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CORPORATE BILL OF RIGHTS

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Corporate Bill of Rights[3]

Abstract

Corporate entities enjoy legal subjectivity in a variety of forms, but they are not human beings. This paper explores, from a normative point of view, one of the limits that ought to be imposed on the capacity of corporations to be treated "as if" they had a human nature, their recognition as legitimate bearers of basic human rights. The assertion that corporations, like living persons, are entitled to constitutional protection was famously brought to the fore by a number of recent Supreme Court cases, most notably the *Citizens United* and the *Hobby Lobby* cases. In the rational choice analysis that follows this paper reveals that the new jurisprudence emanating from *Citizens United* may be justified in the relatively insignificant cases of small companies with egalitarian distribution of shares, but ought to be rejected in the more meaningful cases of large public corporations with controlling stockholders. The ruling in *Hobby Lobby*, on the other hand, can be defended regardless of the size of the corporation or the composition of its owners. In both of these cases it is not the rights of the corporate entity which is truly at stake and the final outcome ought to hinge on the constitutional rights of real human beings.

Key words: Corporations, Constitutional Law, Rational Choice

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Section 1.Introduction

The separate legal person of corporate entities is a staple of every developed legal system. It is commonly interpreted as a device to allocate risk among corporate constituencies, and especially between owners and creditors[4]. It is equally clear, however, that corporations are distinct from natural persons and hence their legal subjectivity, i.e. their capacity to bear rights and obligations of their own, is limited. For example, they cannot be elected to public office. What corporations "can" or "cannot" do is a perennial subject of discussion which permeates numerous fields of law[5]. This paper offers an innovative way to examine, from a normative point of view, the capacity of corporate entities to have constitutional rights of their own, i.e. distinct from the rights of the individual human agents taking part within the corporate contractual nexus.

The most celebrated two cases dealing with this question are, without a doubt, *Citizens United v. Federal Elections Commission*[6], and *Burwell v. Hobby Lobby*[7]. We shall first dwell at some length on the ruling of the Court in *Citizens United*. We show (in Section 2) why its holding makes some sense in the relatively insignificant case of small companies, especially if the distribution of their shares is relatively egalitarian; we then proceed to demonstrate why the same conclusion cannot be extended, from a rational choice perspective, in the much more meaningful case of large public corporations, especially if they are controlled by a single person or a small number of persons acting in concert. It does not follow, however, that *Hobby Lobby* is equally suspect. We highlight the differences between these two cases in Section

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[4] This assertion is based on the premise that as long as a corporation is solvent the "veil" that separates it from its owners need not be "pierced" and hence there is no meaning to the separateness of corporate rights and obligations. Once the corporation becomes insolvent, however, the veil protects owners from the reach of the corporate creditors; hence the existence of a "veil" is a mode of allocating the risk of insolvency to the creditors, rather than to the owners of the firm. The efficiency reasons behind opting for such an allocation of risk, especially in the case of publicly held firms, is articulated, *inter alia*, in Frank Easterbrook and Daniel Fischel, *Limited Liability and the Corporation*, 52 U. Chi. L. Rev. 89 (1985).

[5] Discussions about the nature and scope of the so-called "artificial" legal person have a long and respectable pedigree. For a general survey of the older materials see Martin Wolff, *The Nature of Legal Persons*, 54 Law Q. Rev. 494 (1938).

[6] 558 U.S 310 (2010).

[7] 573 U.S. ---(2014)

3 and conclude that the ruling of the Court in*Hobby Lobby* can easily be defended regardless of the composition of its owners.

Section 2. *Citizens United*

Citizens United, a not-for-profit corporation, sought to challenge a federal statute[8] which put a cap on the amount that corporate entities could lawfully spend in support or in opposition to political candidates on an eve of primary elections. In that case the expenditure was sought to finance widely disseminated communications pejorative to the candidacy of Hillary Rodham Clinton when she ran in the Democratic primaries against Barack Obama[9]. The majority of justices on the Supreme Court sanctioned that challenge and held the federal statute unconstitutional, on the ground that it curtailed free speech in violation of the First Amendment. The main bone of contention in that case was whether the First Amendment was crafted to protect the political speech of natural persons only, or it was meant to be extended to all legal "persons", including corporate entities. The ruling of the Court stands for the proposition that the corporate person is privileged to possess First Amendment liberties just as if it were a natural person.

Citizens United happened to be a closely held corporation and all of its stockholders seem to have shared identical political convictions, in that case the sentiment that Ms. Clinton was not fit to play a leading role in American politics. But the precedent laid out in that case far transcends the case of monolithic companies like Citizens United; it extends to large corporations and unions of all kinds. In that broader sense, *Citizens United* raises at least two difficulties. The first difficulty, which is well-noted, is the risk that election results might be unduly influenced by large donors with an axe to grind. This paper does not deal with that problem. The second difficulty, which is at the crux of this paper, is focused on the implications of letting controlling stockholders use other people's money to fund political agendas which they favor, even though some of the other stockholders or union members do not adhere to their political preferences[10]. In other words, we explore the question whether non-

[8]The Bipartisan Campaign Reform Act of 2002, specifically §203.

[9] The political message was conveyed in a film called *Hillary, The Movie*, which sought to depict the candidate as unfit for office.

[10] It is not entirely clear, on the empirical level, how much campaign money, direct or indirect, is contributed, in the wake of *Citizens United*, by corporations as opposed to wealthy individuals. There

controlling stockholders may be forced to contribute to ideological causes which they abhor, although it is rather clear that such a practice might compromise their own First Amendment liberties[11].

It could perhaps be contended that granting constitutional rights to a politically divided entity is graced by some silver lining, because corporate entitiesare ultimately governed by the majority of its stockholders and hence it may be more reasonable to uphold their constitutional aspirations than to cater to those that reflect the convictions of the minority. This seems hardly the case. Voting rules are distinctly different in the corporate and in the political arenas. In corporate law resolutions are carried by a majority of the voting stock. The majority of the voting stock is often held by a minority or persons; in some cases a single person, or a small number of concert parties control the voting mechanism of the firm. Indeed, an overwhelming majority of companies around the world are controlled by small factions.[12] In the political arena,

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is some evidence that in some cases most of the support given to political aspirants was raised from corporations. See, for example, http://www.huffingtonpost.com/2012/10/18/republican-national-convention-corporations-super-pac_n_1976632.html (showing that the Republican National Convention in support of Mitt Romney's candidacy in 2012 was primarily funded by corporate money). On the other hand there is some evidence that large political actions committees ("Super PACS"), which openly finance most political campaigns, are funded mostly by individuals and only marginally by corporations; the latter prefer to quietly and secretively make contributions to private entities such as 501 (c) (4) non-profits or shell corporations, which are not legally required to disclose their contributors, for fear that publicity might mar their relationship with some of its constituencies. See https://www.publicintegrity.org/2012/10/30/11661/nonprofits-shell-corporations-help-shield-identity-ad-backers . This view is also shared by the political journalism organization *Politico*. See,for example, http://www.politico.com/story/2012/03/corporations-dont-pony-up-for-super-pacs-073804?o=0 . The Center for Responsive Politics has collected some interesting data about political contributions made,*inter alia*, by public corporations and unions until 2014. According to this source At.&T made contributions totaling some 64 million dollars, and Godman Sachs, Citigroup, JP Morgan Chase, Microsoft, General Electric, Lockheed Martin, Boeing, Pfizer, and Chevron, to quote just a few examples, contributed 55, 37,36, 34, 33, 32, 26, 22, and 19 million dollars respectively. See https://www.opensecrets.org/orgs/list.php

[11] *Knox v. SEUI, Local 1000*, 132 S Ct. 2277 (2012); See Catherine Fisk and Erwin Chemerinsky, *Political Speech and Association Rights After Knox v. SEUI, Local 1000*, 98 Cornell L. Q. 1023 (2013).(Arguing that the Supreme Court new jurisprudence is likely to tilt the political pendulum in favor of moneyed interests).

[12] This is almost universally true for unlisted companies both in the United States and abroad and for listed companies outside of the United States. See, for example, Fabrizio Barca and Marco Becht, *The Control of Corporate Europe* (Oxford University Press, 2003). As far as listed American companies are concerned, the empirical evidence is more nuanced. Whereas Barca and Becht reported that the ownership structure in most American firms is more diffused, their allegations are severely challenged by more recent studies. One such study found that an average of 24 to 32 percent of the stock in a sample of public American firms is owned by incumbent insiders (directors and officers): Clifford Holderness, *The Myth of Diffuse Ownership in the United States*, 22 Rev. Fin. Stud. 1377 (2009). Another Study revealed that 22.3% of the 2000 largest industrial American firms are controlled by

on the other hand, the rule of "one *share* one vote" is substituted by the egalitarian rule of "one *person* one vote". It follows that the concept of corporate constitutional rights, which may be aligned only with the views of an unknown and potentially minute faction of the stakeholders, may easily disenfranchise the many in the service of the few.

As we were hammering away at our respective keyboards, a new Supreme Court case popped up which makes this vital distinction clear. That case too recognized the independent right of a corporate entity, in this case the State of Texas, to possess constitutional rights of its own; but this was done with a twist: In *Walker v. Texas Division, Sons of Confederate Veterans Inc*[13]., a not-for-profit organization petitioned the Texas Department of Motor Vehicles to design a license plate of its choice, an option that was permissible in principle under that State's law. The plate designed by the petitioners featured the confederate battle flag. Texas declined to permit that design on the ground that it was offensive to large segments of the population and was unacceptable to its collective conscience. This response triggered a constitutional challenge on First Amendment grounds. The Supreme Court held in a 5-4 decision that license plates convey government messages and hence constituted a protected form of government speech. The Court recognized that government speech may run counter to the creed of some individuals. Nevertheless it sanctioned the government's right to its own speech on the simple ground that in a democracy, government speech reflects the political views of the majority of its voters. As noted above, in corporate law the rule of "one share one vote" does not even attempt to attain that goal.

In the rest of this Section we offer a formal analysis of *Citizens United*. As this formal analysis clarifies, the case cannot be justified on rational choice grounds in instances where it really counts.

We compare two possible legal regimes. The first regime recognizes the constitutional right of a corporation to use its treasury funds as a mode of protected speech, in spite of the fact that some minority stakeholders

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their founders, and another 25.3% are controlled by their heirs. See Ronald Anderson, Augustine Duru and David Reeb, *Founders, Heirs and Corporate Opacity in the United States*, 92 J. Fin. Econ. 205 (2009).

[13]No. 14-144, 576 U.S.----(2015).

object to its contents. This regime was endorsed by the Court in *Citizens United*. The second legal regime permits the controlling stockholders to exercise their right of free speech out of their own pockets, or to raise for that purpose earmarked funds contributed by stakeholders sharing their views; but does not sanction the use of the corporate treasury for that purpose. This second regime falls in line with the ruling of the Supreme Court in *Knox*[14], but not with its ruling in *Citizens United*. Since the ruling of the latter caseisassumed to be universal in its application, i.e. itis assumed to govern every single corporation, no one can be sure, in an ex-ante stage, whether she might be a member of the controlling group, a minority stockholder who shares the controlling stockholder's view, or a member of the disenfranchised constituency. The stockholders' presumed ignorance of the political stance which will be adopted by the firms in their portfolio is easy to justify especially if we recall that most public stockholders invest through financial intermediaries, such as pension funds, and hence have very little say as to where their invested money is destined to be routed. This "veil of ignorance" presents to the uninformed general population a kind of a lottery. In the ex-post stage every agent, regardless of her political persuasion, bears an aliquot part of the total cost, denoted c, if treasury funds are used in support of the expenditures. In addition, if an agent supports the expenditures and it is in fact made, she derives a "political payoff" of $u > 0$, and if she opposes the expenditure her payoff is $-u$. u and $-u$ are assumed to be identical. Indifferent stockholders have zero political payoffs, but still bear their share of the total expenditure.

We start our analysis by probing a simple case where the company has only three stockholders, holding the factions of shares x_1, x_2 and x_3 with $x_i > 0$ and $\Sigma\ x_i = 1$. We discuss separately the case where the factions of shares are equal in size (a "uniform" distribution) and then we proceed to analyze cases where the distribution is non-uniform.

Case 1: the allocation of shares is uniform.

Claim 1: Allowing the corporation to use treasury funds in furtherance of some ideological position is justified from a rational choice perspective if and only if $3/2\ u \geq c$.

[14]See note 11, supra.

Proof: behind the veil of ignorance, each agent has a probability of 3/4 to belong to the faction holding a majority of shares. To understand why this might be the case, recall that with three voters and two alternatives, i.e. to either support a measure (S) or oppose it (O) the votes can be distributed in eight different ways, as indicated in the following table. The preferences of each voter are indicated in the vertical columns. As the table shows, each voter finds herself on the winning side in six out of the eight distributions, i.e. with a probability of 75%. For example, voter number 1 loses out only in the fourth and in the eighth rows.

Voter number 1	Voter number 2	Voter number 3
S	S	S
S	S	O
S	O	S
S	O	O
O	O	O
O	O	S
O	S	O
O	S	S

On the average, then, each stockholder gains 3/4 u and loses 1/4 u, and in addition bears a cost of 1/3 c. This "bargain" is worth her while if and only if-

$$3(3/4\ u - 1/4\ u) - c \geq 0;$$

It follows that each agent's ex- ante payoff is justified from a rational choice perspective if, but only if $3/2\ u \geq c$.■

It is not impossible to surmise that u might be substantial enough and c might be sufficiently modest such that the condition discussed in claim 1 is satisfied, i.e. that in this simple case *Citizens United* might be justified. We proceed now to explore how this result is modified if we discard our assumption of a uniform distribution of shares.

Case 2: The allocation of shares is not uniform. We assume that $x_1 \geq x_2 \geq x_3$, and each agent has an equal chance to belong to any of these factions.

Claim 2: if $x_1 > 1/2$, then using treasury funds to finance ideologically driven causes is justified, from a rational choice perspective, if and only if

$u \geq c$; if $x_1 \leq 1/2$ then, like in claim 1, the measure is justified if and only if $3/2u \geq c$.

Proof. If $x_1 > 1/2$, then the ex-ante probability facing each of the three stockholders that the corporation should use its general treasury in support of her preferences is 2/3. To see this, recall that each shareholder has a 1/3 probability to be the dominant holder of shares, in which case the company will adopt the view that she supports with a probability of 1. In addition, there is a 2/3 probability that she will end up as a minority shareholder, in which case there is a probability of 1/2 that she will agree with the expenditure. Hence the overall probability to be on the winners' side turns out to be 1/3 + (1/2) times (2/3) = 2/3. It follows that her expected payoff for that stockholder is-

$$3(2u/3 - u/3) - c.$$

It follows that a rational maximizer should support *Citizens United* behind the veil of ignorance if but only if $u \geq c$.■

Obviously, if none of the three stockholders has the majority of votes, each coalition of at least two stockholders can carry the relevant resolution, and hence the analysis of case 1 applies.

Thus far we saw that using the treasury to justify a common expenditure in the presence of a battle of ideologies is harder to justify when the distribution of shares is unequal and there is one dominant stockholder who is free, under the voting rules of corporate law, to force her will on the dissenters. As previously observed, the presence of controlling stockholders is quite common as an empirical matter. It follows that claim 2, even in its simplified form, is rather disquieting.

We turn now to discuss a more general case where there are n stockholders and one of them holds the majority of shares. From a political point of view, this case is the most meaningful, because political expenditures made by small firms do not swing election results. Large firms are a different matter. As noted above, there seems to be no clear and uncontroversial evidence thus far that corporate money, as distinguished from political mega-contributions made by the super- rich has either done or undone political campaigns, but *Citizens United* certainly opens the door for such an impact.

Claim 3: Surprisingly, we find that in the case of n stockholders and regardless of the number n or the volume of the expenditure c, which might grow to meaningful proportions, the previous result still holds, namely the common expenditure may be justified if and only if u ≥ c. Algebraically, claims 2 and 3 look identical. Politically they are not, because of the vast differences in magnitude of potential corporate giving.

Proof. Each stockholder's probability of being dominant is 1/n. In the remaining complimentary event (with the remaining probability (n-1)/n), the probability of ending up on either side of the ideological divide is 1/2. This implies that the ex-ante probability of finding oneself on the winning side is-

$$\frac{1}{n}+\frac{1}{2}\frac{n-1}{n}=\frac{n+1}{2n}$$

The probability of being on the losing side is therefore

$$1-\frac{n+1}{2n}=\frac{2n-(n+1)}{2n}=\frac{n-1}{2n}$$

It follows that each stockholder's expected payoff is –

$$u\frac{n+1}{2n}-u\frac{n-1}{2n}-\frac{c}{n}=u\left(\frac{n+1}{n}-\frac{n-1}{n}\right)-\frac{c}{n}=\frac{u}{n}-\frac{c}{n}$$

This expected payoff is positive if but only if u ≥ c.■

Since u is the individual utility of a single stockholder and c is the total expenditure of potentially very large corporations, the last inequality is very likely to be violated; this implies that *Citizens United* has to be normatively rejected, at least where it really counts, i.e. in the case of large corporations with dominant or controlling stockholders.

The intuition behind claim 3 is rather straightforward. If the voting power is concentrated in the hand of a single stockholder then conditional on not being that person, each stockholder has an equal probability of being on the winning side or on the losing side. Hence her expected ideological payoff is zero. The controlling stockholder herself is always on the winning side and hence her ideological payoff is u. The aggregate ideological payoff for the entire population of stockholders is thus u and the total cost of implementing the policy is c. Hence the total expected payoff is positive if and only if $u \geq c$.

The next and final claim is designed to augment the intuition that the problem with *Citizens United* is associated with the phenomenon of an unequal distribution of shares.

Claim 4: If using treasury funds to finance ideologically driven causes is justified under any allocation of shares (for any given values of u and c), then it is also justified under a uniform allocation of shares.

Proof: Any allocation of shares $x_1,x_2,...,x_n$ induces a weighted majority voting rule where a coalition S of voters carries the resolution if and only if $\Sigma_{i\in S}x_i>1/2$. Obviously, each voter's utility is increased if and only if the resolution is aligned with her preferences. We claim that the expected number of satisfied voters is maximized under a uniform allocation of shares. To see this consider the set of all profiles of votes (note that in the sample space that comprises the veil of ignorance- there are 2^n such profiles). A voting rule is a function that maps any such profile to an ideological decision (i.e., in our context, to use treasury funds to finance a political expenditure or not). Clearly, the voting rule that maximizes the (ex-ante) expected number of satisfied voters is the one that assigns to each profile the decision preferred by most of the voters. The voting rule induced by a uniform allocation of shares (i.e., the simple majority rule) does precisely that.■

Section 2. *Hobby Lobby*

In*Burwell v. Hobby Lobby,*Hobby Lobby, a closely held corporation, was a large employer. As such, it was ordained by statute to provide its female employees a bundle of medical benefits which included some contraceptives. A number of the authorized contraceptives could be used at the post-fertilization stage of the female egg (a "morning after" drug). The owners of Hobby Lobby, who were devout Christians, claimed that their religious convictions made them adhere to the view that life begins at the moment of fertilization, and hence forcing them to participate in financing post-fertilization contraceptives could not be squared with their religiousprinciples. The question of protecting the rights of the women beneficiaries of the relevant legislation hardly arose, because it was assumed that if their employers were exempt from providing them with the free contraceptives of their choice they could obtain them from third parties (medical insurance companies) at no additional cost. With the issue of the beneficiaries' rights out of the way, the question boiled down, once again, to whether statutory and constitutional liberties, this instance those relating to religious faith, extends to corporate entities. In this case the Supreme Court was also willing to accept the controlling stockholders' view and hence it sanctioned Hobby Lobby's plea to be exempted from providing the religiously offensive contraceptives to its female employees.

In this case the Court stressed that its ruling applied to close corporations like Hobby Lobby, rather than to publicly owned firms with dispersed ownership. On the other hand it did not rule out the possibility of extending similar principles to larger firms[15]. In the following lines we address the question whether such an extension could be supported from a rational choice perspective. We think that it could not.

We stick to our assumption that in large publicly held firms the stockholders' constituency is equally divided between those who support and those who oppose the ideological expenditure. If the *Hobby Lobby* Court were to rule, counter-factually, that the expenditure could be forced down the throat of the reluctant controlling stockholders, the result would have been even worse than the ruling in *Citizens United*. Applying the results of claim 3 with a slight modification, we observe that the expenditure could be rationalized only if $-u \geq c$, which is obviously a condition that is mathematically impossible. The modification is required since the non-controlling stockholders' utilities cancel out each other, as in claim 3, and we are left with the negative utility, $-u$, which reflects the controlling stockholder's reluctance to authorize the expenditure.

Conclusion

In *Citizens United* the Court ruled that a corporation was entitled to incur some costs as a means of promoting an ideological agenda. In *Hobby Lobby* the Court ruled that a corporation was entitled *not* to spend money

[15] The government argued that for-profit corporations cannot, as a conceptual matter, entertain religious beliefs because the constituencies of public for-profit corporations do not share identical religious convictions. The Court responded that Hobby Lobby was a closely held firm, and, as Justice Alito, speaking for the Court phrased it, "we have no occasion in these cases to consider… [the] applicability [of this matter] to such companies."

as a means of defending another ideological agenda. In spite of the seemingly opposite results (to spend or not to spend), it seems that both cases share the same sentiment, the Court's avowed commitment to shield the constitutionally recognized preferences of the controlling stockholders. The corporate rhetoric, which purported to dress the issue as if corporate, rather than individual rights were at stake, was a mere smokescreen;the "corporate ideology" was used as a rather transparent proxy to reflect the ideology of its stewards. Since it is the constitutional rights of *persons*, not of *corporations* that are truly at stake, the composition of the corporate stockholders emerges as the crucial parameter for a rational decision. If, like in both cases, a company is owned by stockholders who share an identical approach as to the use of the corporate treasury in furtherance of some ideological agenda, it seems appropriate to cater to the owners' preferences from a rational choice perspective. But if the ownership structure of a given corporation is diverse, as is the case in most publicly owned firms, all contributions to ideological agendas ought to be financed "privately" and only by those who support those agendas.In cases of large publicly owned firms with diverse constituencies *Citizens United* makes bad law. *Hobby Lobby* is amply justifiable. The corporate entity *as such* has no constitutional "bill of rights".