have duties to other constituencies besides shareholders.

Building upon this foundation, other CSR scholars and stakeholder theorists have justified consideration of broader stakeholder interests by characterizing the firm by reference to its ‘real’ character,⁶⁰ with one scholar arguing that ‘CSR is most easy to justify in all its forms on the basis of the real theory of the corporation and is likely to remain practiced for the future’.⁶¹

of the most recent Delaware decisions concerning this point is *eBay Domestic Holdings, Inc. v. Newmark*, 16 A 3d 1 (Del. Ch. 2010), in which the court noted that directors are obliged to promote the value of the corporation for the benefit of its shareholders. Nevertheless, the case does not appear to change Delaware’s stance on the corporate purpose and the specific facts and language of the case suggest that directors are not precluded from taking into account non-shareholder constituencies’ interests.

⁵⁷ Companies Act 2006, s. 172.

⁵⁸ See E.M. Dodd, ‘For Whom Are Corporate Managers Trustees?’ (1932) 45 *Harvard Law Review* 1145 at 1146, 1160. Dodd opposed Adolf Berle’s view that managers hold their powers in trust for shareholders as the sole beneficiaries of corporate activities. See A.A. Berle, ‘Corporate Powers as Powers in Trust’ (1931) 44 *Harvard Law Review* 1049.

⁵⁹ Dodd, above n 58 at 1160.

⁶⁰ See, e.g., W. Bradford, ‘Beyond Good and Evil: The Commensurability of Corporate Profits and Human Rights’ (2012) 26 *Notre Dame Journal of Legal Ethics* 141 at 148; S.K. Ripken, ‘Corporations Are People Too: A Multi-Dimensional Approach to the Corporate Personhood Puzzle’ (2009) 15 *Fordham Journal of Corporate & Financial Law* 97 at 117.

⁶¹ R.S. Avi-Yonah, ‘The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility’ (2005) 30 *Delaware Journal of Corporate Law* 767 at 780–782. Conversely, David Millon previously noted that today’s stakeholderism debate is mostly conducted based on aggregate theories of corporate personhood rather than real entity conceptions. D. Millon, ‘The Ambiguous Significance of Corporate Personhood’ (2001) 2 *Stanford Agora* 39 at 43–46.

On the other spectrum of the debate, prominent law and economics scholars and other shareholder theorists have drawn upon both the fiction theory and the nexus of contracts theory to support their opposing view of CSR.⁶² Opining that a corporation is not real but rather a legal fiction and a nexus of contracts, these theorists conclude that the corporation is incapable of having social or moral obligations. As we have already noted above, characterizing the firm as a mere nexus of contracts lends itself to the argument that corporations cannot have societal duties to the public at large.⁶³

IV. Towards a Balancing Approach

As the previous sections have shown, century-old theories on the nature of the firm still pervade important areas of contemporary law, leading to outcomes that can be inconsistent with other legal or economic principles and broader policies. However, as evidenced by the long-standing and seemingly ‘endless’⁶⁴ debate on corporate theories, the nature of the corporate form cannot be conclusively proven and explained. Indeed, albeit interesting, it appears that the question ‘what is the firm?’ – the focal point of traditional approaches to seeking to conceptualize the firm – is largely insignificant and should not be relied on by legislators, courts, or academics. In reality, the choice of a particular theory and its interpretation are a function of convictions, values, and policy goals that may well be arbitrary. Even the now dominant nexus of contracts theory, reminiscent in part of the aggregate and fiction theories, fails to convincingly support its one claim that is of greatest interest for this chapter, namely that shareholders should be the firm’s sole beneficiaries.

Given these shortcomings, this part will explore a new way to conceptualize the firm. The following sections will outline a ‘balancing’ or ‘functional’ approach that suggests that the firm should be defined not by its nature, but rather by its function. This approach, it is argued, is better suited than current corporate theories to deciding matters relating to corporate rights and duties.

⁶² See Bradford, above note 60 at 147 (explaining that these scholars are ‘grounded in a theory of the firm which regards a corporation as a legal creation designed and managed solely to generate profits for its stockholders’).

⁶³ D.R. Fischel, ‘The Corporate Governance Movement’ (1982) 35 *Vanderbilt Law Review* 1259 at 1273.

⁶⁴ M. Radin, ‘The Endless Problem of Corporate Personality’ (1932) 32 *Columbia Law Review* 643.

A. Corporate Characteristics

Corporations are economic creatures. Apart from special types of corporations, these entities, with their limited liability and asset partitioning functions,⁶⁵ are designed and operate with a view to generating profits. As such, prima facie, a legal entity's *rights* should reflect its core economic function and purpose. For instance, with regards to constitutional and statutory rights, the economic core function makes it justifiable to protect corporate commercial speech in order to increase sales of goods and services. Beyond this, corporations may also be given other rights, such as rights to privacy, political speech, and even religious rights if there is a sufficiently strong link to the entity's economic goals. For example, a kosher food company might claim that certain provisions violate its right to religious exercise, or a business could make the case that corporate privacy rights are necessary to protect its confidential documents and trade secrets. Where such a link is not present, the entity may still assert a specific non-economic right,⁶⁶ but, as will be further explained below, there should be a differentiation based on the entity's function and purpose, namely whether we deal with for-profit businesses or entities that pursue other goals.⁶⁷ A case in point is Hobby Lobby Stores, Inc., one of the companies at the center of the US Supreme Court's controversial *Hobby Lobby* decision.⁶⁸ This company, albeit grounded in Christian values, focuses its business on the sale of crafting supplies, not in the dissemination of religious views. While Hobby Lobby as a corporation is free to pursue any non-economic mission that its shareholders approve of, there is no firm basis in the view that its activities in this regard should be legally protected.⁶⁹

Economic considerations further dictate important corporate *duties*. For instance, economic analysis suggests that in many cases it is efficient to hold corporations liable for torts and criminal acts committed by their agents or that otherwise flow out of their business activities. Holding the corporation liable in these cases enhances loss prevention, helps to internalize costs, and facilitates efficient risk allocation.⁷⁰ In particular, the concept of loss internalization demands that the full effects of corporate activities, including negative effects

⁶⁵ On the asset partitioning theory of corporations and other legal entities, see H. Hansmann and R. Kraakman, 'The Essential Role of Organizational Law' (2000) 110 *Yale Law Journal* 387.

⁶⁶ Unless one assumes, as some commentators have argued, that any speech by for-profit corporations is economically motivated commercial speech. See, e.g., Tucker, above n 33 at 521.

⁶⁷ See below Part IV.B.

⁶⁸ On this case, see above Part III.A.

⁶⁹ Of course, the individuals that control Hobby Lobby and similar companies are protected in exercising their own religious rights. After all, they are separate from the companies that they control.

⁷⁰ See Petrin, above n 41 at 1703.

in the form of pollution, injuries, and others, must be internalized, that is reflected in the price of corporate good and services. Only if the true cost to society is reflected in goods and services will there be an optimal volume of production. Yet, full cost internalization can only be achieved if the corporation is liable for crimes and torts of employees and other individuals at all hierarchical levels. However, this stands in contrast to a number of contemporary legal rules in both criminal and tort law, which, as explained above, still reflect the spirit of the real entity theory and require acts or involvement by senior officials as a prerequisite to corporate liability.⁷¹ Conversely, the approach as proposed herein looks to economic theory and the effects of corporations, suggesting that the full costs of torts and crimes should be internalized, regardless of the actors' status within the corporation.

B. Beyond an Economic Function

In addition to the corporation's economic side, legal entities also serve a *social* function and purpose and can have wide-ranging societal effects. Thus, legal entities are commonly used for non-economic goals and the law allows for and supports such use as evidenced by, for instance, non-profit corporations and, in the US, the new class of Benefit Corporations.⁷² Moreover, corporations have considerable effects on society, both in positive and negative ways. These social aspects, which are often intertwined with economic effects, need to be included in a contemporary concept of the firm and should also inform the way in which corporate rights and duties are ascertained.

In terms of rights, it is self-evident that legal entities that primarily or exclusively pursue non-economic interests will need to be granted rights that pertain to their respective social, political, cultural, religious, or other goals. Still, such rights are not without boundaries but have to be balanced against potential effects of the entity's exercise of a right. Thus, as an example, *Citizens United*⁷³ could have entailed weighing the necessity and benefits of granting political speech rights to the plaintiff, a non-profit corporation, against potential negative impacts in the form of a distortion of the electoral process or undue political influence.

⁷¹ See above Part III.B.

⁷² See generally on Benefit Corporations, J.F. Sneirson, 'Green is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance' (2009) 94 *Iowa Law Review* 987 at 1017–1019.

⁷³ On this case, see above Part III.A.

Conversely, when it comes to for-profit companies, the case for granting rights other than those that pertain to their economic functions is much less clear-cut, given that such rights would normally not relate to the company's core. For instance, from a functional viewpoint, the need to give these types of corporations the right to exercise religion is difficult to rationalize, although there is a possibility that certain entities could make a convincing case that adherence to religious beliefs or practices is in fact an essential part of their business. Similarly, the less closely a free speech right relates to an economic goal, the weaker the case will be for extending the right to a for-profit business. Under this approach, then, for-profit firms would have a weaker case for the right to engage in political speech that is ideologically motivated, whereas there would be a stronger case for protecting firms' political speech that is aimed to have an impact on its own profits.

In determining to what extent for-profit entities should bear duties, the social effects of firms also play an important role. In this respect, social considerations are in line with economic analysis that supports broad corporate responsibility for torts and crimes flowing from business activities. Conversely, the question of whether corporations have or should have societal duties is more complex and touches upon a much-contested issue. In this regard, the approach proposed in this chapter does not directly endorse either side. Nevertheless, based on the growing impact that businesses have on society at large, a balancing view incorporates the idea that social considerations should be taken into account in assessing the duties of businesses.⁷⁴ In line with the idea of a balancing approach, the degree to which a corporation owes duties to third parties can be seen as being dependent on its impact as measured by negative externalities. The stronger an entity's 'footprint' is in this regard, the more extensive its duties to affected stakeholders or society at large should be. For example, a corporation that operates in an industry that is prone to extensive pollution should have a corresponding duty towards affected stakeholders, which may go beyond adherence to positive laws and regulations.

⁷⁴ See also K. Greenfield, 'Defending Stakeholder Governance' (2008) 58 *Case Western Reserve Law Review* 1043 at 1059-1062, who has drawn a connection between corporate disasters and corporate duties to act responsibly toward third parties.

C. Summation: Balancing Economic and Social Functions

In short, balancing corporate rights and duties refers to an approach that defines the firm by its economic and social functions, purpose, and effects, which includes elements of an economic and social inquiry into the role of legal entities. It is this inquiry, and not the question of the nature of the firm, that should inform our conception about firms and define corporate rights and duties. Given the dominant function and purpose of corporations, economic considerations are the starting point of this approach. They protect a firm's economic rights and further act as a basis for justifying duties and rules that support the internalization of business risks.

At the same time, the social element factors into a rights and duties analysis in three ways. First, it helps to define the types of non-economic rights a legal entity should be granted. Second, the social element is used in the analysis of a legal entity's duties. The notion that companies should have regard to the interests of third parties and the public at large also ties in with the economic consideration that they should be liable for torts and crimes that result from their activities. Third, the social element can act to counterbalance a firm's rights. In particular, the social functions and purpose of a firm may temper rights that relate to a corporation's economic function and purpose.

V. Conclusion

Theories that define corporations, and legal entities more generally, retain a strong presence and affect various contemporary areas of the law. However, despite the considerable efforts undertaken to explain the nature of the firm, the notion of a corporation as real, fiction, or otherwise fails to provide convincing answers and often only further complicates attempts to solve legal issues. In lieu of traditional approaches, the approach outlined in this chapter provides a more useful and sound framework by which to think about corporations and other business entities and their rights and duties. Ascertaining and assigning rights and duties by balancing a corporation's core economic and social aspects against its impacts on economic and social factors allows courts and legislatures to replace judgments and intuition with tangible and measurable variables to conduct their analysis. This allows for a far more transparent and goal-oriented approach than the status quo. Given the increasing intersections between corporate, economic, and a variety of societal issues, re-orienting the underpinnings

of corporate theory represents an important step closer to a better understanding of the modern company and its rights and duties.