
Volume 118
Issue 1 *Dickinson Law Review - Volume 118,*
2013-2014

6-1-2013

Reconceptualizing the Theory of the Firm-From Nature to Function

Martin Petrin

Follow this and additional works at: <https://ideas.dickinsonlaw.psu.edu/dlra>

Recommended Citation

Martin Petrin, *Reconceptualizing the Theory of the Firm-From Nature to Function*, 118 DICK. L. REV. 1 (2013).

Available at: <https://ideas.dickinsonlaw.psu.edu/dlra/vol118/iss1/2>

This Article is brought to you for free and open access by the Law Reviews at Dickinson Law IDEAS. It has been accepted for inclusion in Dickinson Law Review by an authorized editor of Dickinson Law IDEAS. For more information, please contact lja10@psu.edu.

Articles

Reconceptualizing the Theory of the Firm— From Nature to Function

Martin Petrin*

Abstract

What is the “firm”? This Article revisits and explores the theory of the firm and corporate personhood and shows how the century-old discourse in this area still firmly shapes how scholars, judges, and legislatures treat legal entities in corporate law, constitutional law, tort law, and criminal law, causing unnecessary complications and flawed outcomes.

Traditionally, the firm is characterized as a real entity, a fiction, or an aggregate. Conversely, this Article proposes a novel answer to the perennial question as to how to conceptualize the firm. The new approach refocuses the debate away from the nature of the firm and contends that explanations of the firm should focus instead on its economic and social function, purpose, and effects. It also argues that compared to current approaches, a purely functional approach, as

* Assistant Professor, University College London, Faculty of Laws; S.J.D. (UCLA); LL.M. (Columbia). The author wishes to thank Daniel Attenborough, Barnali Choudhury, Martin Gelter, Peter Oh, Stefan Padfield, Elizabeth Pollman, and the participants of the Leicester Legal Research Forum for their helpful comments. Errors remain my own. This Article has been selected for presentation at the Harvard-Stanford International Junior Faculty Forum 2014.

developed in greater detail in the Article, provides a more useful analytical framework to ascertain what rights and duties corporations and other legal entities should have.

Table of Contents

I.	INTRODUCTION	2
II.	HISTORICAL ORIGINS AND DEVELOPMENT	4
	A. The German Debate on the Nature of Legal Entities	5
	1. Fiction Theory.....	5
	2. Real Entity Theory	6
	B. The Debate’s “Export” to Anglo-American Law	8
	1. Fiction Theory and Aggregate Theory	9
	2. The Ascendance of Real Entity Theory	10
III.	THE REALITY-FICTION-AGGREGATE TRICHOTOMY TODAY	14
	A. Constitutional Law	15
	B. Corporate Law	20
	1. Separate Personality, Limited Liability, and Veil Piercing	20
	2. Stakeholder Theory and Corporate Social Responsibility	22
	C. Tort Law.....	26
	D. Criminal Law	29
IV.	FROM NATURE TO FUNCTION	32
	A. Modern Theories of the Firm	33
	1. The Nexus of Contracts Theory	33
	2. Team Production and Director Primacy.....	35
	3. Asset and Liability Partitioning	37
	4. Limitations	38
	B. The Functional Approach.....	42
	1. Economic Aspects	44
	2. Social Aspects	46
	3. Balancing Economic and Social Considerations.....	48
	B. Applying the Functional Approach	49
V.	CONCLUSION	53

I. INTRODUCTION

What is the firm? How can we explain, in theoretical terms, the characteristics of legal entities such as corporations or other business forms?¹ While the debate behind this question is centuries old, even

1. Although the term “legal entity” is broad in nature and may include entities such as states and municipalities, this Article will focus mainly on corporations and other business organizations, in the following also referred to as “firms.” On the distinctions between the terms “firm,” “business enterprise,” and “corporation,” see Simon Deakin, *The Corporation as Commons: Rethinking Property Rights, Governance and*

today, it still strongly influences important legal questions. To what extent should corporations be given constitutional and statutory rights? Should businesses have social responsibilities toward the public at large? When should shareholders be personally liable for the debts of a corporation? How can legal entities become liable under tort and criminal laws?

This Article revisits and explores the “theory of the firm” and corporate personhood, which provide the theoretical background to scholarly, judicial, and legislative approaches to these and other questions. To shed light on the current law surrounding legal entities, the Article first traces historical approaches to the nature of legal entities, which have focused on whether a firm is real, fictional, or an aggregate. It then shows how this century-old discourse—prematurely proclaimed dead by some commentators²—still firmly shapes important areas of our law today, causing unnecessary complications and flawed outcomes.

In contrast to other contemporary literature in this area, this Article takes a broader view by exploring the impact of the theory of the firm and corporate theory on constitutional law, tort law, criminal law, and corporate law itself. In doing so, the Article focuses mainly on a corporation or another legal entity’s relationship with third parties, but does not scrutinize internal corporate governance matters—such as the relationships between a company, its shareholders, and director or officers—in greater detail.

Ultimately, drawing from modern and emerging theoretical approaches to the firm, this Article proposes a novel answer to the perennial question as to how to conceptualize the firm. The new approach refocuses the debate away from the *nature* of the firm toward a functional viewpoint contending that explanations of the firm should focus on its economic and social function, purpose, and effects. It also argues that compared to current approaches, a purely functional approach that balances economic and social considerations provides a more useful analytical framework and puts lawyers, judges, and legislatures in a better position to ascertain what rights and duties legal entities should have.

Sustainability in the Business Enterprise, 37 QUEEN’S L.J. 339, 350–53 (2012). Although outside the scope of this Article, questions surrounding the theory of the firm also arise in the context of corporate groups. See, e.g., Phillip I. Blumberg, *The Corporate Entity in an Era of Multinational Corporations*, 15 DEL. J. CORP. L. 283 (1990); Virginia Harper Ho, *Theories of Corporate Groups: Corporate Identity Reconceived*, 42 SETON HALL L. REV. 879 (2012).

2. See Ron Harris, *The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business*, 63 WASH. & LEE L. REV. 1421, 1477 (2006) (noting that in the United States corporate personality discourse ended in the 1920s).

This Article begins by tracing, in Part II, the historical origins of the theory of the firm, and traverses its evolutionary path. The Article further describes how these theories, and the conflict between them, have shaped Anglo-American law. Part III then goes on to examine how important aspects of contemporary law remain influenced by the traditional fiction-reality-aggregate paradigm of the firm and demonstrates important shortcomings of viewing the firm through the lens of these theories. Part IV subsequently discusses and evaluates modern and emerging theories of the firm. Finally, this Section concludes by exploring a new approach to the theory of the firm by offering a more useful framework—the functional approach—for conceptualizing legal entities.

II. HISTORICAL ORIGINS AND DEVELOPMENT

Attempts to explain “the firm” and its position within the legal system date back to at least the nineteenth century.³ In particular, during that time, German scholars began to argue that a—broadly defined⁴—legal entity (or juristic person) was either a “real person” or a “fiction.”⁵ These scholars assumed that an understanding of the nature and legal status of groups or associations of individuals was the key to correctly assigning rights and duties to them. The ensuing discussion, which gathered intensity toward the turn of the twentieth century,⁶ revolved in main part around two important theories and their variants: the Roman law inspired “fiction theory,” on the one hand, and the Germanic “real entity theory” on the other.⁷ Subsequently, the controversy was exported

3. While predecessors of what later became known as a “legal entity” or “juristic person” were already recognized in Roman and medieval law, there was no deeper interest at that time in further exploring their nature. See Arthur W. Machen, Jr., *Corporate Personality*, 24 HARV. L. REV. 253, 255 (1911); 2 ROLF WEBER, JURISTISCHE PERSONEN, SCHWEIZERISCHES PRIVATRECHT pt. 4, at 39 (1998). But cf. Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility*, 30 DEL. J. CORP. L. 767, 780–82 (2005) [hereinafter Avi-Yonah, *Cyclical Transformations*] (discussing medieval conceptions of the corporate form).

4. In the context of early German discourse, the term “legal entity” encompassed the State, municipalities, trusts, business associations, and others. At that stage of the discussion, the corporation did not play a large role. See DETLEF KLEINDIEK, DELIKTSHAFTUNG UND JURISTISCHE PERSON 153 (1997) (discussing Savigny’s fiction theory).

5. Although the topic was also discussed in other civil law countries such as France and Italy, this Article will focus on Germany as the most influential in this regard.

6. See Harris, *supra* note 2, at 1422–23 (explaining that the debate grew more intense in Germany after 1868 and was at its height in the early twentieth century).

7. Civil scholars also developed a number of additional theories during that time that did not rise to a level of importance comparable to the fiction or real entity theories. For a brief overview of alternative approaches, see, for example, MAX GUTZWILLER, 2

to the United Kingdom and the United States, leaving lasting marks on both legal systems.

A. *The German Debate on the Nature of Legal Entities*

1. Fiction Theory

The Roman law inspired “fiction theory”⁸ was the first “scientific” theory of legal entities to arise. Early English corporate law incorporated the fiction theory into the common law⁹ and the theory is thought to have governed American corporate theory “from the Founding to the mid-nineteenth century.”¹⁰ Nevertheless, the fiction theory is strongly connected to German jurist Friedrich Carl von Savigny,¹¹ whose work on the subject greatly influenced common law scholars.¹²

Savigny contended that because legal persons could only have recognized rights and duties as a consequence of an act of the State,¹³ they were nothing but artificial beings or fictions.¹⁴ He and other fiction theorists insisted that due to its artificial personality, a firm could only

SCHWEIZERISCHES PRIVATRECHT 439 (1967); PETER TUOR ET AL., DAS SCHWEIZERISCHE ZIVILGESETZBUCH 145 (2009).

8. Also known as the “fictitious personality theory,” the “artificial personality theory,” the “concession theory,” or the “grant theory.” See Harris, *supra* note 2, at 1424.

9. See Case of Sutton’s Hosp., [1613] 77 Eng. Rep. 937 (K.B.) [973] in which Lord Coke referred to the corporation as being “invisible, immortal, and rest[ing] only in intendment and consideration of the law.” See also Blumberg, *supra* note 1, at 292 (citing Coke, Kyd, and Blackstone as early common law sources of the fiction theory); William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1502–06 (1989) [hereinafter Bratton, *The New Economic Theory of the Firm*] (describing how the leading antebellum corporate treatise drew on definitions of the firm that went back to medieval and early British sources); Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 184 (1985) (noting that traditional fiction theory “derived from the antebellum grant theory, as well as older English corporation law”). On the origins of the fiction theory, see also John Dewey, *The Historic Background of Corporate Legal Personality*, 35 YALE L.J. 655, 665 (1926) (tracing the fiction theory to Pope Innocent IV).

10. Darrell A.H. Miller, *Guns, Inc.: Citizens United, McDonald, and the Future of Corporate Constitutional Rights*, 86 N.Y.U. L. REV. 887, 916 (2011).

11. Of particular importance was Savigny’s treatise on Roman law. 2 FRIEDRICH CARL VON SAVIGNY, SYSTEM DES HEUTIGEN RÖMISCHEN RECHTS (1840). See, e.g., KLEINDIEK, *supra* note 4, at 153–56. For references to other German proponents of the fiction theory, see OTTO VON GIERKE, 1 DEUTSCHES PRIVATRECHT 464 n.20 (1895) [hereinafter GIERKE, DEUTSCHES PRIVATRECHT]; GUTZWILLER, *supra* note 7, at 439 n.28.

12. See, e.g., ALEXANDER NÉKÁM, THE PERSONALITY CONCEPTION OF THE LEGAL ENTITY 64–65 (1938); Machen, *supra* note 3, at 255. On the influence of Savigny’s work on his American contemporaries, see generally David M. Rabban, *The Historiography of Late Nineteenth-Century American Legal History*, 4 THEORETICAL INQUIRIES L. 541, 552, 557, 559–61 (2003).

13. SAVIGNY, *supra* note 11, at 275.

14. *Id.* at 236.

have a very limited set of rights and duties, namely those pertaining to property.¹⁵ The nature of legal persons, which represented but a small fraction of a human's personality, did not allow for recognition of non-monetary rights and duties. Because of these limitations, the fiction theory also held that legal entities—apart from instances of strict liability—could not themselves be liable, either civilly or criminally.

The reason for this, in addition to the fact that a tort or crime was not necessary for exercising property rights,¹⁶ is that liability was conditioned upon a finding of culpability or *mens rea*. *Mens rea*, however, was something that a legal person, if thought of as only an artificial being, could not possess.¹⁷ According to Savigny, a legal person could never be liable, but a legal person's representatives or agents who actually committed a tort or a crime could be.¹⁸

2. Real Entity Theory

In response to the fiction theory, particularly as promulgated by Savigny, another group of German scholars—under the leadership of historian and legal academic Otto von Gierke—developed the late nineteenth century “real entity theory” or “organic theory.”¹⁹ According to this premise, legal entities were not fictions. Rather, they were real and capable of possessing their own mind and will. In addition, legal entities enjoyed any rights and duties that they could exercise.²⁰ While

15. *Id.* at 238–39, 314 (discussing legal entities' ability to transfer property rights and enter into contracts).

16. *Id.* at 314.

17. *Id.* at 317. Conversely, because of the lack of *mens rea* requirements, the fiction theory allowed for legal persons to be the subject of strict liability. Indeed, Savigny himself was instrumental in drafting a nineteenth-century Prussian statute that created strict liability for railroad companies, which at the time were organized as corporations. See *Preussisches Eisenbahngesetz* [Prussian Railroad Act], 1838, at §§ 1, 3.

18. Savigny argued that legal entities could only be held liable where they themselves were enriched. However, he saw this type of claim not as sounding in tort, but rather based on unjust enrichment. SAVIGNY, *supra* note 11, at 318–19.

19. See, e.g., OTTO VON GIERKE, *DIE GENOSSENSCHAFTSTHEORIE UND DIE DEUTSCHE RECHTSPRECHUNG* (1887) [hereinafter GIERKE, *DIE GENOSSENSCHAFTSTHEORIE*]. Other important contributors to the real entity theory were Johann Caspar Bluntschli and Georg Beseler. See WERNER FLUME, *1 ALLGEMEINER TEIL DES BÜRGERLICHEN RECHTS* pt. 2, at 17 (1983). For a discussion of the broader background and influences that informed and shaped the real entity theory, see Harris, *supra* note 2, at 1427–30. See also Martin Gelter, *Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light*, 7 N.Y.U. J.L. & BUS. 641, 665–66 (2011) (discussing the wide-ranging influence of Gierke's real entity theory).

20. See GIERKE, *DEUTSCHES PRIVATRECHT*, *supra* note 11, at 473; ARTHUR MEIER-HAYOZ & PETER FORSTMOSER, *SCHWEIZERISCHES GESELLSCHAFTSRECHT* 47 (10th ed. 2007). Nevertheless, real entity theory still limited a legal entity's ability to bear rights by recognizing that there are certain rights that legal entities cannot exercise, such as

the real entity theory recognized that legal entities gained their personality through the law and an act of the State, its proponents still contended that the legal person was not something created by the law, but rather a pre-existing reality that was solely “found” and recognized by the law.²¹

In contrast to the fiction theory, the real entity view held that the firm is a distinct, autonomous being that is separate from, and more than just the sum of, its individual (human) parts.²² In a manner of speaking, the legal entity, under this approach, leads its own “life,”²³ in the sense of a psychological or sociological existence,²⁴ and was thought to have attributes not found among its human components. The only difference between firms and human beings was that legal entities did not represent corporal organisms, but instead composite, social organisms.²⁵

Nevertheless, real entity theorists were confronted with the obvious problem that a legal entity, although thought to be “real” and likened to a living organism, was not capable of acting by itself. However, they solved this problem by providing the entity with “organs,” its metaphorical “hands and mouth.”²⁶ Acts undertaken by these organs—generally higher-ranking officials within the legal entity—were fully and directly binding upon the legal entity.²⁷ Yet, these organs were not viewed as agents. Instead, real entity theorists argued that the organs were part of, and reflected, the legal entity itself.²⁸

The real entity theory further acknowledged that legal entities, as “living creatures,” could be liable both under tort and criminal law.²⁹

those relating to family matters. See MARIO M. PEDRAZZINI & NIKLAUS OBERHOLZER, *GRUNDRISS DES PERSONENRECHTS* 199 (4th ed. 1999).

21. GIERKE, *DIE GENOSSENSCHAFTSTHEORIE*, *supra* note 19, at 611; Harris, *supra* note 2, at 1424 (noting that under the real entity theory a corporate entity is “pre-legal” or “extra-legal”).

22. In this respect, the real entity theory is also markedly different from the aggregate theory, which assumes that the firm is not more than a sum of its individual parts. See Michael J. Phillips, *Reappraising the Real Entity Theory of the Corporation*, 21 FLA. ST. U. L. REV. 1061, 1066–68 (1994); *infra* notes 38–42 and accompanying text (discussing aggregate theory).

23. Gregory A. Mark, Comment, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441, 1473 (1987).

24. Peter Nobel, *Otto von Gierke und moderne Entwicklungstendenzen. Ein Versuch zur Restauration*, in 50 DIE SCHWEIZERISCHE AKTIENGESELLSCHAFT 11, 19 (1978).

25. GIERKE, *DEUTSCHES PRIVATRECHT*, *supra* note 11, at 470, 472 (suggesting that firms represented “social organisms with heads and extremities”).

26. GIERKE, *DIE GENOSSENSCHAFTSTHEORIE*, *supra* note 19, at 603–10.

27. *Id.*

28. PEDRAZZINI & OBERHOLZER, *supra* note 20, at 199–200.

29. As one commentator noted, “Gierke established the understanding that the real entity theory was pro-liability while the fiction theory was anti-liability.” Mark M. Hager, *Bodies Politic: The Progressive History of Organizational ‘Real Entity’ Theory*, 50 U. PITT. L. REV. 575, 588 (1989).

However, because they were only able to act through their organs, legal entities could solely incur liability as a consequence of a tort or criminal offense if committed by one or more organs acting within their official capacities.³⁰ These individuals, moreover, remained personally liable to third parties.³¹ Contrariwise, misconduct by lower-level employees, who were not considered to be organs, was insufficient to incur liability for the legal entity. Importantly, therefore, corporate liability depended on the seniority of the person or employee committing the offense.

B. *The Debate's "Export" to Anglo-American Law*

Around the turn of the early twentieth century, the debate over the nature of the firm was exported from German to Anglo-American law and began to exhibit a strong influence on the practice and theory of the latter.³² As one commentator writing in 1911 observed, it became "difficult indeed for any American lawyer writing upon the subject of corporations to avoid declaring himself" in the controversy.³³ Thus, as evidenced by a flurry of contributions to the philosophic struggle surrounding the legal entity on this side of the Atlantic, common law authors too grew extensively entangled in this discourse.

30. GIERKE, *DIE GENOSSENSCHAFTSTHEORIE*, *supra* note 19, at 743–60; TUOR ET AL., *supra* note 7, at 145.

31. Gierke argued that torts and crimes on the part of a legal person necessarily included individual fault. In case of a tort or crime, the legal entity and any responsible organs were jointly and severally liable. See GIERKE, *DIE GENOSSENSCHAFTSTHEORIE*, *supra* note 19, at 768–71.

32. See Hager, *supra* note 29, at 580 (identifying Maitland's first English translation of Gierke in 1900 as the beginning of the Anglo-American controversy over corporate paradigms); Harris, *supra* note 2, at 1423, 1435, 1461 (noting that the discussion was imported into the Anglo-American world in about 1900 or the late 1890s); Horwitz, *supra* note 9, at 179 (noting that the German discussion on legal entity theory became accessible to English and American legal thinkers after 1900 and that already in the 1890s American scholars had begun to develop a "picture of the corporation as a 'real' or 'natural' entity"). For an in-depth account of the importance and influence of German scholarship for nineteenth century Anglo-American legal thought, see Mathias Reimann, *Nineteenth Century German Legal Science*, 31 B.C. L. REV. 837 (1990).

33. Machen, *supra* note 3, at 253. In addition to Machen, well-known earlier contributions include ERNST FREUND, *THE LEGAL NATURE OF CORPORATIONS* (1897); ALEXANDER NEKAM, *THE PERSONALITY CONCEPTION OF THE LEGAL ENTITY* (1938); George F. Canfield, *The Scope and Limits of the Corporate Entity Theory*, 17 COLUM. L. REV. 128 (1917); Felix S. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809 (1935); Dewey, *supra* note 9; Harold J. Laski, *The Personality of Associations*, 29 HARV. L. REV. 404 (1916); Max Radin, *The Endless Problem of Corporate Personality*, 32 COLUM. L. REV. 643 (1932); Bryant Smith, *Legal Personality*, 37 YALE L.J. 283 (1928); and Paul Vinogradoff, *Juridical Persons*, 24 COLUM. L. REV. 594 (1924).

1. Fiction Theory and Aggregate Theory

Previously, during the first half of the nineteenth century, the fiction theory predominated in England and the United States.³⁴ Here, this theory was also known as the “concession theory” or “grant theory,” owing to the fact that at the time corporations could only be incorporated based on a state legislature’s award of a special concession, grant, or charter.³⁵ In the landmark case *Trustees of Dartmouth College v. Woodward*,³⁶ for instance, Chief Justice Marshall characterized the corporation as an “artificial being, invisible, intangible, and existing only in contemplation of law,” which, as a mere creature of law, “possesses only those properties which the charter of its creation confers upon it.”³⁷

However, during this period, the fiction theory also competed with the “aggregate” or “contractualist” theory, which was particularly popular in nineteenth century England³⁸ and emerged more clearly in the United States during the latter half of the same century.³⁹ The “aggregate” or “contractualist” theory asserted that corporations and other legal entities constituted aggregations of natural persons whose relationships were structured by way of mutual agreements.⁴⁰ As such,

34. See William W. Bratton, Jr., *The “Nexus of Contracts” Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 434 (1989) [hereinafter Bratton, *The “Nexus of Contracts” Corporation*] (noting that the concession theory and the legal fiction conception “enjoyed vitality during the first half of the nineteenth century”); Phillips, *supra* note 22, at 1065 (“The concession and fiction ideas dominated American theorizing about corporations in the first part of the nineteenth century”). See also Machen, *supra* note 3, at 257 (“[T]he orthodox doctrine in this country is similar to Savigny’s [fiction theory].”).

35. Harris, *supra* note 2, at 1424; Phillips, *supra* note 22, at 1065. Nevertheless, some scholars separate the fiction theory from the concession theory, stating that the former is a medieval doctrine that is philosophical in nature, whereas the latter is based on the later rule that corporations existed only due to an act of state. See Dewey, *supra* note 9, at 667 (stating that although similar in their results, the two theories have “nothing essentially in common”); Nicholas H.D. Foster, *Company Law Theory in Comparative Perspective: England and France*, 48 AM. J. COMP. L. 573, 581–83 (2000).

36. *Trs. of Dartmouth Coll. v. Woodward*, 17 U.S. 518 (1819).

37. *Id.* at 636.

38. Foster, *supra* note 35, at 585. One reason for the aggregate theory’s appeal is due to the fact that English company law is strongly rooted in partnership principles. See L.C.B. Gower, *Some Contrasts Between British and American Corporation Law*, 69 HARV. L. REV. 1369, 1370–72 (1956).

39. See Jess M. Krannich, *The Corporate “Person”: A New Analytical Approach to a Flawed Method of Constitutional Interpretation*, 37 LOY. U. CHI. L.J. 61, 68 n.38 (2005) (noting that while the artificial entity theory was predominant when the nation was founded, the aggregate theory was already present as well); Phillips, *supra* note 22, at 1063–64; John C. Coates IV, Note, *State Takeover Statutes and Corporate Theory: The Revival of an Old Debate*, 64 N.Y.U. L. REV. 806, 815–18 (1989) (finding that the aggregate theory achieved dominance by 1880).

40. See, e.g., Bratton, *The New Economic Theory of the Firm*, *supra* note 9, at 1489; Phillips, *supra* note 22, at 1065–67.

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 can be construed to reflect upon the legal entity itself.

The idea behind this aspect of the aggregate theory is exemplified by cases such as *San Mateo v. Southern Pacific Railroad*.⁴¹ In the context of constitutional rights, that court referred to private corporations as "aggregations of individuals united for some legitimate business" and opined that it would be unusual if a constitutional provision for the protection of individuals "should cease to exert such protection the moment the person becomes a member of a corporation."⁴² Instead, the court concluded "that whenever a provision of the constitution, or of a law, guaranties [sic] to persons the enjoyment of property . . . the benefits of the provision extend to corporations, and . . . the courts will always look beyond the name of the artificial being to the individuals whom it represents."⁴³

2. The Ascendance of Real Entity Theory

With the emergence of the twentieth century, the increasing importance and prevalence of corporations led to growing dissatisfaction with the fiction theory's effects, including its hostility toward liability of legal entities.⁴⁴ In addition, the fiction theory was difficult to reconcile with the shift from special chartering to general incorporation. At the same time, the aggregate theory failed to provide a plausible explanation for the adoption of limited liability for corporations⁴⁵ and the decoupling of corporate and individual rights and duties in general. As a consequence, Gierke's real entity theory, together with previous discourse over its clash with the fiction theory, was "transplanted" from Germany⁴⁶ to England and the United States,⁴⁷ where it gained traction, challenging both the fiction and aggregate theories.

41. *The Railroad Tax Cases*, 13 F. 722 (C.C.D. Cal. 1882).

42. *Id.* at 743–44.

43. *Id.* at 744.

44. *See, e.g., Salt Lake City v. Hollister*, 118 U.S. 256, 260–61 (1886); Gilbert Geis & Joseph F.C. DiMento, *Empirical Evidence and the Legal Doctrine of Corporate Criminal Liability*, 29 AM. J. CRIM. L. 341, 343 (2002) (citing the growing powers accumulated by businesses as one of the reasons for the shift to allowing corporate criminal liability); Horwitz, *supra* note 9, at 209–10 (noting the increasing size and importance of corporations).

45. *See* Avi-Yonah, *Cyclical Transformations*, *supra* note 3, at 789.

46. Harris, *supra* note 2, at 1435.

47. The rise of the real entity theory also coincided with and, arguably, was supported by the ascendance of the corporate form as the primary means to organize

In England, Cambridge Professor Frederic William Maitland translated some of Gierke's major works and introduced his real entity theory to English and American judges and academics.⁴⁸ In the United States, Ernst Freund, a U.S. born academic with German roots, published *The Legal Nature of Corporations*,⁴⁹ which also contributed to the wider recognition of Gierke's theory in the U.S. legal community.⁵⁰

While the real entity theory was not as successful in the common law as in the civil law, where it clearly defeated the fiction theory,⁵¹ it did gain considerable prominence and both U.K. and U.S. courts began to rely increasingly on the ideas it incorporated.⁵² In the iconic 1897 case *Salomon v. A. Salomon & Co.*,⁵³ the House of Lords upheld a company's separate legal personality and limited liability, finding that a company's existence was "real" and rejecting the notion that it was

economic activities and, relatedly, new views on the State's role in regulating business and curbing corporate powers. See David Millon, *The Ambiguous Significance of Corporate Personhood*, 2 STAN. AGORA 39, 43–46 (2001) [hereinafter Millon, *Ambiguous Significance*], available at <http://stanford.io/17GkPRh>; Elizabeth Pollman, *Reconceiving Corporate Personhood*, 2011 UTAH L. REV. 1629, 1640.

48. Important works include OTTO GIERKE, *POLITICAL THEORIES OF THE MIDDLE AGE* (F.W. Maitland trans., 1900); FREDERICK POLLACK & FREDERIC WILLIAM MAITLAND, *THE HISTORY OF ENGLISH LAW BEFORE THE TIME OF EDWARD I* (1st ed. 1895). See also DAVID RUNCIMAN, *PLURALISM AND THE PERSONALITY OF THE STATE* 66, 175, 187 (1997) (discussing Gierke's influence on English and American writers); Harris, *supra* note 2, at 1431–35 (describing Maitland's role in importing the real entity theory from Germany).

49. FREUND, *supra* note 33.

50. William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 743 n.32 (2001) ("In the United States, the theory's most prominent advocate was Ernst Freund."); see also Harris, *supra* note 2, at 1431–35 (stating that the "standard narrative suggests that Frederic Maitland and Ernst Freund imported the corporate personality discourse by importing the real entity theory from Germany," but crediting in greater part Maitland).

51. In the civil law, the debate was resolved around 1900 mostly in favor of the real entity theorists. In the wake of the industrialization of Europe, Continental European courts were sympathetic toward the real entity theory and increasingly began to embrace the idea that legal entities were "real" beings, finding that companies could be liable for torts. Subsequently, the introduction of European civil codes, many of which went on to elevate the real entity's basic principles into statutory law, largely defused the civil law debate surrounding the nature of the firm. See, e.g., GUTZWILLER, *supra* note 7, at 440. Until recently, however, civil law jurisdictions adhered to the fiction theory in the area of criminal law. See *infra* notes 152–54 and accompanying text.

52. As one commentator noted, "The real entity theory became the most prominent definition of the corporate 'person' in the early twentieth century." Krannich, *supra* note 39, at 85. See also Horwitz, *supra* note 9, at 182 (stating that by 1900 the real entity theory had largely triumphed in the United States). See also *United States v. Bank of N.Y. & Trust Co.*, 77 F.2d 866, 875 (2d Cir. 1935) ("[T]he Court of Appeals of New York, in recent cases, seems to have adopted what may be called the organic theory of juristic personality in opposition to the fictional theory which to this day has held a predominant position in the field of legal philosophy and judicial history and is the theory of our own law.").

53. *Salomon v. A. Salomon & Co.*, [1897] A.C. 22 (H.L.) (appeal taken from Eng.).

nothing more than a myth or fiction.⁵⁴ Similarly, the influence of the real entity theory reinforced the tendency by Anglo-American courts to recognize the tortious liability of companies,⁵⁵ followed by a partial recognition of criminal liability as well.⁵⁶ Moreover, the real entity theory's ascendance led to the decline of the *ultra vires* doctrine,⁵⁷ helped strengthen limited liability and the business judgment rule,⁵⁸ and may have been partially responsible for the introduction of a corporate income tax regime,⁵⁹ which treated corporations as separate taxable entities.

The tension between the real entity theory and its counterparts, the fiction and aggregate theories, also made its mark on constitutional law, particularly in the United States.⁶⁰ Over the course of the nineteenth and

54. *Id.* at 30 (per Lord Halsbury, L.C.). For an in-depth account of this case, see Allan C. Hutchinson & Ian Langlois, *Salmon Redux: The Moralities of Business*, 35 SEATTLE U. L. REV. 1109 (2012). In addition, statutory provisions, namely the Companies Act 1862, also reflected the change in the way the corporation was perceived and influenced the House of Lords' decision. See, e.g., Paddy Ireland et al., *The Conceptual Foundations of Modern Company Law*, 14 J.L. SOC'Y 149, 150 (1987).

55. E.g., *Denver & Rio Grande Ry. Co. v. Harris*, 122 U.S. 597, 608 (1887); *Salt Lake City v. Hollister*, 118 U.S. 256, 260–61 (1886); *Nat'l Bank v. Graham*, 100 U.S. 699, 702 (1879); *Phila., Wilmington, & Balt. R.R. Co. v. Quigley*, 62 U.S. 202, 210 (1858); *Campbell v. Paddington Corp.*, [1911] 1 K.B. 869 (Eng.); see also Vinogradoff, *supra* note 33, at 602 (discussing the necessity of adopting the real entity theory in order to allow for tortious liability of legal entities). On the influence of the reality-fiction dichotomy on attribution of torts, including products liability, to the corporate entity, see also Jonathan Kahn, *Product Liability and the Politics of Corporate Presence: Identity and Accountability in Macpherson v. Buick*, 35 LOY. L.A. L. REV. 3, 17–20, 41–45 (2001).

56. See Hager, *supra* note 29, at 587–611 (discussing the path toward recognition of civil and criminal liability by corporate and unincorporated entities). As one commentator notes, in the early 1900s, some U.S. courts overcame the restrictions of the fiction theory and, following the real entity doctrine, “transformed the inanimate ‘corporation’ into a ‘person’ capable of committing criminal delicts and harboring criminal intent.” Kathleen F. Brickey, *Rethinking Corporate Liability Under the Model Penal Code*, 19 RUTGERS L.J. 593, 593 (1987). See, e.g., *N.Y. Cent. & Hudson R.R. Co. v. United States*, 212 U.S. 481, 492–93 (1909) (noting that while “[s]ome of the earlier writers on common law held the law to be that a corporation could not commit a crime,” the modern position is the other way); *Moussell Bros. v. London & Nw. Ry. Co.*, [1917] 2 K.B. 836 (Eng.) (imposing liability on a company for misrepresenting goods to avoid shipment tolls).

57. In the period before the early twentieth century, the notion that acts not covered by the corporate grant or corporate powers are void thrived, supported by the notion of a corporation's artificial nature. See Horwitz, *supra* note 9, at 186–88.

58. Reuven S. Avi-Yonah, *Citizens United and the Corporate Form*, 2010 WIS. L. REV. 999, 1018–19 [hereinafter Avi-Yonah, *Citizens United*].

59. See Steven A. Bank, *Entity Theory as Myth in the Origins of the Corporate Income Tax*, 43 WM. & MARY L. REV. 447, 450–52 (2001) (citing sources supporting this proposition but expressing skepticism as to its validity).

60. See generally Blumberg, *supra* note 1, at 299–318; Krannich, *supra* note 39, at 90–100; Sanford A. Schane, *The Corporation is a Person: The Language of a Legal Fiction*, 61 TUL. L. REV. 563, 569–92 (1987). Theories of the corporation were

twentieth centuries, a number of Supreme Court cases found that a corporation was akin to a real person and therefore entitled to constitutional rights such as freedom of the press, commercial speech, and protections against unreasonable searches and seizures, among others.⁶¹ Conversely, in other cases decided during that time, the fictional nature of the firm prevailed. For example, the Supreme Court refused to grant legal entities certain Fourth and Fifth Amendment guarantees and limited their right to privacy because they were only “artificial” in nature.⁶² Moreover, as discussed in more detail below, all three traditional theories of the firm have had, and continue to have, an impact on corporate political speech rights.⁶³

influential in deciding whether certain constitutional protections applied to corporate entities. Nevertheless, they were not by themselves determinative. As Blumberg points out:

[R]ecognition of the status of the corporation for certain purposes did not result in automatic qualification for constitutional protection of the corporation to the same extent as a natural person. The application of each constitutional provision to the corporation was a matter of interpretation and development in the light of the nature of the corporate interest being asserted, the history of the particular provision, and its purpose in the light of the constitutional jurisprudence of the time. Competing theories of the nature of the corporate personality influenced such developments, but the process reflected a struggle over competing values and interests. . . .

Blumberg, *supra* note 1, at 323 (footnote omitted).

61. See, e.g., *First Nat'l Bank of Bos. v. Bellotti*, 435 U.S. 765 (1978) (political speech); *Va. State Bd. of Pharmacy v. Va. Citizen's Consumer Council, Inc.*, 425 U.S. 748 (1976) (commercial speech); *Ross v. Bernhard*, 396 U.S. 531, 542 (1970) (Seventh Amendment right to trial by jury); *Russ. Volunteer Fleet v. United States*, 282 U.S. 481 (1931) (Fifth Amendment protections against double jeopardy and takings); *Hale v. Henkel*, 201 U.S. 43 (1906) (Fourth Amendment protections against unreasonable searches and seizures), *overruled in part by* *Murphy v. Waterfront Comm'n of N.Y. Harbor*, 378 U.S. 52 (1964); *Covington & Lexington Tpk. Rd. Co. v. Sanford*, 164 U.S. 578 (1896) (Fourteenth Amendment due process); *Cnty. of Santa Clara v. S. Pac. R.R. Co.*, 118 U.S. 394 (1886) (Fourteenth Amendment equal protection); *United States v. R.L. Polk & Co.*, 438 F.2d 377 (6th Cir. 1971) (Sixth Amendment right to trial by jury).

62. See *Miller*, *supra* note 10, at 910, 919–20. In particular, the Supreme Court denied extending the Fifth Amendment privilege against self-incrimination to corporations because it was held to be a purely personal right available only to natural persons. See *United States v. White*, 322 U.S. 694, 698 (1944); *Wilson v. United States*, 221 U.S. 361, 383–84 (1911); *Hale*, 201 U.S. at 74–75; Susanna Kim Ripken, *Corporations Are People Too: A Multi-Dimensional Approach to the Corporate Personhood Puzzle*, 15 *FORDHAM J. CORP. & FIN. L.* 97, 118 n.75 (2009) [hereinafter Ripken, *Corporations Are People Too*] (suggesting that *Hale*, in this respect, is an example of an application of fiction theory). Similarly, the Court was reluctant to provide corporate entities with rights to privacy. See *United States v. Morton Salt Co.*, 338 U.S. 632, 650–52 (1950) (stating that corporations enjoy lesser privacy protections than individuals); *Fleck & Assocs. v. Phoenix*, 471 F.3d 1100, 1104 (9th Cir. 2006) (declining to find a corporate right of privacy).

63. *Infra* Part III.A.

III. THE REALITY-FICTION-AGGREGATE TRICHOTOMY TODAY

Despite a longer “antitheoretical” period in which scholars—but much less so the courts—tended to ignore theories of the firm,⁶⁴ the debate has proven to be of particular longevity in American law.⁶⁵ Still today, in court decisions, legislation, and academic writings, the fiction, reality, or aggregate nature of corporations and other business entities retains a strong presence and influences the law in a number of ways.⁶⁶ Unlike in the civil law jurisdictions, in which discussion surrounding the nature of legal entities has mostly come to an end,⁶⁷ here the debate indeed seems “endless”⁶⁸ and, as the U.S. Court of Appeals for the Second Circuit recently noted, “continues to evolve in complex and unexpected ways.”⁶⁹

As one commentator observed, “the artificial entity theory is enervated, but it is not extinct. It is a doctrinal device that the Court uses to justify regulation of corporations to a degree different than individuals.”⁷⁰ Even today, the artificial entity theory continues to appeal to corporate scholars.⁷¹ Similarly, although the traditional real

64. Roughly between the late 1920s and 1970s, scholars were reluctant to resolve practical legal questions by deducing solutions from corporate theories. See Krannich, *supra* note 39, at 84 (noting that even during this time, the Supreme Court continued to use various corporate metaphors). Yet, the debate revived with the rise of modern economic theories of the firm. See Krannich, *supra* note 39, at 84; Phillips, *supra* note 22, at 1070–71, 1073; *infra* Part IV.A.

65. See, e.g., Millon, *Ambiguous Significance*, *supra* note 47, at 41 (noting the ongoing debate about the nature of the corporation).

66. See Harper Ho, *supra* note 1, at 896 (noting that “the legacy of the real entity view remains today in modern corporate codes and common law doctrines”); Krannich, *supra* note 39, at 67, 84, 90 (stating that the traditional fiction, aggregate, and real entity theories are still present in modern court decisions and corporate theory and pointing to a resurgence in the debate over corporate personality); *infra* Parts III.A–D.

67. See discussion *supra* note 51.

68. Radin, *supra* note 33.

69. *Kiobel v. Royal Dutch Petroleum Co.*, 621 F.3d 111, 118 n.11 (2d Cir. 2010) (internal citations omitted), *aff'd*, 133 S. Ct. 1659 (2013). See also Lyman Johnson, *Law and Legal Theory in the History of Corporate Responsibility: Corporate Personhood*, 35 SEATTLE U. L. REV. 1135, 1141 (2012) (footnote omitted) (“[S]harp disagreement continues today over what legal rights should go along with modern understandings of corporate personhood. Importantly, pointed disagreement also continues today over what responsibilities should go along with twenty-first-century understandings of corporate personhood.”).

70. Miller, *supra* note 10, at 920.

71. See Stefan J. Padfield, *Rehabilitating Concession Theory*, OKLA. L. REV. (forthcoming), available at <http://bit.ly/1e0xYhj> (discussing concession theory and arguing that there remains a serious role for this theory—which is often equated with artificial entity theory—in discussions concerning the allocation of power between corporations, the State, and individuals); Charles D. Watts, Jr., *Corporate Legal Theory Under the First Amendment: Bellotti and Austin*, 46 U. MIAMI L. REV. 317, 377–78

entity theory is said to have fallen out of favor among corporate law scholars,⁷² a number of commentators have argued in favor of its renaissance, suggesting that its principles are well suited to solve contemporary legal problems.⁷³ Still, other academics declare that “corporate speech is people speech” and thereby seek to revive the traditional aggregate view of the firm.⁷⁴

In short, both the traditional theories and the surrounding debate remain very much alive today and continue to influence contemporary law. Focusing on the core areas of constitutional, corporate, tort, and criminal law, the following sections aim to discuss some of these traditional influences and highlight numerous problems and distractions that arise as a result of reliance on the traditional theories.⁷⁵

A. *Constitutional Law*

The influence of theories surrounding the nature of legal entities remains particularly visible in contemporary constitutional law. Given that the Constitution and the Bill of Rights protect various liberties of “persons” and “citizens,” but fail to define the precise meaning of these terms, it is not surprising that courts and commentators continue to question whether and to what extent these rights apply to legal and corporate entities.⁷⁶ Moreover, similar questions arise in the statutory

(1991) (advocating a fictional entity conception of the corporation when considering corporate free speech issues).

72. Harper Ho, *supra* note 1, at 895.

73. See David Gindis, *From Fictions and Aggregates to Real Entities in the Theory of the Firm*, 5 J. INSTITUTIONAL ECON. 25, 27 (2009) (arguing in favor of a modernized real entity theory); Hager, *supra* note 29, at 646 (urging “progressives [to] explore the advantages of using real entity theory or something akin to it in discussions of free expression rights for organizations”); Phillips, *supra* note 22, at 1101 (finding that real entity theory is more plausible than other theories of the firm); Thomas A. Smith, *The Use and Abuse of Corporate Personality*, 2 STAN. AGORA 69, 70–71 (2001), available at <http://stanford.io/1apopXJ> (“[O]f the whole menu of theories of corporate personality that is offered to us by American legal history . . . it is the natural entity theory of some hundred years ago or so that comes closest in its broad overall outlines to the truth.”).

74. Larry Ribstein, *Abolishing Corporate Personhood*, TRUTH ON THE MARKET (Nov. 6, 2011), <http://bit.ly/166qjJH>. See also Stephen M. Bainbridge, Citizens United, *Corporate Personhood, and Nexus of Contracts Theory*, PROFESSORBAINBRIDGE.COM (Jan. 21, 2010), <http://bit.ly/5jd69F> (noting that “it is very important to remember that [the corporation] is still a fiction that we embrace to facilitate protection of the rights of individuals”); Ilya Somin, *People Organized as Corporations Are People Too*, VOLOKH CONSPIRACY (Jan. 21, 2010), <http://bit.ly/18B3lrM> (“Human beings organized as corporations shouldn’t have fewer constitutional rights than those organized as sole proprietors, partnerships, and so on.”).

75. In view of these problems, this Article will argue in favor of adopting an alternative, functional approach to conceptualizing the firm. *Infra* Part IV.B.

76. See Harris, *supra* note 2, at 1467–68 (explaining that the ratification of the Fourteenth Amendment coupled with the presence of corporations in foreign states

context, where it may be equally unclear whether a provision applies to a legal entity or not.⁷⁷

In the constitutional law arena, the struggle among various conceptions of the firm has been especially evident in Supreme Court decisions on corporate free speech rights in the political context.⁷⁸ In *Buckley v. Valeo*,⁷⁹ for instance, the Court relied on the aggregate theory and refused to restrict corporate political speech, finding that such restrictions would affect the freedom of association of the individuals that form a corporation.⁸⁰ Subsequently, in *First National Bank of Boston v. Bellotti*,⁸¹ a majority of Justices “treated corporations as equivalent to individuals.”⁸² The *Bellotti* Court, rejecting the aggregate and fiction theories of the firm, ruled that the First Amendment protected a corporation’s right to participate in or influence political processes.⁸³ The Supreme Court then changed its position in *Austin v. Michigan Chamber of Commerce*.⁸⁴ Relying again on the “artificiality” of corporations, the Court upheld governmental restrictions on corporate political speech.⁸⁵

brought the issue of corporate constitutional rights to the forefront, while the prevailing grant theory could not account for applying rights to legal entities); Jonathan A. Marcantel, *The Corporation as a “Real” Constitutional Person*, 11 U.C. DAVIS BUS. L.J. 221, 223 (2011) (arguing that the drafters and ratifiers of the Constitution and its amendments did not intend to extend constitutional protection to corporations as “real” constitutional entities).

77. For instance, in *FCC v. AT&T, Inc.*, 131 S. Ct. 1177 (2011), the Supreme Court answered in the negative the question of whether a corporation could claim a “personal privacy” interest in certain law enforcement records under an exemption of the Freedom of Information Act. *See id.* at 1185. The question was not whether a corporation falls under the definition of “person”—the Act expressly states that it does—but whether the word “personal” included “artificial ‘persons’ like corporations.” *Id.* at 1181. *See also* Harper Ho, *supra* note 1, at 928 (noting that in most federal statutes “person” is defined to include corporations and other organizations). In addition, courts are split over the question of whether for-profit corporations have a right to exercise religion within the meaning of the Religious Freedom Restoration Act. *See discussion infra* note 244.

78. *See* Anne Tucker, *Flawed Assumptions: A Corporate Law Analysis of Free Speech and Corporate Personhood in Citizens United*, 61 CASE W. RES. L. REV. 497, 506–15 (2010) (tracing the evolution of corporate political speech rights). Another area in which the question of corporate theory flared up regularly is that of corporate takeovers and, specifically, the validity of state takeover statutes. *See, e.g.*, Avi-Yonah, *Cyclical Transformations*, *supra* note 3, at 803–10; Coates, *supra* note 39.

79. *Buckley v. Valeo*, 424 U.S. 1 (1976), *superseded by statute as stated in* *McConnell v. FEC*, 540 U.S. 93 (2003).

80. *Id.* at 22.

81. *First Nat’l Bank of Bos. v. Bellotti*, 435 U.S. 765 (1978).

82. Avi-Yonah, *Citizens United*, *supra* note 58, at 1033–34.

83. *See Bellotti*, 435 U.S. at 778 n.14, 784, 810.

84. *Austin v. Mich. Chamber of Commerce*, 494 U.S. 652 (1990), *overruled by* *Citizens United v. FEC*, 130 S. Ct. 876 (2010).

85. *See* Avi-Yonah, *Citizens United*, *supra* note 58, at 1038 (stating that the majority opinion reflects the artificial entity view); Miller, *supra* note 10, at 918 (referring to the

Recently, however, in *Citizens United v. Federal Election Commission*,⁸⁶ the Court reversed its position once more and struck down statutory provisions limiting corporate election contributions based on the real entity and aggregate theories.⁸⁷ *Citizens United* raised questions as to whether corporations should be granted First Amendment political speech rights, thus allowing them to use their general treasury funds to influence election campaigns.⁸⁸ The decisive question for the Court turned on whether, from a constitutional standpoint, corporate political speech differed from that of individual political speech such that it should be more limited. The majority held, in essence, that there was no difference between individuals and corporations in this respect.⁸⁹

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,⁹⁰ the wording of the decision suggests that the Court adopted both the aggregate and real entity theories as the basis for its decision.⁹¹ On the one hand, the Court,

Supreme Court's approach as "artificial-entity-lite"). For a more detailed discussion, see generally Watts, *supra* note 71.

86. *Citizens United v. FEC*, 558 U.S. 310 (2010).

87. *See id.* at 365.

88. The case arose when non-profit corporation Citizens United released a documentary critical of then-Senator Hillary Clinton and wanted to advertise the film using television ads. In view of possible civil and criminal penalties for violating certain provisions of the Bipartisan Campaign Reform Act of 2002 (BCRA), Citizens United sought declaratory and injunctive relief, arguing that portions of the BCRA were unconstitutional as applied to its documentary and ads. *Id.* at 318–21.

89. As a result, the Court invalidated parts of a federal campaign finance law. *Id.* at 365.

90. Susanna Kim Ripken, *Citizens United, Corporate Personhood, and Corporate Power: The Tension Between Constitutional Law and Corporate Law* 3–4 (Chapman Univ. Sch. of Law Legal Studies Research Paper Series, Paper No. 12-10, 2012) [hereinafter Ripken, *Citizens United*], available at <http://bit.ly/17Lj9YO> (arguing that the personhood of corporations was not the basis of the decisions and noting that "the Court framed the issue in terms of whether the speech is the type of *speech* the First Amendment protects, not whether the *speaker* is the type of person who can claim First Amendment rights").

91. *See* Avi-Yonah, *Citizens United*, *supra* note 58, at 1040–42 (suggesting that both the majority opinion and the dissent are based on a real entity view of the corporation); Harper Ho, *supra* note 1, at 922–23 (arguing that the opinion includes elements of both a real entity and aggregate conception of corporate personhood); Miller, *supra* note 10, at 930 (finding that the case "contains understated allusions to the aggregate nature of the corporation"); Stefan J. Padfield, *The Dodd-Frank Corporation: More than a Nexus-of-Contracts*, 114 W. VA. L. REV. 209, 224–25 (2011) (detecting a "battle between the concession and contractarian views"); Beth Stephens, *Are Corporations People? Corporate Personhood Under the Constitution and International Law*, RUTGERS L.J. (forthcoming 2013), available at <http://bit.ly/17EWUFV> ("The majority opinion included references to each of the major theories of corporate personhood, although the real entity theory is most evident."); Tucker, *supra* note 78, at 505, 515 (2010) (stating that "[t]he majority in *Citizens United* employed both the aggregation-of-rights and entity theory")

alluding to the aggregate nature of legal entities, asserted that corporations should be entitled to the rights of the individuals of which they are comprised,⁹² because corporations are “associations of individuals.”⁹³ On the other hand, scholars asserted that the Court invoked the “reality” of a legal entity, noting that under *Citizens United*, “[a] corporation generally is no different than a natural person when it comes to the First Amendment,”⁹⁴ “corporations are to be treated identically to individuals,”⁹⁵ and “corporations are equal to human beings.”⁹⁶ Thus, in a related development, *Citizens United* has also triggered a nationwide wave of proposals and initiatives to amend the U.S. Constitution and individual state constitutions to reflect the fact that corporations are not people in the eyes of the law.⁹⁷

While the majority opinion of *Citizens United* may be read as giving corporations human-like qualities, the dissent, authored by Justice Stevens, does exactly the opposite.⁹⁸ Justice Stevens argued that corporations should generally not be given political speech rights, based in part on his belief that corporations are “legal fiction[s]” that “have no consciences, no beliefs, no feelings, no thoughts, [and] no desires.”⁹⁹ In the same vein, Justice Sotomayor raised the question in oral arguments as to what extent “the fact that the Court imbued a creature of State law with human characteristics” interfered with the democratic process by cutting off legislative efforts to curb corporate influences over the electoral process.¹⁰⁰ In effect, both Justices appeared to contend that because corporations are artificial, their constitutional rights should be

and that “Justice Kennedy utilized both the artificial-entity and aggregate-rights theories to conceptualize corporations”).

92. See Stephens, *supra* note 91, at 15.

93. *Citizens United v. FEC*, 558 U.S. 310, 393 (2010) (Scalia, J., concurring).

94. Miller, *supra* note 10, at 887. “*Citizens United* is a revolution in corporate constitutional doctrine. It is a near-complete vindication of the belief that the Constitution protects a corporation’s political speech just as much as it protects the political speech of individuals.” *Id.* at 893.

95. Joan MacLeod Heminway, *Thoughts on the Corporation as a Person for Purposes of Corporate Criminal Liability*, 41 STETSON L. REV. 137, 138 (2011).

96. Elizabeth R. Sheyn, *The Humanization of the Corporate Entity: Changing Views of Corporate Criminal Liability in the Wake of Citizens United*, 65 U. MIAMI L. REV. 1, 2 (2010).

97. See Susanna Kim Ripken, *Corporate First Amendment Rights after Citizens United: An Analysis of the Popular Movement to End the Constitutional Personhood of Corporations*, 14 U. PA. J. BUS. L. 209 (2010); see generally Saru M. Matambanadzo, *The Body, Incorporated*, 87 TUL. L. REV. 457 (describing the movement to abolishing corporations’ legal status as “persons”).

98. See *Citizens United*, 558 U.S. at 393–479 (Stevens, J., concurring in part and dissenting in part).

99. *Id.* at 466.

100. Transcript of Oral Argument at 33, *Citizens United v. FEC*, 558 U.S. 310 (2010) (No. 08-205).

severely restricted. By doing so, however, and despite the fact that Justice Stevens made clear that he did not wish to base his dissent on any corporate theory,¹⁰¹ both justices invoked the core idea of nineteenth century fiction theory.¹⁰²

Nevertheless, as the changing constitutional history of corporate personhood and corporate political speech demonstrates, the nature of a legal entity provides, in truth, hardly any guidance as to whether courts will grant or deny a constitutional right.¹⁰³ A stark example of the inconsistency with which the Supreme Court has applied legal entity theory is *Hale v. Henkel*,¹⁰⁴ which held that corporations are persons entitled to Fourth Amendment protections from unreasonable searches while, at the same time, finding that corporations are not persons warranting Fifth Amendment privileges against self-incrimination.¹⁰⁵

Hence, the use of corporate theory is result-oriented—or, in the words of one scholar, “a conclusion, not a question or starting point”¹⁰⁶—and appears to serve as a vehicle that can be used to both mask and inject policy into judicial decision-making.¹⁰⁷ More generally, some courts, when asked to assess corporate constitutional rights, are drawn to deductive reasoning. Sidestepping the first task of conducting a functional analysis of the specific case at hand, courts take the shorter route of using one or more of the well-known theories of the firm as a premise and basis for their decisions.¹⁰⁸

101. See *Citizens United*, 558 U.S. at 465 n.72 (Stevens, J., concurring in part and dissenting in part) (internal citations omitted) (“Nothing in this analysis turns on whether the corporation is conceptualized as a grantee of a state concession, a nexus of explicit and implicit contracts, a mediated hierarchy of stakeholders, or any other recognized model. . . . It is not necessary to agree on a precise theory of the corporation to agree that corporations differ from natural persons in fundamental ways, and that a legislature might therefore need to regulate them differently if it is human welfare that is the object of its concern.”).

102. In particular, the language used by Justice Stevens is strikingly similar to a statement by prominent eighteenth-century fiction theory proponent Edward Thurlow (“First Baron Thurlow”) who famously opined that corporations could not be criminally liable, as they had no “conscience . . . no soul to be damned, and no body to be kicked.” John C. Coffee, Jr., “*No Soul to Damn: No Body to Kick*”: *An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 386 (1981) (quoting First Baron Thurlow).

103. Similarly, philosopher John Dewey’s main criticism of the real entity and fiction theories was that the same theory can be used to support opposite outcomes. See Dewey, *supra* note 9, at 669.

104. *Hale v. Henkel*, 201 U.S. 43 (1906).

105. *Id.* at 75–76.

106. Ripken, *Citizens United*, *supra* note 90, at 25.

107. See *id.* at 24–25 (“Applying corporate personhood in certain contexts and not in others is a matter of policy and expediency, not a matter of logic or consistent reasoning.”).

108. I thank Martin Gelter for emphasizing this point to me.

In addition, as another commentator remarked, “the three conceptions of corporate personality from the nineteenth century . . . do not bolster the Court’s reasoning because each conception is flawed or incomplete and the Court’s variance with them only adds to the inconsistency of its approach.”¹⁰⁹ As such, however, corporate personhood and the nature of the firm become irrelevant¹¹⁰ and judicial conceptualizations of the firm would be both more useful and transparent if courts would forgo their reliance on them in assessing corporate constitutional rights.

B. *Corporate Law*

In corporate law, the influence of the traditional theories of the firm evidences itself in a myriad of ways.¹¹¹ With respect to the corporation’s relationship with third parties and the focal point of this Article, the most notable areas are perhaps limited liability, veil piercing, and corporate social responsibility. The “fictional nature” of a corporate entity can cause courts to disregard limited liability. Theories of the legal entity and its nature also play a considerable role in the shareholder-stakeholder controversy and discussion of corporate social responsibility. Depending on what theory is adopted, businesses can be said to be incapable or capable of pursuing the interests of non-shareholders.

1. Separate Personality, Limited Liability, and Veil Piercing

Although separate legal personality and limited liability are universally considered bedrock corporate law principles,¹¹² they are not absolute. Under the veil piercing doctrine, courts may disregard separate corporate identity and hold shareholders and other individuals personally

109. Pollman, *supra* note 47, at 1660.

110. Ripken, *Citizens United*, *supra* note 90, at 25.

111. For example, under Delaware law, directors owe their duties both to shareholders *and* the corporate entity—and actions can be brought by and on behalf of the corporation—exemplifying the idea that duties can be owed to the legal entity as a separate “thing.” See, e.g., Stephen M. Bainbridge, *Much Ado About Little? Directors’ Fiduciary Duties in the Vicinity of Insolvency*, 1 J. BUS. & TECH. L. 335, 352–53 (2006). See also Iris H-Y Chu, *The Meaning of Share Ownership and the Governance Role of Shareholder Activism in the United Kingdom*, 8 RICH. J. GLOBAL L. & BUS. 117 (2008) (providing a U.K. perspective and discussing, *inter alia*, the real entity theory’s influence on many aspects of the corporate law framework).

112. See, e.g., Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 574–75 (1986). See generally Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479 (2001) [hereinafter Bainbridge, *Abolishing Veil Piercing*] (analyzing the principle and its justifications with regards to limited liability); Daniel R. Kahan, *Shareholder Liability for Corporate Torts: A Historical Perspective*, 97 GEO. L.J. 1085, 1088 (2009) (defining limited liability and describing its function).

liable for corporate debts without restricting their liability by the amount of their investment in the firm's equity.¹¹³

Historically, the real entity theory helped support the trend to grant corporate entities limited liability.¹¹⁴ Conversely, courts and academics, among other grounds, have frequently explained veil piercing by recourse to the idea that the legal entity is a fiction or artificial person.¹¹⁵ Still today, under a common test, the “fiction” will not be honored and courts may pierce the veil if the corporation is controlled and operated in a manner that makes it a “mere instrumentality of another” and the “observance of the fiction of separate existence would, under the circumstances, sanction fraud or promote injustice.”¹¹⁶ Hence, if the corporation is fictitious, courts can use this test to disregard the corporation's separate personality and limited liability, directing instead third-party claims to the “real” persons that are behind the fiction.

Courts' reliance on the ancient corporate imagery of a real or fictional being, however, and the fact that “courts slavishly continue to demand metaphorical proof”¹¹⁷ in deciding veil piercing cases, have resulted in confusion and weakened the validity of and trust in the concept of veil piercing as a whole.¹¹⁸ Not surprisingly, therefore, the principle of veil piercing has often been decried as flawed and unprincipled.¹¹⁹ Thus, in this area, the tendency to focus on whether the

113. See, e.g., John H. Matheson, *Why Courts Pierce: An Empirical Study of Piercing the Corporate Veil*, 7 BERKELEY BUS. L.J. 1, 51–57 (2010) (examining various factors of substantive common law piercing); Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81 (2010) [hereinafter Oh, *Veil-Piercing*] (providing an extensive empirical study of veil-piercing); Peter B. Oh, *Veil-Piercing Unbound*, 93 B.U. L. REV. 89 (2012) (advancing the conception of veil-piercing as constructive trust).

114. Avi-Yonah, *Citizens United*, *supra* note 58, at 1018–19.

115. See, e.g., I. MAURICE WORMSER, *DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS* (1927); cf. also Radin, *supra* note 33, at 659 (“Evidently courts who value the entity theory—and English courts profess to set a high value on it—disregard it with reluctance. Courts who think of it as only a convenient device will of course feel free to disregard it when it becomes inconvenient.”).

116. *Gidwitz v. Stirco, Inc.*, 646 F. Supp. 825, 830 (N.D. Ill. 1986) (citing *Main Bank of Chi. v. Baker*, 427 N.E.2d 94, 101 (Ill. 1981)). Other courts took similar approaches. See, e.g., *Laborers' Pension Fund v. Lay-Com, Inc.*, 580 F.3d 602, 610 (7th Cir. 2009); *Mobridge Cnty. Indus., Inc. v. Toure, Ltd.*, 273 N.W.2d 128, 132 (S.D. 1978); *First Nat'l Bank v. Gamble*, 132 S.W.2d 100, 103 (Tex. 1939).

117. Oh, *Veil-Piercing*, *supra* note 113, at 84; *id.* at 83 n.7 (stating that litigants seeking to pierce a corporation's veil have had to establish, *inter alia*, the defendant was an “alias,” “creature,” “curious reminiscence,” “delusion,” or “fiction”); see also Robert W. Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 982–83 (1971) (noting the problems with “name calling” of legal entities in veil piercing cases).

118. Cf. Oh, *Veil-Piercing*, *supra* note 113, at 83–84.

119. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985) (describing instances of piercing by courts as “rare, severe, and unprincipled”); David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305, 1307

corporation or other business entity is real or fictional under the circumstances is problematic. This approach stands in the way of applying more appropriate factors to guide the analysis in these cases. If veil piercing is an exception to the privilege of separate corporate personality and limited liability,¹²⁰ defining appropriate grounds for veil piercing must start by applying a contemporary understanding of these two concepts and their functions.

Assuming that limited liability is not an absolute principle and that veil piercing is, in principle, a useful tool,¹²¹ the credibility of veil piercing needs to be restored. In this respect, courts, instead of focusing on metaphorical and equity driven explanations, should attempt to engage with scholarly analyses of limited liability and veil piercing.¹²² This approach would provide an opportunity to align veil piercing with substantive, tangible factors that could aim, ultimately, to yield socially beneficial policy outcomes. In effect, because limited liability is in many cases inextricably connected to the firm itself, applying such an understanding means that the functions and effects of the firm, rather than its nature, should guide the analysis.

2. Stakeholder Theory and Corporate Social Responsibility

In the corporate law arena, academics have further used the principles behind real entity and fiction theories to argue for and against Corporate Social Responsibility (“CSR”) and the imposition of corporate duties to stakeholders other than shareholders.¹²³

The question of whether corporate directors and managers are required to maximize shareholder value or whether, and to what degree, they can engage in acts that are beneficial primarily to other stakeholders

(2007) [hereinafter Millon, *Piercing the Corporate Veil*] (describing the area as “notoriously incoherent” and as one in which courts “typically [base] their decisions on conclusory references to criteria of doubtful relevance”).

120. Oh, *Veil-Piercing*, *supra* note 113, at 90.

121. *Contra* Bainbridge, *Abolishing Veil Piercing*, *supra* note 112.

122. As one commentator has observed, “Judges typically seem to be concerned more with the facts and equities of the specific case at bar than with the implications of personal shareholder liability for society at large.” *Id.* at 481.

123. The lines between stakeholder theory and CSR, if any, tend to be blurred. Generally, both stand for the proposition that managers should consider not only their shareholders in making decisions but also other constituencies such as employees, communities, or governments. See generally John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1 (2005); David Millon, *Two Models of Corporate Social Responsibility*, 46 WAKE FOREST L. REV. 523 (2011) [hereinafter Millon, *Two Models*].

is controversial.¹²⁴ Because corporate law fails to provide clear guidance on this point,¹²⁵ scholars have frequently attempted to solve the controversy by developing arguments that draw from theories of the firm. As one commentator noted, “[a] standard argumentative move in these debates has been the effort to justify a position for or against legal reform by reference to some kind of characterization of the corporate person.”¹²⁶

For instance, Merrick Dodd’s classic account of corporate citizenship and CSR was inspired by real entity theory.¹²⁷ Dodd, opposing Adolf Berle’s views on who should be the beneficiary of managerial duties,¹²⁸ opined that because the corporation is real and

124. See, e.g., David K. Millon, *Enlightened Shareholder Value, Social Responsibility, and the Redefinition of Corporate Purpose Without Law 7* (Wash. & Lee Pub. Legal Studies Research Paper Series, Paper No. 2010-11, 2010) [hereinafter Millon, *Enlightened Shareholder Value*], available at <http://bit.ly/17GmdDj> (arguing that Delaware law does not mandate shareholder primacy); Millon, *Two Models, supra* note 123, at 527 (“Delaware courts have never stated plainly that management’s fiduciary responsibilities . . . imply a general duty to maximize profits without regard to competing nonshareholder considerations.”); Lynn A. Stout, *New Thinking on Shareholder Primacy 1* (UCLA Sch. of Law, Law-Econ. Research Paper No. 11-04, 2011), available at <http://bit.ly/15FpfON> (“[S]hareholder primacy thinking in its conventional form is on the brink of intellectual collapse.”). *But cf.* STEPHEN M. BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE* 53 (2008) (“[S]hareholder wealth maximization . . . indisputably is the law in the United States.”).

125. See, e.g., William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 *CARDOZO L. REV.* 261 (1992); Matthew T. Bodie, *Nascar Green: The Problem Of Sustainability In Corporations And Corporate Law*, 46 *WAKE FOREST L. REV.* 491, 497 (2001) (“[T]here is relatively little corporate law substance that can be said to require a shareholder primacy approach”); Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law*, 59 *ALA. L. REV.* 1385 (2008); Barnali Choudhury, *Serving Two Masters: Incorporating Social Responsibility into the Corporate Paradigm*, 11 *U. PA. J. BUS. L.* 631, 633 (2009) (emphasizing corporate law’s collective ambiguity in terms of the question of whom corporations should operate to benefit); Millon, *Enlightened Shareholder Value, supra* note 124, at 18 (“U.S. law . . . is agnostic on the question of corporate purpose.”). *But cf.* David G. Yosifon, *The Law of Corporate Purpose* (Santa Clara Univ. Sch. of Law Legal Studies Research Paper Series, Working Paper No. 14-12 (2013), available at <http://bit.ly/17WFh6g> (arguing that, under Delaware law, there is no ambiguity as corporate managers are obliged to maximize shareholder value). Recently, the Delaware Chancery Court has noted that directors are obliged “to promote the value of the corporation for the benefit of its stockholders” and that “[t]he corporate form . . . is not an appropriate vehicle for purely philanthropic ends.” *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010) (emphasis added). Arguably, however, the specific facts and language of *eBay Domestic Holdings* still leave some room for directors to temper the shareholder value maxim by taking into account other constituencies’ interests.

126. Millon, *Ambiguous Significance, supra* note 47, at 40.

127. See E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 *HARV. L. REV.* 1145, 1146, 1160 (1932) (rejecting the theory that corporations are fictions or aggregates and instead relying on an “entity approach”).

128. Berle had previously argued that managers held their powers in trust for shareholders as the sole beneficiaries of corporate activities. See A.A. Berle, Jr.,

different from the individual shareholders behind it, the corporation as a separate institution could pursue interests that are different from those of its shareholders.¹²⁹ Viewed this way, businesses and corporate managers can pursue societal interests and have duties to other constituencies besides shareholders.¹³⁰

Building upon this foundation, other CSR scholars and stakeholder theorists have justified consideration of broader stakeholder interests by characterizing the firm “as not merely a legal fiction but rather as a moral organism with social and ethical responsibilities,”¹³¹ or built upon the view of the corporation as “an entity existing in time” and as a “distinct person.”¹³² Echoing Dodd’s proposition, commentators have also portrayed the corporation as the equivalent to a citizen. As a “real person in society,” the corporation should bear a citizen’s duties to have regard

Corporate Powers as Powers in Trust, 44 HARV. L. REV. 1049, 1049 (1931). Subsequently, Berle responded to Dodd’s critique by conceptualizing corporations as property belonging to shareholders, advancing the argument that managers needed to be accountable to the legal entity’s proprietors. See ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932); A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1931). Viewed this way, however, the corporation owed duties exclusively to its owners, the shareholders, but not to other parties. See Millon, *Ambiguous Significance*, *supra* note 47, at 49–50. See also William W. Bratton & Michael L. Wachter, *Shareholder Primacy’s Corporatist Origins: Adolf Berle and The Modern Corporation*, 34 J. CORP. L. 99, 122–35 (2008) (providing an in-depth account of the Berle-Dodd debate and its political backdrop).

129. See Dodd, *supra* note 127, at 1160 (“If the unity of the corporate body is real, 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.”).

130. In Germany, the shareholder-stakeholder debate is often traced to the writings of Walther Rathenau and the ensuing early debate surrounding the concept of the “enterprise in itself” (*Unternehmen an sich*). See Gelter, *supra* note 19, at 680–94 (noting that this discussion marks the beginning of the emancipation of the corporation from its shareholders).

131. William Bradford, *Beyond Good and Evil: The Commensurability of Corporate Profits and Human Rights*, 26 NOTRE DAME J.L. ETHICS & PUB. POL’Y 141, 148 (2012). See also Michael Bradley et al., *The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 L. & CONTEMP. PROBS. 9, 41–47 (1999) (characterizing the firm as an entity capable of doing both good and harm). Millon has noted that today’s debate over the desirability of stakeholderism is mostly conducted without regard to entity-based arguments and focuses on aggregate theories of corporate personhood. See Millon, *Ambiguous Significance*, *supra* note 47, at 54, 58. Conversely, Avi-Yonah contends that the real entity theory remains dominant. See Avi-Yonah, *Cyclical Transformations*, *supra* note 3, at 817 (“[I]t can be argued that in practice most corporations are still operating on the basis of the real theory, not the aggregate one. Thus, 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.”).

132. Millon, *Two Models*, *supra* note 123, at 523–24 (sketching a sustainability model of CSR).

to a broad range of parties that are affected by its presence.¹³³ In addition to the apparent usefulness of the real entity metaphor, CSR thinking has also been said to benefit from the traditional view of the firm as an aggregate. The main precondition under this approach is to define the aggregate broadly as being comprised not only of shareholders, but also of a variety of constituencies, including non-shareholders, that are also the beneficiaries of corporate duties.¹³⁴

Contrariwise, a number of 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 viewpoint on CSR.¹³⁵ 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 Daniel Fischel wrote:

A corporation . . . is nothing more than a legal fiction that serves as a nexus for a mass of contracts which various individuals have voluntarily entered into for their mutual benefit. Since it is a legal fiction, a corporation is incapable of having social or moral obligations much in the same way that inanimate objects are incapable of having these obligations.¹³⁶

Thus, these scholars caution against falling into the “reification trap,” that is, an undue personalization of the firm.¹³⁷ Instead, scholars such as Bainbridge emphasize that individual human actors—namely those who make corporate decisions—as opposed to business entities themselves, are the actual bearers of moral obligations and legal duties.¹³⁸

133. See Ripken, *Corporations Are People Too*, *supra* note 62, at 117. Similarly, the Supreme Court of Canada has introduced the idea of corporations as “good corporate citizens.” *BCE Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. 560, para. 66 (Can.).

134. See Millon, *Two Models*, *supra* note 123, at 526.

135. See Bradford, *supra* note 131, 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”). See also *infra* Part IV.A.1 (providing an overview of the nexus of contracts theory).

136. Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1273 (1982).

137. Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 971 n.1 (1992) [hereinafter Bainbridge, *Interpreting Nonshareholder Constituency Statutes*]. See also Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976) (arguing that “the personalization of the firm implied by asking questions such as ‘what should be the objective function of the firm,’ or ‘does the firm have a social responsibility’ is seriously misleading”).

138. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, *supra* note 137, at 971 n.1.

Ultimately, however, it becomes apparent that recourse to either of the traditional theories of the firm cannot provide a coherent answer to the shareholder primacy versus stakeholderism debate. Whether a legal entity is a fiction, a (social) reality, or an aggregate is a question that cannot be answered conclusively. More than 150 years of unresolved academic debate—the product of which one commentator has labeled a “confused mass of absurd literature”¹³⁹—should be sufficient evidence of the impossibility of answering that question (as this Article argues, the question itself also does not matter). The choice of which particular theory of the firm and its interpretation are a function of convictions, values, and policy goals that may well be arbitrary.¹⁴⁰ Similarly, the nexus of contracts theory, reminiscent in part of the fiction theory, also fails to convincingly support its claim that shareholders should be the firm’s sole beneficiaries.¹⁴¹ In sum, the stakeholder and CSR conundrum cannot be solved by looking to the nature of the firm.¹⁴²

C. Tort Law

Tort law is a further area that reflects the considerable influence of the debate concerning a firm’s nature. Continental European tort law remains almost wholly captured by the real entity theory. In these jurisdictions, the idea that only torts committed by a company’s higher-ranking officials can incur the company’s liability or that solely knowledge possessed by these “organs” can be attributed to the company is still commonplace.¹⁴³ Moreover, while the real entity theory has loosened its grip over English tort law, the approach still “has a lingering grip” on the civil liability of corporations.¹⁴⁴

139. FRITZ SCHULZ, CLASSICAL ROMAN LAW 87 (1951) (referring to the earlier civil law debate).

140. See, e.g., *supra* Part III.A (discussing the use of corporate theory in assessing constitutional rights).

141. See *infra* Part IV.A.4.

142. See Gelter, *supra* note 19 (reaching same conclusion from in-depth comparative analysis). See also Millon, *Ambiguous Significance*, *supra* note 47, at 56–58 (arguing that the debate about corporate personhood obscures the critical question of the relationship between shareholders and other stakeholders and contending that today’s personhood theories do not appear to be helpful in developing solutions to these issues).

143. While vicarious liability for employees is recognized, it may still depend upon a finding of a breach of duty on the part of the company organs. See Martin Petrin, *The Curious Case of Directors’ and Officers’ Liability for Supervision and Management: Exploring the Intersection of Corporate and Tort Law*, 59 AM. U. L. REV. 1661, 1690 n.151 (2010).

144. BRENDA HANNIGAN, COMPANY LAW 77 (3d ed. 2012). See also *Stone & Rolls Ltd. v. Moore Stephens*, [2008] EWCA (Civ) 644, [2009] 1 A.C. 1391 (Eng.) (attributing a company’s beneficial owner’s fraudulent conduct to the entity based on his position as a “directing mind”).

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 and the manner in which courts assess those damages against corporations and other business entities.¹⁴⁵ Here, some jurisdictions reject pure corporate vicarious liability for punitive damages. Instead, statutory provisions and case law in a number of states provide that punitive damages can only be awarded upon a showing of involvement by those higher-level corporate officials that control and represent the corporation itself.¹⁴⁶

For example, under the California Civil Code, a corporate employer can be liable for punitive damages when the triggering act is authorized, ratified, or committed by an officer, director, or managing agent¹⁴⁷ of the corporation.¹⁴⁸ Alternatively, courts can assess punitive damages under the Code where an officer, director, or managing agent had advance knowledge of the unfitness of an employee and employed him or her with a conscious disregard of the rights or safety of others.¹⁴⁹ In both scenarios, the idea is that by confining liability to situations involving these individuals, the statute punishes the corporation for malice that reflects "the corporate 'state of mind' or the intentions of corporate leaders."¹⁵⁰ "This assures," as one court has put it, "that punishment is imposed only if the *corporation* can be fairly be [sic] viewed as guilty of the evil intent sought to be punished."¹⁵¹

145. Nevertheless, in early decisions a number of American courts relied on the concept of the "directing mind" of a company in assessing liability. For example, in *Atchison, T. & S.F.R. Co. v. Wilson*, 48 F. 57 (8th Cir. 1891), the court applied the principle that the fellow-servant rule would not protect an employer—in that case a railroad company—from liability for injuries sustained by an employee as a consequence of his co-workers' negligence where a higher-ranking employee-agent who could be seen to represent the company itself was present and supervised the work. *See id.* at 60.

146. *See* Christopher R. Green, *Punishing Corporations: The Food-Chain Schizophrenia in Punitive Damages and Criminal Law*, 87 NEB. L. REV. 197, 200 (2008) (finding that a clear majority of U.S. jurisdictions follows the "managerial agent" or similar approaches in assessing corporate punitive damages). For an historical account of punitive damages in the corporate context, see *Fort Worth Elevators Co. v. Russell*, 70 S.W.2d 397, 402–07 (Tex. 1934).

147. In interpreting the statute, the Supreme Court of California has defined managing agents as "those employees who exercise substantial independent authority and judgment over decisions that ultimately determine corporate policy." *White v. Ultramar, Inc.*, 981 P.2d. 944, 951 (Cal. 1999).

148. CAL. CIV. CODE § 3294 (West 2013); *see also White*, 981 P.2d. at 950–53. Moreover, both the Restatement (Second) of Torts and the Restatement (Second) of Agency contain similar provisions. *See* Restatement (Second) of Torts § 909 (1979); Restatement (Second) of Agency § 217C (1958); *see also Briner v. Hyslop*, 337 N.W.2d 858, 861 (Iowa 1983).

149. CAL. CIV. CODE § 3294(b) (West 2013).

150. *Cruz v. HomeBase*, 99 Cal. Rptr. 2d. 435, 439 (Cal. Ct. App. 2000).

151. *Id.*

Jurisdictions other than California have adopted similar approaches and emphasize the role of managerial agents in assessing punitive damages.¹⁵² For instance, Texas law clearly states that the reason for requiring involvement of a managing agent is to ensure that the corporation is liable only for its “own conduct,” and that acts or omissions by individuals who can be seen as the corporation’s “alter ego” will suffice.¹⁵³ Texas law further expresses the availability of punitive damages against corporate entities in terms of vice-principal liability. Under this theory, punitive damages against an employer or corporation are available if the act is authorized by a “vice-principal,” a person who represents the corporation *itself*.¹⁵⁴

The concept that misconduct must stem from officers, directors, or managing agents is reminiscent of the idea that only misconduct by “organs” can be attributed to a company. Indeed, the definition of a “managing agent” or “vice-principal” closely matches the attributes that the civil law sees as characteristic of the “organs” of a legal entity in the sense of the real entity theory; that is, the ability to exercise independent influence of corporate policy or responsibility for managing a business or parts thereof.¹⁵⁵

Yet, approaches to corporate torts inspired by the real entity theory may yield unfortunate outcomes, as the question of whether victims of such conduct may recover damages depends in part on the hierarchical position of the corporate agents that are responsible for the violation in question. With respect to punitive damages, the result is that where there is malice solely on the part of lower-level employees, tort victims will not be successful in claiming these damages. This is the case despite the

152. See, e.g., *Martinez v. Brinks, Inc.*, 410 F. Supp. 2d 1202, 1214 (S.D. Fla. 2004); *Dewick v. Maytag Corp.*, 296 F. Supp. 2d 905, 911 (N.D. Ill. 2003); *Snow v. Capitol Terrace, Inc.*, 602 A.2d 121, 127 (D.D.C. 1992); *Pirre v. Printing Developments, Inc.*, 468 F. Supp. 1028, 1038–39 (S.D.N.Y. 1979); *Schropp v. Crown Eurocars, Inc.*, 654 So. 2d 1158, 1159–61 (Fla. 1995); *Partington v. Metallic Eng’g Co.*, 792 So. 2d 498, 501 (Fla. Dist. Ct. App. 2001); *Briner*, 337 N.W.2d at 866–67 (following the rule of Restatement (Second) of Agency § 217C and Restatement (Second) of Torts § 909).

153. See, e.g., *Fort Worth Elevators Co. v. Russell*, 70 S.W.2d 397, 402, 407 (Tex. 1934). See also *Qwest Int’l Commc’ns, Inc. v. AT&T Corp.*, 167 S.W.3d 324, 326–27 (Tex. 2005) (holding that a corporation is liable for exemplary damages only if it (1) authorizes or ratifies an agent’s malice, (2) maliciously hires an unfit agent, or (3) acts with malice through a vice principal).

154. See *Qwest Int’l Commc’ns, Inc.*, 167 S.W.3d at 326; *THI of Tex. at Lubbock I, LLC v. Perea*, 329 S.W.3d 548, 581–82 (Tex. Ct. App. 2010). Vice-principals include: corporate officers; those who have authority to employ, direct, and discharge other employees; those engaged in performing the corporation’s nondelegable or absolute duties; and those responsible for the management of the whole or a department or a division of the business. *Mobil Oil Corp. v. Ellender*, 968 S.W.2d 917, 922 (Tex. 1998).

155. See, e.g., *Bundesgericht [BGer] [Federal Supreme Court] Oct. 29, 2001*, 128 *ENTSCHEIDUNGEN DES SCHWEIZERISCHEN BUNDESGERICHTS [BGE] III 29, 33* (Switz.).

fact that the resulting harm is the same in either instance and corporate liability for malicious acts by employees would be in line with the goals of punitive damages: punishment, deterrence, and retribution.¹⁵⁶ The main difference is that the law assumes that in one scenario, the “company” itself acted and is responsible, while in the other, only the agent himself is to blame.

D. Criminal Law

Criminal liability of legal entities has long been a subject of dispute. Courts and scholars in many jurisdictions adhered to the traditional axiom that, following the fiction theory, legal entities lacked the capability of incurring mens rea and could not be criminally liable.¹⁵⁷ Instead, only individuals acting on behalf of a company could be subject to criminal punishment.¹⁵⁸ The International Commission of Jurists noted that “legal entities have been viewed as fictitious beings, with no physical presence and no individual consciousness. As such, many perceive it to be impossible to prove that a business entity had criminal intent, or knowledge.”¹⁵⁹

In keeping with these views, civil law has been particularly slow to adopt any form of corporate criminal liability. Still today, many civil law countries typically do not recognize general corporate criminal

156. See, e.g., *State Farm Mutual Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 416 (2003).

157. See Geis & DiMento, *supra* note 44, at 342–48 (discussing how until the early twentieth century there was resistance to holding corporations criminally liable due to the implications of the fiction theory); V.S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?*, 109 HARV. L. REV. 1477, 1490 (1996) (describing courts’ and scholars’ reluctance to recognize corporate criminal liability based on fiction theory and describing how a number of European countries failed or were slow to recognize the concept). For a detailed account, see generally Markus D. Dubber, *The Comparative History and Theory of Corporate Criminal Liability* (July 10, 2012) (unpublished manuscript), available at <http://bit.ly/1fGncs0>.

158. 2 INT’L COMM’N OF JURISTS, *CORPORATE COMPLICITY & LEGAL ACCOUNTABILITY: CRIMINAL LAW AND INTERNATIONAL CRIMES* 56 (2008).

159. *Id.* at 58. Commenting on its own position on the issue, the Commission also noted that it “believes there are no insurmountable conceptual obstacles to imposing criminal liability on businesses as legal entities” and that it would welcome the possibility of business entities’ criminal liability in view of improvements in terms of victims’ redress and remedy. *Id.* at 58–59. The issue of reality and fiction and its impact on corporate liability has also surfaced in international law. See, e.g., *Kiobel v. Royal Dutch Petroleum Co.*, 621 F.3d 111, 119–20 (2d Cir. 2010) (holding that corporations cannot be subject to liability under the Alien Tort Claims Act and observing that “the principle of individual liability for violations of international law has been limited to natural persons—not ‘juridical’ persons such as corporations—because the moral responsibility for . . . an ‘international crime’ has rested solely with the individual men and women who have perpetrated it”), *aff’d*, 133 S. Ct. 1659 (2013).

liability, with the narrow exception of certain statutory liabilities.¹⁶⁰ In this area, the idea of the fictional character of the firm and its inability to have mens rea prevailed, making it impossible to hold that a company has committed a crime.

Conversely, in the United Kingdom and Canada, a corporation's criminal liability is often premised on the principles of the real entity theory. However, this approach is also fraught with problems. According to the classic "directing mind" or "identification" theory,¹⁶¹ which corresponds to the real entity theory, only misconduct by individuals that can be regarded as physical embodiments of the company itself—namely directors, officers, or other senior employees¹⁶²—can be attributed to the company.

Only recently have both the United Kingdom and Canada introduced legislation to mitigate some of the harsh effects of identification doctrine. Yet, while these statutory rules relax the doctrine's requirements, they still require a breach of duty on the part of senior management and remain reminiscent of the real entity theory.¹⁶³

160. See, e.g., Gerhard O. W. Mueller, *Mens Rea and the Corporation: A Study of the Model Penal Code Position on Corporate Criminal Liability*, 19 U. PITT. L. REV. 21, 28–32 (1957); Patricia S. Abril & Ann Morales Olazábal, *The Locus of Corporate Scierter*, 2006 COLUM. BUS. L. REV. 81, 106 (2006); SCHWEIZERISCHES STRAFGESETZBUCH [STGB] [CRIMINAL CODE] Dec. 21, 1937, SR 311, art. 102 (Switz.) (setting forth specific offenses for which organizations may be held criminally liable).

161. These theories were established by the House of Lords in *Lennard's Carrying Co. v. Asiatic Petroleum Co.*, [1915] A.C. 705 (H.L.) (appeal taken from Eng.), and adopted by the Supreme Court of Canada in *Canadian Dredge & Dock Co. v. R.*, [1985] 1 S.C.R. 662 (Can.). See also *H.L. Bolton (Eng'g) Co. v. T.J. Graham & Sons, Ltd.*, [1957] 1 Q.B. 159, a civil case that courts have often relied on in the criminal context, in which Lord Justice Denning used Gierke's real entity approach. "Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company. . . ." *Id.* at 172.

162. See *Tesco Supermarkets Ltd. v. Nattrass*, [1972] A.C. 153 (H.L.); see also *Meridian Global Funds Mgmt. Asia Ltd. v. Sec. Comm'n*, [1995] 2 A.C. 500 (P.C.) (extending the circle of individuals who may count as the embodiment of the corporation to persons less elevated in the corporate hierarchy).

163. In the United Kingdom, the Corporate Manslaughter and Corporate Homicide Act 2007 may impose criminal liability on organizations if the way in which their activities are managed or organized 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, c. 19, § 1 (U.K.). In Canada, Section 22.1 of the Criminal Codes provides that an organization can be guilty of committing a crime of negligence committed by employees upon a showing that a senior officer should have taken reasonable steps to prevent them from doing so. Criminal Code, R.S.C. 1985, c. C-46, § 22.1 (Can.). In addition, under Section 22.2, an organization can commit a crime requiring an awareness of a fact or a specified intent if a senior officer commits, directs, or authorizes the criminal act. *Id.* § 22.2.

Under U.S. 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.¹⁶⁴

On the one hand, federal courts hold that corporations may become vicariously liable for criminal acts committed by employees of any hierarchical level.¹⁶⁵ Under this approach, criminal liability does not require any involvement by senior corporate officials.¹⁶⁶ On the other hand, a considerable number of states follow the approach incorporated in the American Law Institute's Model Penal Code ("MPC").¹⁶⁷ 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 the scope of his office or employment."¹⁶⁸

As seen in its reliance on high managerial agents, the MPC's approach represents a variation of the English identification theory.¹⁶⁹ It

164. See 3 PHILLIP I. BLUMBERG ET AL., *BLUMBERG ON CORPORATE GROUPS* 107-6 n.6 (2d ed. 2004) (noting the split between jurisdictions); MacLeod Heminway, *supra* note 95, at 141-42 (observing that important legal scholars are divided and the discussion is influenced by the question of whether a corporation can have mens rea).

165. See BLUMBERG ET AL., *supra* note 164, at 107-6 n.6. In *United States v. Ionia Management S.A.*, 555 F.3d 303 (2d Cir. 2009), the Second Circuit refused to follow a defendant's argument that vicarious corporate criminal liability that extends to lower-level employees is inconsistent with Supreme Court precedent and, as the amici curiae brief in this case contended, is in violation of broader criminal law goals. See *Ionia*, 555 F.3d at 309-10.

166. In contrast, behavior by senior officials or managing agents may be required for imposing punitive damages on corporations. See *supra* notes 145-56 and accompanying text.

167. BLUMBERG ET AL., *supra* note 164, at 107-6 n.6; Green, *supra* note 146, at 200 (finding that of 55 jurisdictions surveyed, 26 tend to use a "restrictive" approach that is identical with or similar to the MPC's rules on corporate crime); Benjamin Thompson & Andrew Yong, *Corporate Criminal Liability*, 49 AM. CRIM. L. REV. 489, 494-95 (2012).

168. MODEL PENAL CODE § 2.07(1)(c) (Proposed Official Draft 1962). The MPC defines a "high managerial agent" as an officer or agent that has "duties of such responsibility that his conduct may fairly be assumed to represent the policy of the corporation." *Id.* § 2.07(4)(c). In addition, a corporation can incur criminal liability under the MPC where a "legislative purpose to impose liability on corporations plainly appears" and the conduct is performed by an agent of the corporation acting in the scope of his office or employment and in scenarios in which "the offense consists of an omission to discharge a specific duty of affirmative performance imposed on corporations by law." *Id.* § 2.07(1)(a)-(b).

169. See Eric Colvin, *Corporate Personality and Criminal Liability*, 6 CRIM. L.F. 1, 9-11 (1995); Eli Lederman, *Models for Imposing Corporate Criminal Liability: From Adaptation and Imitation Toward Aggregation and the Search for Self-Identity*, 4 BUFF. CRIM. L. REV. 641, 657 (2000).

therefore embodies an outflow of traditional real entity theory¹⁷⁰ and causes the same problems. Because a third party that incurred harm as the consequence of a legal entity's activities is required to show that someone akin to an "organ" of the company was involved in the offense, holding business entities criminally liable becomes difficult. In the absence of any involvement of higher-ranking officials, and if none of the MPC's more specific routes for corporate liability apply, companies cannot be held criminally responsible. Moreover, even if directors or managerial agents are at fault, finding the necessary proof of a crime, which is essential to hold the entity liable, can be a particularly challenging task in larger, decentralized companies.

IV. FROM NATURE TO FUNCTION

As we have seen, century-old theories on the nature of the firm still pervade important areas of contemporary law. However, trying to resolve legal issues by focusing on the nature of a company and, in particular, drawing upon its reality or fiction leads to a number of problems and obfuscates the underlying substantive issues. Today, reliance on the firm's perceived nature continues to stand in the way of effective solutions to a plethora of fundamental legal issues surrounding corporate and other legal entities and their rights and duties.

In view of continuing difficulties, this Article argues that the firm should be defined not by its nature, but rather by its function. The question, therefore, should not be "what are firms?" but "why do we have firms?"¹⁷¹ and "how do they affect us?" Recent approaches to corporate theory have, to some extent, already begun to focus on some of these aspects. Yet while these efforts are important, they tend to be relatively limited in scope and are not aimed toward offering broader solutions.

Thus, this Part will transcend previous endeavors and propose a more encompassing framework and novel approach to conceptualizing the firm based on function. To illustrate the mechanics and impact of this new "functional approach," this Part will conclude with a section that uses a number of specific examples to outline the concept.

170. See Mueller, *supra* note 156, at 24–25 (noting that the MPC's corporate liability rule rationalizes corporate criminal liability by the natural person analogy).

171. This question is the main focal point of economic theories of the firm. See Matthew T. Bodie, *The Post-Revolutionary Period in Corporate Law: Returning to the Theory of the Firm*, 35 SEATTLE U. L. REV. 1033, 1040–45 (2012).

A. *Modern Theories of the Firm*

Despite the reality-fiction-aggregate debate and its persistent presence in both the common law and civil law, as outlined in the previous sections, some scholars began to argue that theories of the firm should emphasize functional and economic aspects rather than only the *nature* of legal entities.¹⁷² The American legal realist movement around the 1920s and similar movements in Europe had largely discredited classical legal thought and formalism, paving the way for approaches such as law and economics.¹⁷³

Academics were thus provided with the necessary breathing room to advance new, more contemporary theories of the firm and, more broadly, corporate law and corporate governance in general. The following sections provide a brief overview of selected approaches, concluding with an assessment of their limitations in the context of assessing a firm's third-party relationships and its rights and duties in this regard.

1. The Nexus of Contracts Theory

Around the 1970s, drawing upon economic theories developed by Ronald Coase and other pioneers,¹⁷⁴ legal scholars began to develop models of the firm that focused primarily on efficiency and the firm's role as a device to minimize transaction costs within production processes.¹⁷⁵ Because these economics-based corporate law models were more concerned with what firms *do*, rather than what they *are*, they were termed "functional" theories.¹⁷⁶

172. See, e.g., Deakin, *supra* note 1, at 345 n.13 (stating that "past so-called juristic theories of the corporation . . . have been overtaken by the insights of functional or economic analysis, and little would be gained from making them once again the focus of debate").

173. See Kristoffel Grechenig & Martin Gelter, *The Transatlantic Divergence in Legal Thought: American Law and Economics vs. German Doctrinalism*, 31 HASTINGS INT'L & COMP. L. REV. 295, 348–53 (2008).

174. The groundbreaking work in this regard is Ronald Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937). In addition, the new institutional economics approach that is closely associated with the development of this view of the firm was shaped by, among others, Oliver Williamson. See generally, e.g., OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975).

175. Deakin, *supra* note 1, at 340–41.

176. *Id.* at 340 n.2 (stating that the use of the term "functional" originates in Henry Hansmann & Reinier Kraakman, *What Is Corporate Law?*, in *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 5 (Reinier Kraakman et al. eds., 2004) [hereinafter Hansmann & Reinier, *What Is Corporate Law?*]).

The most notable of these “functional” theories is the nexus of contracts theory,¹⁷⁷ which—albeit broadly in the tradition of the old aggregate theory—is now the dominant corporate law theory of the firm.¹⁷⁸ According to the nexus of contracts model, the firm consists of various explicit and implicit contracts between a firm’s constituencies¹⁷⁹ or, in other words, a complex “aggregate of various inputs acting together to produce goods or services.”¹⁸⁰

While the nexus of contracts approach is associated with the contractual or aggregate conception of a legal entity, it embraces a view of the firm that is, in part, analogous to the view of the firm as a fiction. As one commentator explains:

In brief, the nexus of contracts or contractarian model conceptualizes the firm not as an entity, but simply as a legal fiction representing the complex set of contractual relationships between many constituencies providing, or serving as, inputs for the corporation’s productive processes. In other words, the firm is not a thing, but rather a nexus or web of explicit and implicit contracts establishing rights and obligations among the various inputs making up the firm.¹⁸¹

The nexus of contracts theory posits that corporate law represents a number of default contracts that allow the parties involved to opt-out or deviate from these rules by way of mutual agreement. As a consequence, a central normative claim put forward by nexus of contracts proponents is that corporate law should be largely non-mandatory in order to provide private parties the opportunity to freely order their affairs as they see fit.¹⁸²

In addition, nexus of contracts theorists normally subscribe to a shareholder primacy view of the firm. Directors and officers are treated

177. In addition to Coase, the theory is often traced to the works of Armen A. Alchian, Harold Demsetz, Michael C. Jensen, and William H. Meckling. See, e.g., Bratton, *The “Nexus of Contracts” Corporation*, *supra* note 34, at 415.

178. See, e.g., William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1399 (1993) (“The work of the law and economics scholars has come, I believe, to dominate the academic study of corporate law.”); Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 COLUM. L. REV. 1449, 1449 (1989) (“Critics and advocates agree that a revolution, under the banner ‘nexus of contracts,’ has in the last decade swept the legal theory of the corporation.”).

179. See, e.g., BAINBRIDGE, *supra* note 124, at 28; FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 12 (1991).

180. BAINBRIDGE, *supra* note 124, at 28.

181. Bainbridge, *Abolishing Veil Piercing*, *supra* note 112, at 485.

182. See Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 577–78 (2003) [hereinafter Bainbridge, *Director Primacy*]; Phillips, *supra* note 22, at 1090–95 (discussing the “contractualist agenda”).

“as contractual agents of the shareholders, with fiduciary obligations to maximize shareholder wealth.”¹⁸³ Thus, according to the standard nexus of contracts account, shareholders retain a privileged position among the various contracting parties that make up the firm whereas the interests of non-shareholder constituencies remain subordinated.¹⁸⁴

Nevertheless, this shareholder-oriented model of the firm does not imply that corporate directors and officers are always obliged to maximize financial returns to shareholders without regard to the consequences for third parties. Rather, as some commentators point out, managers are not in violation of their fiduciary duties “if they follow conventional morality in acting fairly and even generously toward constituencies other than shareholders,” provided that this behavior is what shareholders, as a group, would prefer.¹⁸⁵

2. Team Production and Director Primacy

Particularly notable modern theories of the firm are Margaret Blair and Lynn Stout’s team production model and Stephen Bainbridge’s director primacy theory.¹⁸⁶ While both are grounded in contractarian theory, they differ from the standard nexus of contracts account and provide alternative and unique insights into the nature of firms.

In the team production model, the corporation is a team-production unit that serves as a vehicle through which teams of shareholders, creditors, managers, employees, and other stakeholders relinquish control over firm-specific resources to a board of directors.¹⁸⁷ The public firm is a “mediating hierarchy” whose essential function, exercised through the

183. Bainbridge, *Director Primacy*, *supra* note 182, at 548. See also EASTERBROOK & FISCHER, *supra* note 179, at 36–39, 92–93. As an exception, the team production model of the firm is grounded in contractarian thought but nevertheless promotes the view that the firm should take non-shareholder interests into account. See *infra* Part IV.A.2.

184. See, e.g., Bainbridge, *Director Primacy*, *supra* note 182, at 548.

185. Henry Hansmann & Reinier Kraakman, *Reflections on the End of History for Corporate Law*, in CONVERGENCE OF CORPORATE GOVERNANCE: PROMISE AND PROSPECTS 32, 36 (Abdul Rasheed & Toru Yoshikawa eds., 2012), available at <http://bit.ly/1en8p7T>. See also Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1433 (2006) (“Managers can promote shareholders’ interests without maximizing profits to the extent the shareholders have some objective other than profit maximization.”).

186. For another alternative view of the firm, see also Deakin, *supra* note 1, at 368–71 (analogizing the corporation to a “shared resource” or “commons,” whose sustainability depends on the participation of multiple constituencies or stakeholders in its governance).

187. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).

board of directors, is to coordinate team members' activities, allocate production outputs, and mediate disputes among team members.¹⁸⁸

Notably, in contrast to the traditional contractarian approach, team production implies that the board should take into account interests other than only those of shareholders, because its responsibility is to protect the firm-specific resources for all team members.¹⁸⁹ Because of the board's independent position, floating above the other team members and exercising a role similar to that of a trustee for the firm's assets, a team production approach tends to support policies that shield directors from shareholder or stakeholder control.¹⁹⁰

Under the director primacy theory, the focus is not on a firm's nature as a nexus of contracts. Instead, the guiding idea is that the firm *has* a central nexus of contracts, which is a board of directors equipped with ultimate "power of fiat."¹⁹¹ The board, in turn, negotiates with and hires the various factors of production or "capital."¹⁹² Drawing in part from Arrow's work on organizational decision-making, director primacy contends that effective corporate governance demands that ultimate authority over the firm's conduct is vested in a central place—a model that is mirrored by the decision-making structure of today's public corporations.¹⁹³ Thus, the board of directors, not shareholders, is and should be in control of the corporation, exercising almost unfettered authority. Among the model's most important claims is that, in order to ensure corporate decision-making efficiency, neither shareholders nor courts, subject to narrow exceptions, should trump the board's decision-making authority.¹⁹⁴

Finally, director primacy, in contrast to the team production theory but in accordance with the nexus of contracts theory, also asserts that shareholders alone, as opposed to other stakeholders, are the appropriate beneficiaries of director fiduciary duties. Consequently, director primacy entrusts the board with maximizing the wealth of shareholders. According to the model, the interests of shareholders should prevail over those of any other constituency.¹⁹⁵

188. *Id.* at 250–51, 276–81.

189. *Id.* at 253, 287–88, 290–92.

190. *Id.* at 254, 290.

191. *E.g.*, Bainbridge, *Director Primacy*, *supra* note 182, at 554–60; Stephen M. Bainbridge, *Response to Increasing Shareholder Power: Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006).

192. Bainbridge, *Director Primacy*, *supra* note 182, at 560.

193. *See id.* at 557–59, 568.

194. BAINBRIDGE, *supra* note 124, at 11.

195. *Id.*; Bainbridge, *Director Primacy*, *supra* note 182, at 577–87.

3. Asset and Liability Partitioning

While the nexus of contracts' distinctly economic perspective embodies functional aspects by characterizing the firm in terms of its ability to reduce transaction costs, other and more recent approaches use a different angle in their focus on function. Among other characteristics, these approaches characterize a legal entity by highlighting its asset and liability partitioning capabilities.

In Germany—the birthplace of the historical debate on the nature of the firm—the now prevailing view among scholars is that legal entities should be approached solely from an abstract and technical standpoint without regard to their personhood or nature.¹⁹⁶ A legal entity is purely a product of positive law and its personality is reduced to a principle of applied law. Accordingly, this principle separates legal entities from the individuals that form them while, at the same time, giving the entity the ability to bear rights and duties and have its own assets and liabilities, thereby enabling it to be more effective in pursuing its goals and interests.¹⁹⁷ Thus, in defining legal entities, the scholarly view in Germany focuses on their function, with the most dominant elements being the firm's ability to have assets partitioned between individuals and the firm as well as the limited liability effect caused by the firm's ability to bear its own duties and liabilities.¹⁹⁸

The firm's separate assets and its function as a (limited) liability entity are also at the center of a modern strand of U.S. corporate law theory. Its proponents argue that the defining criterion of a legal entity is its, depending on the entity's precise organizational form, more or less pronounced ability to separate the entity's assets from assets belonging to individuals that make up the legal entity.¹⁹⁹ In Hansmann and

196. See, e.g., Günter Weick, *Einleitung zu § 21 ff.*, in JULIUS VON STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH § 5 (Herbert Roth et al. eds., 2009). This view is inspired by the classic work of 1 LUDWIG ENNECCERUS & HANS CARL NIPPERDEY, ALLGEMEINER TEIL DES BÜRGERLICHEN RECHTS, § 103 (15th ed. 1959).

197. E.g., FLUME, *supra* note 19, at 28; KLEINDIEK, *supra* note 4, at 148; Weick, *supra* note 196, at *Einleitung zu § 21 ff.* nos. 2, 5; Thomas Raiser, *Der Begriff der juristischen Person. Eine Neubestimmung*, 199 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS 104, 105 (1999).

198. See SCHMIDT, VERBANDSZWECK UND RECHTSFÄHIGKEIT IM VEREINSRECHT 4 (1984); Franz Wieacker, *Zur Theorie der Juristischen Person des Privatrecht*, in FESTSCHRIFT RUDOLF HUBER 339, 358–59 (Ernst Forsthoff et al. eds., 1973). The other characteristic elements of a legal entity are described as its ability to remain unaffected by any changes in its membership and potential permanency. E.g., Weick, *supra* note 196, at *Einleitung zu § 21 ff.* no. 8.

199. Fundamental in this regard is Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387 (2000) [hereinafter Hansmann & Kraakman, *The Essential Role of Organizational Law*]. On the firm's "capital lock-in" effect, see also Margaret Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. Rev. 387, 388–89 (2003);

Kraakman's influential account of the role of asset partitioning—which they see as the firm's most important element²⁰⁰—in corporate and organizational law, this separation comes in two forms. First, a legal entity's creditors normally have no or only limited means of holding individuals that are members of or act for a legal entity liable for the entity's debts.²⁰¹ Second, creditors of members or officials and agents of the legal entity have no direct access to the firm's assets. Instead, they have to yield to creditors of the firm itself.²⁰²

By emphasizing corporate law's property function, in essence, the asset partitioning model departs from the now prevailing nexus of contracts theory of legal entities, which portrays them as standard-form contracts with off-the-rack terms.²⁰³ While Hansmann and Kraakman recognize the practical importance of organizational law's contractual functions, they argue that a legal entity's core defining characteristic is its ability to separate individual and “corporate” assets.²⁰⁴ This property law-based effect, they contend, would be difficult or impossible to achieve in the absence of organizational law.²⁰⁵ Given its importance, Hansmann and Kraakman contend that a focus on asset partitioning provides “a definition of juridical persons that is simpler, clearer, and more functional than those that have characterized the traditional literature.”²⁰⁶

4. Limitations

The nexus of contracts and other contractarian theories have considerable descriptive and normative appeal. Nevertheless, while a more detailed assessment of their strengths and weaknesses is beyond the scope of this Article, two limitations become apparent in the present

and Lynn A. Stout, *On the Nature of Corporations*, 2005 U. ILL. L. REV. 253, 256 (“Like a tar pit, a corporation is much easier for equity investors to get into, than to get out of.”). Note that Hansmann and Kraakman explore asset partitioning in the context of a broader definition of legal entities, while Blair and Stout limit their discussions to the narrower context of incorporated business forms.

200. In addition, Hansmann and Kraakman have also listed five basic characteristics of corporations: (1) legal personality; (2) limited liability; (3) transferable shares; (4) delegated management under a board structure; and (5) investor ownership. See Hansmann & Kraakman, *What Is Corporate Law?*, *supra* note 176, at 5.

201. See Hansmann & Kraakman, *The Essential Role of Organizational Law*, *supra* note 199, at 393–98.

202. *Id.*

203. See *id.* at 440 (“At its essential core, organizational law is property law, not contract law.”).

204. *Id.* at 393.

205. *Id.* at 436 (discussing the inadequacy of contractual solutions).

206. *Id.* at 439.

context: (1) their assumptions regarding the relationship between the firm and non-shareholders; and (2) their scope.

First, contractarians usually deny the firm's ability to bear social or moral duties and responsibilities based on its fictional character and, in addition, contend that shareholder interests are paramount.²⁰⁷ Stakeholders other than shareholders are to protect their interests in two ways. First, other stakeholders should adjust the price of their contracts with the firm to account for the fact that managers will give primacy to the interests of shareholders.²⁰⁸ Second, non-shareholders should rely on the political process and external regulations.²⁰⁹

A considerable problem with this proposition is, as scholars on the opposite side of the stakeholder debate have remarked, that it is somewhat unrealistic. On the one hand, it appears to assume perfect market conditions—free from information asymmetries, inequalities in bargaining power, etc.—under which bargaining between the firm and non-shareholder constituencies takes place.²¹⁰ On the other hand, depending on the circumstances, it may be a stretch to contend that constituencies such as communities affected by corporate activities have, even in a looser sense of the word, “bargained” with the firm and thus had a chance to negotiate the terms of their contracts.²¹¹ Of course, these weaknesses could be overcome if non-corporate laws and regulations effectively protected third parties affected by corporations. While this is the case to a certain extent, external regulation may well be “narrow in scope, limited by jurisdiction, and often captured by corporate

207. An exception is the team production theory. See *supra* Parts IV.A.1–2.

208. Stephen M. Bainbridge, *In Defense Of The Shareholder Wealth Maximization Norm: A Reply To Professor Green*, 50 WASH. & LEE L. REV. 1423, 1443–44 (1993).

209. *Id.*

210. Barnali Choudhury, *Aligning Corporate and Community Interests: From Abominable to Symbiotic*, 2013 BYU L. REV. (forthcoming), available at <http://bit.ly/1fGnsr2>; see also Michael Galanis, *Vicious Spirals in Corporate Governance: Mandatory Rules for Systemic (Re)Balancing?*, 31 OXFORD J. LEGAL STUD. 327 (2011).

211. See Choudhury, *supra* note 210, at 17 (“The communities surrounding the Deepwater Platform in the BP oil spill or the city of Bhopal after the Union Carbide factory explosion, for example, are unlikely to have bargained to be a party to the externalities eventually imposed upon them.”); Kent Greenfield, *Defending Stakeholder Governance*, 58 CASE W. RES. L. REV. 1043, 1059–62 (2008) (discussing employees’ lack of protections and bargaining power); Ribstein, *supra* note 181, at 1438 (noting that according to social responsibility theorists, those dealing with or affected by the firm may lack adequate information to make socially-efficient bargains and, even if information is widely available, the firm may impose costs on parties who are not in a position effectively to bargain with the firm for compensation or lack bargaining power).

interests.”²¹² Thus, the protections offered by regulatory mechanisms are far from complete.

Adding to these problems are the implications of recent corporate crises, the latest of which being the financial crisis of 2008, which have weakened the case for shareholder primacy. Commentators from across the ideological spectrum have recently begun to express doubt as to whether strict adherence to shareholder wealth maximization, as promulgated by the nexus of contracts model, is in fact beneficial for shareholders. As Margaret Blair observed, a number of strong shareholder value advocates have backed away from a commitment to shareholder value maximization as the exclusive goal of corporate governance.²¹³ In the same vein, some scholars and legislatures have expressed growing concern that shareholder wealth maximization may lead to harmful short-termism and negative effects on the economy and society at large.²¹⁴ Assuming this is true, an effective model of the firm should also incorporate these potential effects in assessing firms’ responsibilities.

Furthermore, contractarian theories are limited in scope. Apart from the debate surrounding corporate duties to broader groups of constituencies, the main focus of these models is firmly on shareholders and corporate directors and officers.²¹⁵ As a consequence, however, the importance of the corporation or legal entity itself tends to be diminished.²¹⁶ Ultimately, “[t]he ironic result is,” as Lyman Johnson has observed, “that orthodox corporate theory currently has relatively little to say about the corporation itself and even less to say about corporate responsibility.”²¹⁷

Thus, contemporary corporate theory focuses in great part on shedding light on two fundamental governance questions: (1) for whose

212. Kent Greenfield, *The Disaster at Bhopal: Lessons for Corporate Law?*, 42 *NEW ENG. L. REV.* 755, 758–59 (2008).

213. Margaret M. Blair, *Corporate Law and the Team Production Problem 2* (Vanderbilt Univ. Law Sch., Law & Econ. Working Paper No. 12-12, Pub. Law & Legal Theory Working Paper No. 12-14, 2012), available at <http://bit.ly/1apezK> (referring to Michael Jensen, Jack Welch, Lucian Bebchuk, and others).

214. See, e.g., LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* (2012). The EU Commission, stating that the financial crisis might have been in part caused by shareholders’ focus on short-term profits, has recently noted that its “confidence in the model of the shareholder-owner who contributes to the company’s long-term viability has been severely shaken.” *Commission Green Paper on Corporate Governance and Remuneration Policies for Financial Institutions*, COM (2010) 284 (June 2, 2010).

215. See Johnson, *supra* note 69, at 1162 (“[A]s an intellectual field of study, corporate governance and corporate law concerns itself only with what are considered the three key groups: shareholders, directors, and executive officers.”).

216. See *id.* at 1160 (footnote omitted).

217. *Id.* at 1163.

benefit does the firm operate; and (2) who should be in charge of corporate decision-making.²¹⁸ Traditional corporate law scholarship does not concern itself with rights and duties based on non-corporate laws or the corporation's constitutional status. As Hansmann and Kraakman note, the "standard shareholder-oriented model" includes the principle that non-shareholder corporate constituencies should have their interests protected by contractual and regulatory means rather than through mechanisms of corporate governance.²¹⁹ The traditional corporate law account leaves it up to tort, criminal, constitutional, or other laws and lawyers to solve corporate issues that arise in these fields and to provide the theoretical underpinnings, if any.

As a result, contractarian theories are incomplete. They leave us mostly in the dark when it comes to deciding which rights and duties legal entities should have outside the realm of core corporate law. If we view the firm as a nexus of contracts and deny its character as an entity, the firm could not bear any rights or be liable. If the firm is simply a nexus of interconnected individual parties, the legal entity wholly disappears and all that is left are its single components. Given this atomistic nature of the firm, any claims would logically have to be directed against those individuals or constituencies that act for or as part of the nexus. Similarly, under a strict contractarian model, rights would always apply solely to individuals, but not personified legal entities.²²⁰ Although nexus of contracts theorists do not wish to completely absolve the firm of liability, the fact remains that contractarian approaches do not provide guidance on a number of important legal questions faced by corporations that fall outside of a narrower area of corporate law.

Finally, asset partitioning also fails to provide a more complete picture. This approach defines the firm by its ability to separate personal and business assets, emphasizing the "designated pool of assets"²²¹ for the benefit of the firm's own creditors. However, given its importance, the asset partitioning effect of legal entities is weaker than one might expect. Shareholders or members may still be personally liable toward the company's creditors where they themselves are involved in harmful activities or the corporate veil is pierced.²²² Moreover, directors, officers, and employees usually remain personally liable for torts and

218. See René Reich-Graefe, *Deconstructing Corporate Governance: Director Primacy Without Principle?*, 16 *FORDHAM J. CORP. & FIN. L.* 465, 481 (2011).

219. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 *GEO. L.J.* 439, 440–41 (2001).

220. See Gindis, *supra* note 73, at 28 (discussing how nexus of contracts proponents focus on individuals and their acts, duties, and responsibilities).

221. Hansmann & Kraakman, *The Essential Role of Organizational Law*, *supra* note 199, at 392–93.

222. See, e.g., *Smith v. Isaacs*, 777 S.W.2d 912, 913–14 (Ky. 1989).

crimes that they commit in their official capacities or scope of employment²²³ or may be strictly liable based on statutory violations by subordinates.²²⁴

Nevertheless, asset partitioning and liability partitioning theorists have not argued that third-party liability should be channeled more vehemently to the legal entity by, for example, broadening the scope of corporate criminal liability or by limiting corporate agents' personal liability. Moreover, although Hansmann and Kraakman identify asset partitioning as the firm's defining attribute, they themselves remain highly skeptical of corporate limited liability. Indeed, in previous works, they have advanced a regime of pro rata shareholder liability for corporate debt²²⁵ and viewed corporate limited liability for torts as a "historical accident."²²⁶ In sum, therefore, asset partitioning and similar function-based (or property-based) theories convincingly account for the various purposes of different types of organizations and explain the law governing their defining attributes. Nevertheless, it appears that, thus far, there are few, if any, normative claims attached to these theories.²²⁷

B. *The Functional Approach*

In view of the shortcomings or limitations of existing approaches, traditional and modern, this Section will outline the novel solution of a functional approach to conceptualizing the firm.²²⁸ The approach, while still grounded in economic considerations as the starting point that

223. See generally Petrin, *supra* note 143.

224. The most prominent principle in this regard is the responsible corporate officer doctrine. See, e.g., *In re Dougherty*, 482 N.W.2d 485 (Minn. Ct. App. 1992); Martin Petrin, *Circumscribing the "Prosecutor's Ticket to Tag the Elite"—A Critique of the Responsible Corporate Officer Doctrine*, 84 TEMP. L. REV. 283 (2012).

225. Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991) [hereinafter Hansmann & Kraakman, *Toward Unlimited Shareholder Liability*].

226. Hansmann & Kraakman, *The Essential Role of Organizational Law*, *supra* note 199, at 431.

227. Blair has indicated, without further elaborating, that the core functions of corporations may shed light on policy questions in the constitutional law arena. See Margaret M. Blair, *The Four Functions of Corporate Personhood* 1 (Vanderbilt Univ. Law Sch., Law & Econ. Working Paper No. 12-15, Pub. Law & Legal Theory Working Paper No. 12.-15, 2012), available at <http://bit.ly/14rmUpe> ("Careful analysis of the functions of 'personhood,' or 'entity status' can shed light on policy questions about what Constitutional rights should be recognized for corporations.").

228. The functional approach outlined in the following sections is not to be confused with functional theories of corporate law that refer to a purely economics-based approach to the firm. See *supra* notes 168-72 and accompanying text. It also differs from what one commentator has termed a "functional analysis" of corporate rights, see *infra* note 253, or what has been termed a "functional approach" to deciding under what circumstances courts may disregard a corporate entity. See Hamilton, *supra* note 117, at 979.

governs the analysis, adds alternative social viewpoints and expands the theory of the firm to areas other than corporate law. As the following will explain in more detail, the assessment of a legal entity's rights and duties in its relationship with external parties should not depend on attempts to extract meaning from labels such as "real" or "fictional" or by focusing on a corporation's aggregate or contractual nature. Instead, the focus should be on the broader economic and social function, purpose, and effects of legal entities.

Indeed, while commentators have noted the Supreme Court's inability to develop a coherent theory of corporate personhood,²²⁹ this Article contends that courts should not be concerned with theories of personhood insofar as they represent attempts to define the nature of legal entities. Instead, a legal entity should be viewed simply as a tool by which the legislature has chosen to enable individuals to pursue certain collective (or, in the case of a one-man company, individual) goals in a more effective and convenient manner.²³⁰ Beyond this definition, law—in contrast perhaps to sociology or philosophy—does not need to assess the nature of the firm. Viewed this way, legal entities have those rights and duties that legislators and courts find them to have. In turn, these rights and duties should flow from what the firm is meant to achieve and how it affects society.

In part, this Article thus agrees with the nineteenth-century legal realist view and, in particular, John Dewey's argument that a legal entity should be defined in terms of its consequences and that it is mainly a "right-and-duty-bearing unit" that is "whatever the law makes it mean."²³¹ However, "the law" does not form its opinions and assign corporate rights and duties in a vacuum. Therefore, this Article goes one

229. See, e.g., Krannich, *supra* note 39, at 103 (arguing that the Court relies on a faulty notion of corporate personality); Miller, *supra* note 10, at 914, 909 ("No unified theory governs when or to what extent the Constitution protects a corporation. Instead, the Justices resort to a grab bag of history, metaphysical rumination, Lochnerian tailings, and pragmatism. . . ."); Pollman, *supra* note 47, at 1657 ("While the Court has significantly expanded corporate rights, it has not grounded these expansions in a coherent concept of corporate personhood.").

230. See also Hamilton, *supra* note 117, at 980 ("Realistically, a corporation is simply a device by which individuals conduct a business and other individuals share in the profit or loss."); Radin, *supra* note 33, at 658 (suggesting that "the dangers inherent in corporat[e] theory [may] threaten our thinking").

231. See Cohen, *supra* note 33, at 821–22 (referring to the "functional method" or "functional approach" employed by legal realists); see also Dewey, *supra* note 9, at 656 (citing FREDERIC WILLIAM MAITLAND, COLLECTED PAPERS 307 (1911)). In this sense, the functional approach lies within the tradition of legal pragmatism or legal realism. For a concise explanation of this concept, see, for example, Gerald B. Wetlauffer, *Systems of Belief in Modern American Law: A View From Century's End*, 49 AM. U. L. REV. 1, 18–21 (1999).

important step further in identifying specific elements and considerations that could govern an alternative approach to conceptualizing the firm.

1. Economic Aspects

Looking at a firm's economic functions, two core elements emerge. First, a legal entity serves an asset partitioning function; it has its own assets, separate from those of its members, directors, officers, and employees. Second, and relatedly, in some legal entities shareholders are not liable for company debts over and above the amount they invested.²³² These attributes serve the greater economic purpose of seeking to achieve profits for shareholders or members²³³ or, in the case of non-profit companies, to pursue other goals.

The relevance of these observations is threefold. First, if, as some scholars now convincingly argue, asset partitioning and limited liability are the firm's core function, attempts and concepts to weaken them should be carefully scrutinized in light of their potential benefits. Hence, veil piercing and proposals to introduce certain forms of "unlimited" shareholder liability²³⁴ tend to be difficult to reconcile with a functional view of corporations.

Second, *prima facie*, a legal entity's *rights* (constitutional, statutory, and common law) should reflect its core economic function and purpose. For instance, it is justifiable to protect corporate commercial speech—although there may be limits—in order to increase sales of products.²³⁵ Beyond this obvious case, a legal entity may also be given other rights, including rights to privacy, political speech, and even religious rights, albeit on the preliminary condition that there is a sufficiently strong link

232. See *supra* Part IV.A.3 (discussing liability and asset partitioning). In addition to the corporation, business organizations such as the limited liability company, the limited liability partnership, and the limited liability limited partnership now also offer limited liability. See Millon, *Piercing the Corporate Veil*, *supra* note 119, at 1309. See also *supra* note 200, for additional basic features of the corporate form.

233. Although there is a lively debate surrounding shareholder wealth maximization, it should be clear from cases such as *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010), that shareholder value, at least under Delaware law, is normally a corporation's primary goal. See *supra* notes 124–26 and accompanying text.

234. See *infra* notes 260–63 and accompanying text.

235. Additionally, there may be a societal aspect to allowing corporate commercial speech. See *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council*, 425 U.S. 748, 764 (1976); see also *First Nat'l Bank of Bos. v. Bellotti*, 435 U.S. 765, 766 (1978) (quoting *Va. State Bd. of Pharmacy*, 425 U.S. at 764) (noting that "commercial speech is accorded some constitutional protection not so much because it pertains to the seller's business as because it furthers the societal interest in the 'free flow of commercial information'").

to its economic goals.²³⁶ Absent such a link, a legal entity may still assert a specific non-economic right. Yet, as we shall see, the analysis will be different.²³⁷

Third, economic considerations also 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.²³⁸ Given that the effects of operating a company may include a number of negative externalities, loss internalization is of particular importance. In this regard, economic theory suggests that, in order to achieve an optimal volume of production, goods and services have to reflect their true cost to society. Therefore, prices of goods and services should also internalize the liability risks associated with them.²³⁹

Yet, cost internalization can only be achieved if the corporation is liable for crimes and torts of individuals at all hierarchical levels. In contrast to the real entity theory, economic theory does not distinguish between the status or seniority of an agent. Instead, all that counts is that the costs of torts and crimes are, in fact, internalized. Conversely, a number of contemporary legal rules in both criminal and tort law still reflect the spirit of the real entity theory.²⁴⁰ In particular, U.S. law contains rules that provide that punitive damages as well as criminal liability can only be imposed on corporate defendants based on the misconduct of senior corporate officials.²⁴¹ Following a functional approach, however, economic considerations would suggest that a

236. For example, a kosher food company could claim that undue regulatory provisions violate its right to religious exercise, or a technology business could make a case that privacy rights are necessary to protect its confidential documents and trade secrets. In addition, certain companies might argue that their economic success is dependent on efforts to have their opinion heard in the political process. Moreover, some commentators have argued that any type of speech by for-profit corporations is necessarily commercial in nature. See Ripken, *Citizens United*, *supra* note 90, at 29 n.80, 30–32; Tucker, *supra* note 78, at 521. Nevertheless, while there is undoubtedly a tendency for any corporate speech to relate to its profits, there may still be instances in which speech is motivated by other factors, particularly ideological ones. See David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility after Citizens United*, 89 N.C. L. REV. 1197, 1226–27 (2011).

237. See *infra* Part IV.B.2.

238. See Petrin, *supra* note 143, at 1703.

239. Other effects, such as the impact on the environment, employees, creditors, taxpayers, and the economy at large could also be considered “economic” in nature. Nevertheless, these will be dealt with in the following section under the rubric of “social aspects.” See *infra* Part IV.B.2.

240. See *supra* Part III.C–D.

241. See *supra* Part III.C–D.

different methodology is followed that abandons these traditional distinctions.

2. Social Aspects

Economic considerations are only one, albeit important, aspect of the firm. 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 the recent creation of Benefit Corporations.²⁴² Moreover, their impact on society can be considerable. Societal effects, some of which are intertwined with economic consequences, may be positive and negative. They may include, in no particular order, creation and destruction of jobs and wealth; impacts on health, safety, and the environment; tensions among different groups of society; advancement of new technologies; changes in everyday behavior or even broader cultural shifts; and many others.²⁴³

These combined social aspects need to be included in a contemporary concept of the firm and should, in addition to economic considerations, inform the way in which legal entities' rights and duties are ascertained. In terms of rights, it is self-evident that legal entities that explicitly pursue non-economic interests will, by definition, need to be granted rights that pertain to their respective social, political, cultural, religious, or other goals. Nevertheless, these rights cannot be without limits, the boundaries of which, in turn, depend on the effects of the entity's exercise of a particular right.

On the other hand, 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 purpose and, arguably, are of lesser importance. For instance, from a functional viewpoint, the need to give these types of corporations the right to exercise religion would be difficult to rationalize,²⁴⁴ although there is a possibility that certain

242. For a discussion of B Corporations, see generally Judd F. Sneirson, *Green is Good: Sustainability, Profitability, and a New Paradigm for Corporate Governance*, 94 IOWA L. REV. 987, 1017–19 (2009).

243. See, e.g., Millon, *Piercing the Corporate Veil*, *supra* note 119, at 525 (discussing negative effects of corporate activities).

244. Indeed, while religiously affiliated corporate entities have been granted the protections of the First Amendment's free exercise clause, it remains unclear whether they extend to for-profit entities as well. See *Hosanna-Tabor Evangelical Lutheran Church and Sch. v. E.E.O.C.*, 132 S. Ct. 694 (2012); *Prima Iglesia Bautista Hispana of Boca Raton, Inc. v. Broward Cnty.*, 450 F.3d 1295, 1304 (11th Cir. 2006) (both granting standing to non-profit legal entities to assert the right to free exercise of religion); *Newland v. Sebelius*, 881 F. Supp. 2d 1287, 1299–1300 (D. Colo. 2012) (granting a for-

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 right asserted under the First Amendment relates to an economic goal, the weaker the case will be for extending the right to a for-profit business. Under this approach, then, 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' speech that constitutes lobbying efforts designed to have an impact on the firm's bottom line.

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.²⁴⁵ In this regard, the functional approach does not directly endorse either side. Nevertheless, based on the growing impact that businesses have on society at large, it incorporates the idea that social considerations should be taken into account in assessing the duties of businesses.²⁴⁶

As a middle ground, a functional view is amenable to the idea that in areas where an entity, due to its externalities, can reasonably be foreseen to produce considerable harm that outweighs its other benefits, imposing corresponding corporate duties to non-shareholder constituencies can be justified. Moreover, given the effects of legal entities, the functional approach suggests that there may be the need for a baseline minimum standard of firm behavior in relation to the public, perhaps in the manner envisaged by Milton Friedman. Friedman not only famously declared that "the social responsibility of business is to increase its profits," but also stated that while "mak[ing] as much money as possible" is a business's foremost duty, firms also needed to

profit corporation a preliminary injunction based on potential infringement of its right to free exercise of religion). *But cf.* *Tyndale House Publishers, Inc. v. Sebelius*, 904 F. Supp. 2d 106, 114 (D.D.C. 2012) (declining "to address the unresolved question of whether for-profit corporations can exercise religion within the meaning of the [Religious Freedom Restoration Act] and the Free Exercise Clause"). For an in-depth discussion of this issue, see Ronald J. Colombo, *The Naked Private Square*, 51 HOUS. L. REV. (forthcoming 2013), available at <http://bit.ly/1cQ17dt>.

245. See *supra* notes 123–26 and accompanying text.

246. *Cf. also* Greenfield, *supra* note 211 (drawing a connection between corporate disasters and corporate duties to act responsibly toward third parties); Kent Greenfield, *Saving the World with Corporate Law?*, (Bos. Coll. Law Sch. Legal Studies Research Paper Series, Research Paper No. 130, 2007), available at <http://bit.ly/14yiZ4R> (discussing the failures and externalities of corporations).

“conform[] to the basic rules of the society, both those embodied in law and those embodied in ethical custom.”²⁴⁷

This approach also tends to be in line with what appears to be growing support beyond scholarly circles of the notion that firms are bearers of certain societal duties. For example, corporate constituency statutes,²⁴⁸ even if largely ineffective in their current forms,²⁴⁹ provide evidence of legislative interest in advancing the role of societal considerations in corporate decision-making. On an international level, the Supreme Court of Canada has held that “[d]irectors . . . may be obliged to consider the impact of their decisions on corporate stakeholders,”²⁵⁰ while the U.K. government has introduced 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.²⁵¹ Finally, views such as those expressed in the OECD Guidelines for Multinational Enterprises suggest that many governments are now of the opinion that corporations should take non-shareholder interests into account and promote positive contributions to economic, environmental, and social progress.²⁵²

3. Balancing Economic and Social Considerations

As the previous Sections have explained, the functional approach defines the firm by its economic and social functions, purpose, and effects. The functional approach is a balancing approach that consists 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

247. Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, available at <http://bit.ly/112BM>. Conversely, the ALI Principles of Corporate Governance state that if corporate profit and shareholder gain are not thereby enhanced, corporations *may* (but not must) take into account ethical considerations. See 1 PRINCIPLES OF CORP. GOVERNANCE § 2.01 (Am. Law Inst. 1994).

248. Constituency statutes generally allow or even require directors of public corporations to consider the welfare and other interests of non-shareholder groups in the course of making corporate decisions. Currently, 41 U.S. states (notably excluding Delaware) have enacted various forms of such statutes. See Kathleen Hale, *Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes*, 45 ARIZ. L. REV. 823, 833 n.78 (2003) (providing a list of the states and the statutes).

249. For a recent analysis and critique, see Bodie, *supra* note 125, at 497–98; Andrew Keay, *Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado About Little?*, 22 EUR. BUS. L. REV. 1 (2011).

250. BCE Inc. v. 1976 Debentureholders, [2008] 3 S.C.R. 560, para. 66 (Can.).

251. Companies Act, 2006, c. 2, § 172 (U.K.).

252. See ORG. FOR ECON. CO-OPERATION AND DEV., OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES 5 (2008), available at <http://bit.ly/17ebmq>.

inform the way we think about firms and, in particular, help define their rights and duties.

As many legal entities are economic beings at heart, economic considerations are the starting point of the analysis. They protect a firm's economic rights and are geared toward preserving the firm's core element, its liability and asset partitioning function, which regularly serves to support its profit-seeking. In addition, economic considerations are also a basis for justifying duties and rules that support internalization of business risks, namely in the form of third-party liability, on the part of firms.

At the same time, the social element factors into a rights and duties analysis in three ways. First, it can help to ascertain what kinds of non-economic rights a legal entity should be granted. Due to their different functions, these will be narrower in the case of for-profit corporations as compared to non-profits. Second, the social element should play a role 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 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. Thus, even where a right conferred upon or demanded by the corporation is in line with its profit-making goal—such as commercial speech in the form of advertising or political speech aimed at influencing laws and regulations that affect its bottom line—there is still a need to inquire into the overall effects of granting that right and discern whether there is a countervailing social consideration.

B. Applying the Functional Approach

The idea behind the functional approach is not that it gives, in and of itself, the answers to the legal problems that some legislators, courts, and scholars currently look to the nature of the firm to solve. Instead, the real value of the functional approach is that it provides a more appropriate legal framework by which to assess these problems. Nevertheless, in order to clarify the main mechanics of the functional approach, the following is a short illustration of how courts or legislators could apply the functional approach to facilitate the resolution of some of the issues identified earlier in this Article.

First, in ascertaining a corporation's constitutional rights, the functional approach suggests that legal entities should be given the rights

that pertain to or further its economic or social function and purpose.²⁵³ However, the granting of these rights must be balanced against a consideration of the effects these rights could have on society if exercised. Thus, in *Citizens United*,²⁵⁴ the functional approach would have mandated a more nuanced analysis of the issues, balancing the factors in favor of granting political speech rights to legal entities against the threat of a distortion of the electoral process or undue political influence by giving such entities this right.²⁵⁵ As part of this balancing approach, the Supreme Court could also have considered the type of entity that was involved, such as the fact that *Citizens United* was a non-profit corporation, and its specific function and purpose.²⁵⁶

Second, in the corporate law arena, the functional approach could replace the unprincipled equity-based method upon which courts still regularly rely in the context of veil piercing. Using the functional approach would enable the courts to replace the metaphoric tests that are currently in place in favor of an in-depth engagement with the function and effects of limited liability itself. As a starting point for this analysis, courts would need to consider the benefits and disadvantages that limited liability offers.

For instance, in terms of benefits, limited liability is thought to offer two main advantages. First, it minimizes the risks associated with investing and thereby assists in aggregating capital.²⁵⁷ Second, it reduces the need for investors to monitor managers and fellow investors, which, in turn, reduces the cost of investing.²⁵⁸ At the same time, limited

253. Recently, a commentator also argued that the doctrine of corporate personhood should only serve as a starting point and that, using a “functional analysis,” courts “should consider the purpose of the constitutional right at issue, and whether it would promote the objectives of that right to provide it to the corporation—and thereby to the people underlying the corporation.” Pollman, *supra* note 47, at 1631.

254. *Citizens United v. FEC*, 558 U.S. 310 (2010).

255. This was the approach that was adopted more than two decades ago in *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652 (1990), and which was rejected by the majority in *Citizens United*. *Austin* upheld a statute prohibiting corporations from using corporate treasury funds for independent expenditures in supporting or opposing candidates in elections for state office, finding that “the Act is precisely targeted to eliminate the distortion caused by corporate spending while also allowing corporations to express their political views.” *Id.* at 660. It also held that the State’s compelling interest in this case was to “counterbalance” the advantages conferred by the corporate form. *Id.* at 665.

256. In part, this ties in with Ronald Colombo’s recent proposal that corporations that represent genuine communities with specific cultures should receive greater protections in terms of political speech than other types of corporations. See Ronald Colombo, *The Corporation as a Tocquevillian Association*, 85 TEMP. L. REV. 1, 1–2 (2012).

257. See Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 96–97 (1985).

258. *Id.* at 94–95.

liability can often be problematic.²⁵⁹ Thus, commentators have suggested that because of the harms it can impose, limited liability should be restricted to public companies,²⁶⁰ that there should be pro rata shareholder liability for corporate torts,²⁶¹ that limited liability should be preconditioned on financially responsible behavior,²⁶² or that parent companies or controlling shareholders should not be able to rely on limited liability.²⁶³ These and other considerations may deserve the attention of courts that are considering piercing the corporate veil, whereas the firm's supposed nature as a fiction should be irrelevant.

Moreover, a functional approach could also be helpful in the ongoing debate over the corporate purpose. While this Article does not attempt to solve the question of whether firms should generally owe corporate social responsibility or stakeholder duties, analyzing and weighing firms' economic and social effects—both positive and negative—against each other promises to be a more realistic approach to ascertaining this issue compared to analyses of the nature of the firm. In this sense, the functional approach tends to support a view that puts shareholders and economic goals first, but demands due attention to economic and social externalities.²⁶⁴

Finally, in tort and criminal law, the functional approach would free courts and legislatures from the restrictions of the real entity theory, identification theory, or “managerial agent” approach and its outdated reliance on company “organs.” As a result, firms could be held liable for misconduct by employees at all hierarchical levels, based on the economic principle that businesses should internalize the full cost of their

259. In addition to the authors cited in the following footnotes, see, for example, Janet Cooper Alexander, *Unlimited Shareholder Liability Through a Procedural Lens*, 106 HARV. L. REV. 387, 391 (1992) (arguing that limited liability threatens fundamental tort law principles).

260. See Paul Halpern et al., *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. TORONTO L.J. 117, 148–49 (1980) (finding that limited liability is only efficient when granted to large public firms); David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1568–69 (1991) (arguing that limited liability may only be justified in the context of closely held firms).

261. See Hansmann & Kraakman, *Toward Unlimited Shareholder Liability*, *supra* note 225, at 1880.

262. See Millon, *Piercing the Corporate Veil*, *supra* note 119, at 1308.

263. See, e.g., Bainbridge, *Abolishing Veil Piercing*, *supra* note 108, at 529; Nina A. Mendelson, *A Control-Based Approach to Shareholder Liability for Corporate Torts*, 102 COLUM. L. REV. 1203, 1271 (2002) (controlling shareholders).

264. Balancing the advantages and disadvantages of shareholder value and stakeholder interests is admittedly complex. Only one consideration among many is the fact that large parts of the U.S. workforce are now, via their pension plans, major shareholders themselves. Consequently, their savings will be affected if shareholder value is not maximized. See generally Martin Gelter, *The Pension System and the Rise of Shareholder Primacy* (Fordham Univ. Sch. of Law Working Paper Series, Research Paper No. 2079607, 2012), available at <http://bit.ly/19qUjP2>.

activities, as well as social considerations that relate to the protection of public health and safety.²⁶⁵

In this context, the functional approach would also be amenable to corporate liability based on theories of collective mens rea. In these instances, and in contrast to the traditional real entity approach, a business organization's state of mind is different and independent of the state of mind of individuals acting for the business. For example, the emerging concept of "collective scienter" and similar theories allow courts to aggregate the states of mind of multiple corporate agents to show the corporation's own knowledge.²⁶⁶ Contrary to traditional approaches, these emerging efforts, which aim to hold the corporation or legal entity directly, as opposed to vicariously, liable, are more suited to modern corporate environments. In particular, in complex group companies it may be virtually impossible to locate one identifiable individual or group of individuals that are responsible for misconduct or harm to third parties.²⁶⁷

Yet, only a shift away from both fictional and real entity thinking can accommodate the reality of modern corporate structures and decision-making and explain direct liability. While the real entity and fiction theories assume that legal entities act through individual organs or agents, respectively, the functional approach is not bound by such views. Instead, it can accommodate the notion that harm that is typical for a

265. Note that this would not exclude duty-based regimes under which firms can mitigate their criminal liability by engaging in monitoring, self-reporting, and cooperation with the government. See Jennifer Arlen, *Corporate Criminal Liability: Theory and Evidence*, in RESEARCH HANDBOOK ON THE ECONOMICS OF CRIMINAL LAW 167 (Alon Harel & Keith Hylton eds., 2012) (summarizing the case for this approach). Still, some have argued that making criminal liability dependent on the conduct of directors and high managerial agents is preferable because that approach aims to hold corporations morally responsible for the results of official corporate policy and facilitates corporations' ability to conform their behavior to the law. See, e.g., John Hasnas, *The Centenary of a Mistake: One Hundred Years of Corporate Criminal Liability*, 46 AM. CRIM. L. REV. 1329, 1356 (2009).

266. See *Gutter v. E.I. Dupont De Nemours*, 124 F. Supp. 2d 1291, 1309 (S.D. Fla. 2000) (finding that the "knowledge necessary to adversely affect the corporation need not be possessed by a single corporate agent," as "the cumulative knowledge of several agents can be imputed to the corporation"); Abril & Olazábal, *supra* note 160, at 86, 91–98, 116–21 (discussing the concept and asserting that it has been used by many courts); V.S. Khanna, *Is the Notion of Corporate Fault A Faulty Notion?: The Case of Corporate Mens Rea*, 79 B.U. L. REV. 355, 371–75, 407–12 (1999) (discussing corporate fault as collective mens rea); Sandra F. Sperino, *A Modern Theory of Direct Corporate Liability for Title VII*, 61 ALA. L. REV. 773, 795–98, 806 (2010) (discussing the concept of "corporate scienter" and noting that it has not yet been widely adopted); Thompson & Yong, *supra* note 167, at 502 (pointing out the doctrine's limited applicability and suggesting that it has not yet been widely accepted).

267. See Sperino, *supra* note 266, at 797.

certain business activity should be its responsibility,²⁶⁸ independent of individual misconduct and discussions of whether legal entities themselves can have mens rea.

V. CONCLUSION

Despite a number of countervailing developments, the trichotomy between a legal entity's reality, fiction, or aggregate nature retains a strong presence in important areas of contemporary law. Yet, as it turns out, looking at the nature of the firm fails to provide convincing answers and often only further complicates attempts to solve legal issues.

Instead of holding on to traditional approaches, the functional approach provides a more useful and sound framework by which to think about legal entities and their rights and duties. The approach proposes to conceptualize legal entities and assess their rights and duties by looking to their economic and social function, purpose, and effects. While this functional framework is not outcome-determinative, it will make a significant difference to the analysis.

To be sure, the functional approach is not free from weaknesses. Its strengths, flexibility and pragmatism also represent its most important limitation: there may be uncertainty given that there can be different views on the content of a legal entity's economic and social function, purpose, and effects.²⁶⁹ Nevertheless, compared to the nature or personhood of the firm, economic and social factors are far more tangible and at least measureable to some extent, which results in a more transparent and goal-oriented approach.

Moving away from the traditional paradigms and attempting to redefine the way we think about the firm is, no doubt, a challenging task. However, because it shapes a variety of important aspects of the law, the issue of how to conceptualize the firm and proposals on how to improve these concepts are of utmost importance.

268. As Judge Friendly explained, an enterprise should not only bear the benefit, but also the typical costs flowing from its activities. *See* *Ira S. Bushey & Sons, Inc. v. United States*, 398 F.2d 167, 171 (2d Cir. 1968).

269. It is therefore likely that in order to provide greater clarity, scholars and courts would have to develop a number of categories of corporate rights and duties, which would generally be followed unless the specific circumstances in a given case or scenario demand a different outcome.
