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Reuven Avi-Yonah's "Citizens United and the Corporate Form": A Comment

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Abstract

Avi-Yonah's article is to be commended for bringing corporate theoretical sophistication to bear on the opinions of a Court that is largely unfamiliar with the real world of corporate and business practice. But the essential question with which I leave Avi-Yonah's work is: Why does it matter? The principal flaw in Avi-Yonah's argument is that it consistently operates at the level of high theory while failing to contextualize the theoretical debate in a way that might elucidate for us theory's importance. While he takes us through all of the standard cases, he disregards the purposes for which theory was used in each. For corporate theory in the context of constitutional law is about the power relationship between the corporation and the state, while corporate theory in the context of corporate law is about the relationship between directors and shareholders, and thus the distribution of power within the corporation. One set of theories is largely independent of the other, as clear as the contrast between the Progressive Era theoretical literature Avi-Yonah cites, and Berle and Means's "The Modern Corporation and Private Property". What difference does it make? Constitutional law is about power within politics, writ both large and small. Corporate law is about power within business. The former goes to the question of the corporation's power vis-a-vis the state and society. The latter goes to questions of the efficiency of the enterprise and the legitimacy of its organization.

KEYWORDS: corporation, legal fiction, legal person, real entity, constitutional rights, free speech

JEL Classification Codes: K10, k22, l50, l20

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Reuven Avi-Yonah (2011; hereafter: Avi-Yonah) has made a serious attempt to make sense of the corporate jurisprudence of the United States Supreme Court, most recently expressed in its decision in *Citizens United v. FEC*,¹ through the device of tracing what he notes are the three distinct principal theories of the corporation that underlie its American judicial treatment.² While the theoretical ground is heavily trodden, Avi-Yonah seeks to explain *Citizens United* as a momentary convergence of the real entity theory of corporate law, the theory that sees the corporation as an entity distinct from its owners and the state, in contrast to the aggregate theory which treats the corporation as the sum of its shareholders, and the artificial entity theory which sees the corporation as a creation of the State. By doing so, he allows us to place the majority and dissenting opinions on the same theoretical footing, and isolate the constitutional issue addressed by the Court, exposing it for the political dispute that it surely is.

Avi-Yonah is to be commended for bringing corporate theoretical sophistication to bear on the opinions of a Court that is largely unfamiliar with the real world of corporate and business practice.³ But the essential question with which I leave Avi-Yonah's work is: Why does it matter?⁴ The principal flaw in Avi-Yonah's argument is that it consistently operates at the level of high theory while failing to contextualize the theoretical debate in a way that might elucidate for us theory's importance. While he takes us through all of the standard cases, he disregards the purposes for which theory was used in each.⁵ Indeed, his treatment of *Edgar v. MITE Corp.*,⁶ *CTS Corp. v. Dynamics Co.*,⁷ and *Paramount v. Time*⁸

¹ 2010 LEXIS 766 (2010).

² See also Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility*, 30 Del. J. Corp. L. 767 (2005).

³ It is my view that this is a problem which, for some time, has plagued the Supreme Court's jurisprudence on issues of corporate and business law. Lawrence E. Mitchell, *No Business Like No Business*, in *The Rehnquist Court: Judicial Activism on the Right* 227 (Herman Schwartz, ed. 2002).

⁴ For a further essay on my skepticism about corporate theory see Lawrence E. Mitchell, *The Relevance of Corporate Theory to Corporate and Economic Development: Comment on The Transplantation of the Legal Discourse on Corporate Personality Theories*, 63 Wash. & Lee L. Rev. 1489 (2006).

⁵ This failure stands in stark contrast to the carefully contextualized and nuanced approach to corporate theory taken by Morty Horwitz. Morton J. Horwitz, *The Transformation of American Law, 1870-1960: The Crisis of Legal Orthodoxy*, 65-107 (1992).

⁶ 457 U.S. 624 (1982).

⁷ 481 U.S. 69 (1987).

⁸ 571 A. 2d 1140 (Del. 1989).

as part of the same data set for his analysis illustrates the importance of context in assessing the relevance of theory. For, as I shall argue, corporate theory in the context of constitutional law is about the power relationship between the corporation and the state, while corporate theory in the context of corporate law is about the relationship between directors and shareholders, and thus the distribution of power within the corporation. One set of theories is largely independent of the other, as clear as the contrast between the Progressive Era theoretical literature Avi-Yonah cites, and Berle and Means's *The Modern Corporation and Private Property*. What difference does it make? Constitutional law is about power within politics, writ both large and small. Corporate law is about power within business. The former goes to the question of the corporation's power *vis-a-vis* the state and society. The latter goes to questions of the efficiency of the enterprise and the legitimacy of its organization.

Avi-Yonah goes to pains to explore the fractured applications of the three principal corporate theories in and across Supreme Court cases from the early nineteenth century up to *Citizens United*. But while corporate theory may have been useful in justifying or denying the corporation certain constitutional rights, it might have been helpful for Avi-Yonah to have spent some time looking at the corporation from the ground up, at the level of corporate law creation. Take, for example, a simple comparison of two Delaware opinions by one highly accomplished judge.

*Blasius Industries, Inc. v. Atlas Corporation*⁹ presented the question of whether a board of directors, acting in good faith, could, consistent with its fiduciary duties, act in a manner that blocked the attempt of a dissident shareholder to amend the corporation's bylaws to expand the board and fill the new directorships for the purpose of effectuating a business plan the dissident thought would release greater shareholder value. In siding with the dissident, Chancellor William Allen wrote the following:

[The board's action] inevitably involves the question who, as between the principal and agent, has authority with respect to a matter of internal corporate governance.

Judicial review of such an action involves a determination of the legal and equitable obligations of an agent towards his principal.

The theory of our corporation law confers power upon directors as the agents of the shareholders.

⁹ 563 A. 2d 651 (Del. Ch. 1988).

[The shareholders] are . . . entitled to restrain their agents, the board, from acting of the principal purpose of thwarting [their] action.

Contrast these statements with the Chancellor’s opinion a year later in *Paramount Communications, Inc. v. Time Incorporated*,¹⁰ which addressed the question of whether Time’s board of directors could recast a merger (as to which shareholders were entitled to vote) as a friendly takeover to avoid a hostile bid, at a very high premium. The answer, in this rather different set of circumstances, was no:

In the decision they have reached here, the Time board may be proven in time to have been brilliantly prescient or dismayingly wrong. In this decision, as in other decisions affecting the financial value of their investment, the shareholders will bear the effects for good or ill. That many, presumably most, shareholders would prefer the board to do otherwise than it has done does not, in the circumstances of a challenge to this type of transaction, in my opinion, afford a basis to interfere with the effectuation of the board’s business judgment.

From a theoretical perspective, the difference is striking. Using the three theories described by Avi-Yonah, although not a perfect fit, one can see Allen applying a form of aggregate theory in *Blasius*, and either the artificial or real entity theory in *Paramount*. More, one can argue that *Blasius* goes so far as to adopt the functionally aggregate neo-classical contractual theory of the firm which, sometimes metaphorically and sometimes not, describes directors as agents of the shareholders, while *Paramount* is entirely respectful of their separate spheres, within and outside the corporate structure.

Was Allen inconsistent? Had he forgotten *Blasius* in a year? Did he not see the theoretical inconsistencies? I don’t think so. In the first place, his opinion in *Blasius* clearly uses corporate theory for what he thinks it is. While echoing the traditional, if perhaps changing, view that shareholder power is more fanciful than real, he writes: “The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power exists.” And more: [The shareholder vote] is critical to the theory that legitimates the exercise of power by some . . . over vast aggregations of property that they do not own.” Regardless of the facts as they had developed historically, theory was a legitimating device of the internal organization of corporate power and one that, in this context, one ignored at one’s peril. By contrast, the implicit theory in *Paramount* was about the efficiency of

¹⁰ CCH FED. SEC. REP. p. 94, 514 (1989), *aff’d* 571 A. 2d 1140 (Del. 1990).

the organization: directors run the corporation. Or, to sum up the two cases, while individuals who serve as directors have no (formal, legal) power over whether shareholders elect them, once they are in office, the board as an institution is empowered to run the corporation as it sees fit without (formal, legal) shareholder interference.

Second, and most telling, the contexts were different, at least as a formal matter. *Blasius* involved voting; *Paramount* was about a change in corporate control.¹¹ *Blasius* was about legitimating directorial power; *Paramount* was about the exclusivity of that power with respect to its management of the corporation's business. In each case, theory mattered, in *Blasius* by upsetting a carefully designed business restructuring designed to achieve the directors' vision of long-term value; in *Paramount* by preventing Time's shareholders from accepting a highly lucrative takeover bid to protect the directors' vision of long-term value. Did theory determine the outcome in either case? That's hard to say, especially in light of Allen's recognition in both cases of a possible mismatch between theory and facts. But if theory did matter, he is equally clear in both cases that its importance was as a legitimating device. One can infer that he believed that the sorry results in each case were necessary in order to sustain the legitimacy of our model of corporate governance.

This is not a grand theory of corporate personhood, as are the theories explored by Avi-Yonah. Indeed one can see *Blasius* as entirely consistent with aggregate theory, and *Paramount* as entirely consistent with either form of entity theory. These inconsistencies are irrelevant, for that level of high theory doesn't matter to the creation of corporate law, although it can matter to constitutional determinations of the protections afforded the corporation by the state, its private or public nature, and its exercise of social and economic power.

Indeed, the history of the development of American corporate law reveals that it is nothing if not intensely practical.¹² For example, Avi-Yonah notes, in passing, the changes made in New Jersey law between 1889 and 1896 that essentially enabled the creation of the giant modern corporation.¹³ Theory had nothing to do with this development. It was driven by business lobbying and the parlous condition of New Jersey's own treasury, not by Supreme Court theorizing about corporations. Such theorizing as the Supreme Court engaged in was a

¹¹ One could characterize it as a matter of the shareholders' rights to take a lucrative tender offer, but that question had largely been settled in *Unocal Corporation v. Mesa Petroleum Corp.*, 493 A.2d 946 (Del. 1985).

¹² Lawrence E. Mitchell and Dalia T. Mitchell, *The Financial Determinants of Corporate Governance*, in *Corporate Governance* (H. Kent Baker and Ronald Anderson, eds; forthcoming 2010); Lawrence E. Mitchell, *The Speculation Economy: How Finance Triumphed Over Industry* (2007); *The Trouble with Boards*, in *The New Corporate Governance*, Troy A. Paredes and F. Scott Kieff, eds.; forthcoming 2010).

¹³ Mitchell, *The Speculation Economy*, Ch. 2.

consequence of the Progressive Era effort to legitimate the corporate structure as a collective source of power in a traditionally individualistic society. For, by the time the real entity theory had come to the United States, the giant public corporation was already a fact on the ground. Very few, most prominently Louis Brandeis, wanted to change that fact (although his patron, Woodrow Wilson, did not).

The Delaware cases employ theory carefully shaped by context, applied in order to preserve the structure of Delaware corporate law. So do the Supreme Court cases, in their own distinct sphere and with their own distinct concerns. And that is the lesson of this brief excursion into Delaware jurisprudence. Context matters.

Thus, while Avi-Yonah provides an important insight by clearing away the corporate underbrush to permit political and constitutional debate, I am left with the question with which I began: Does corporate theory really matter beyond the confines of corporate law?

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