INDIVIDUAL AUTONOMY IN CORPORATE LAW

ELISABETH DE FONTENAY*

The field of corporate law is riven with competing visions of the corporation. This Article seeks to identify points of broad agreement by negative implication. It examines two developments in corporate law that have drawn widespread criticism from corporate law scholars: the Supreme Court's recognition of corporate religious rights in Burwell v. Hobby Lobby and the Nevada legislature's decision to eliminate mandatory fiduciary duties for corporate directors and officers. Despite their fundamental differences, both resulted in expanding individual rights or autonomy within the corporation—for shareholders and managers, respectively.

The visceral critiques aimed at these two developments suggest a broadly shared view that the corporation is a device that should be optimized for collective action of a particular type—namely large-scale economic activity. As such, once one has opted into the corporate form, little room remains for the exercise of individual rights and autonomy ex post. Corporate law permits shareholders and managers to act only in limited and highly formalized ways. In this view, the strong assertion of shareholder and managerial autonomy in Hobby Lobby and Nevada's corporate law is problematic for three reasons. First, it conflicts with longstanding principles underlying the corporate form. Second, it is arguably inefficient, even where it comports with the parties' private ordering. Third, despite its liberalizing aims, it is likely to foster even greater regulatory complexity or involvement in the long run.

While there are no easy answers to how one should weigh individual rights against economic efficiency, advancing personal autonomy by altering the corporate form may ultimately provide little autonomy bang for one's buck. From both a rights and an efficiency perspective, there are better means to champion the individual over the group.

TABLE OF CONTENTS

INTRODUCTION 184

I. DEFINING THE CORPORATE FORM 187
   A. *Lingering Questions in Corporate Law* 187
   B. *Forms in Business Organizational Law; The Corporate Form* 188

II. EFFICIENCY CONSIDERATIONS IN THE USE OF FORMS 192
   A. *To Form or Not To Form* 192
   B. *Individual Versus Group Action in Corporate Law* 195

III. CORPORATE RELIGIOUS RIGHTS 199
   A. *Corporate Rights or Individual Rights?* 199
   B. *The Clash with Corporate Law* 201
   C. *Separate Law for For-Profit Corporations?* 207

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* Associate Professor, Duke University School of Law; defontenay@law.duke.edu. For comments or discussions, thanks are due to Stuart Benjamin, Jim Cox, Deborah DeMott, Jennifer Hill, Darrell Miller, Elizabeth Pollman, Andrew Verstein, and participants in the 2017 Junior Business Law Colloquium at the University of Colorado Law School. Samantha Abrams-Widdicombe, Ashley Shan, and Ashley Waid provided outstanding research assistance. All errors are mine.

D. *The Effects of Recognizing Corporate Religious Rights* .. 212
IV. The Elimination of Corporate Managements' Fiduciary Duties 213
A. *The Case for Fiduciary Duties* 213
B. *Curbing or Eliminating Fiduciary Duties* 217
C. *The Effects of Eliminating Fiduciary Duties* 218
Conclusion 223
Appendix 225

Introduction

What is a corporation? The question is surprisingly difficult to answer. In the United States, the technical, albeit tautological, answer is that it is an entity recognized by state law as a "corporation." So long as one follows to the letter the steps for incorporation prescribed by a state's corporate statute—such as filing a charter with the secretary of state and designating a registered agent for service of process—the end product is a corporation. A more satisfactory answer might point to the corporation's particular governance structure. Generalizing across state corporate statutes, a corporation might be described as a legal entity that is managed by a board of directors, which in turn is elected by "stockholders"—individuals or entities having a residual claim on the entity's profits. This definition is also problematic, however, in that corporate statutes also routinely allow for corporations that do not issue stock, while some allow for shareholder-managed corporations. A third approach would be to consider the uses to which corporations tend to be put. The *permitted* uses of corporations are virtually unrestricted under state law today. The *typical* uses of corporations are bifurcated: corporations that issue stock tend to conduct business for profit, sometimes on a very large scale, while nonstock corporations tend to engage in charitable, educational, religious, or other non-profit activities. Yet the lines of demarcation are far from clear.

A final approach would refer to the various theories for why one might conduct business through a corporate entity, rather than directly in the market. Transaction costs,[1] asset specificity,[2] asset partitioning,[3] and incomplete contracting,[4] among others, have all been offered as justifications for the corporation. Yet these "theories of the firm" fail to distinguish corporations from other business entities: they explain not only corporations, but also

[1] *See* Ronald H. Coase, *The Nature of the Firm*, 4 Economica 386, 390–93 (1937).

[2] *See* Oliver E. Williamson, Markets and Hierarchies: Analysis and Antitrust Implications 20–40 (1975).

[3] *See* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 Yale L.J. 387, 393 (2000); Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 Harv. L. Rev. 1333, 1336 (2006).

[4] *See* Oliver E. Williamson, *Transaction Cost Economics*, *in* 1 Handbook of Industrial Organization 135 (Richard Schmalensee & Robert Willig eds., 1989).

unincorporated business entities such as partnerships and limited liability companies.

The ontological task of defining the corporation is particularly challenging today, when the state has largely ceded to private parties the task of establishing rights and duties among the corporation and its various stakeholders. Under this "contractarian" approach, the primary function of corporate statutes and the common law of corporations is not regulation, but rather helping parties set their own terms for the corporate endeavor.[5] As a result, today's corporation is a protean vehicle, able to accommodate a wide range of activities and on a wide scale.

Given its many competing visions, it is perhaps easier to clarify what the corporation *is* by finding agreement over what the corporation is *not*.[6] This Article seeks to do precisely that. It explores two relatively recent developments in corporate law that have mostly been greeted with criticism by corporate law scholars. The first is the Supreme Court's recognition of corporate religious rights in *Burwell v. Hobby Lobby Stores, Inc*.[7] The second is the Nevada legislature's decision to eliminate management's mandatory fiduciary duties to the corporation. To be sure, both developments are perhaps best viewed as anomalous within corporate law and likely narrow in application. Yet just as the "anti-canon" in U.S. constitutional law reveals broad zones of agreement in an otherwise contentious field,[8] so do these much-criticized developments in corporate law help identify shared understandings of the corporate form today.

By most counts, these two developments are entirely unrelated: they differ as to the decision-maker (the judiciary versus the legislature), the source of authority (federal versus state law), the subject matter, and the area of law. Accordingly, they have thus far been criticized on entirely different grounds. Nonetheless, there is a common thread between them. Both can be interpreted at least in part as efforts to expand individual rights or autonomy

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[5] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305, 311 (1976) (defining the firm as a "nexus for contracting relationships").

[6] For the more difficult exercise of building a consensus view of the corporation and corporate law from the bottom up, see William W. Bratton, *Framing a Purpose for Corporate Law*, 39 J. Corp. L. 713, 723 (identifying the purpose of corporate law as "facilitat[ing] corporate attempts to maximize productive output . . ., encouraging long-term investment at the lowest cost of capital, subject to exterior regulations that control externalities").

[7] 134 S. Ct. 2751 (2014). As of the writing of this Article, the Supreme Court's decision is anticipated in a related case, Craig v. Masterpiece Cakeshop, Inc., 370 P.3d 272 (Colo. App. 2015) (determining whether corporations have a constitutional right to the free exercise of religion, in the context of a bakery's objection to a Colorado antidiscrimination law requiring it to bake a cake for a same-sex wedding), *cert. granted sub nom.* Masterpiece Cakeshop, Ltd. v. Colo. Civil Rights Comm'n, 137 S. Ct. 2290 (2017). *Hobby Lobby* was decided under a 1993 federal statute prohibiting government from burdening a person's exercise of religion, while *Masterpiece* addresses a constitutional claim under the First Amendment's Free Exercise Clause.

[8] *See generally* Richard A. Primus, *Canon, Anti-Canon, and Judicial Dissent*, 48 Duke L. J. 243 (1998).

of a particular corporate constituency—shareholders in the case of *Hobby Lobby*, and management in the case of Nevada corporate law. Both reflect the political or philosophical stance that, even within a vehicle designed to constrain individual behavior ex ante, a particular space should be preserved for individual rights and autonomy ex post.

Yet the strong criticisms of *Hobby Lobby* and Nevada's corporate law suggest a majority or plurality view among corporate law scholars that individual rights and autonomy should not be expanded indefinitely within the corporation, *even when the relevant parties contract to that effect* or simply fail to specify otherwise. In particular, these criticisms seem to reveal implicit agreement on several points: that the corporation is first and foremost a device optimized for collective action of a particular type, namely large-scale economic activity; that the corporation is a relatively poor vehicle for exercising individual rights of expression or individual autonomy; and, finally, that corporate law should restrict individual rights and autonomy ex post, when the latter threatens the ex ante efficiency of collective action. This is so for several reasons. First, expanding individual autonomy may conflict with other longstanding principles and goals underlying the corporate form. Second, doing so may well be inefficient, regardless of whether the parties may be deemed to have bargained for that outcome. The cost-benefit balancing for both the *Hobby Lobby* decision and Nevada's corporate law is either speculative or likely unfavorable. Third, though clearly liberalizing in aim, both developments are likely to have the opposite effect in practice, whether by increasing regulatory complexity or by requiring greater regulatory involvement over time.

This Article does not offer a historical review of theories of the corporation. Nor is it intended as a critique of the contractarian approach to corporate law. Rather, it looks to corporate law scholarship today to ask whether we have reached the point where further deference to private ordering and further alterations to the corporate form for the sake of individual autonomy would be at odds with economic efficiency. The failure in *Hobby Lobby* and Nevada's fiduciary duty debate to address efficiency considerations head-on is surprising in an area of law where they typically loom large today. More surprising still, these two changes to corporate law appear likely to result in a regulatory morass that ultimately increases individual autonomy relatively little.

As a general matter, of course, the charge that expanding individual rights can be economically inefficient may be very much beside the point. The claim here is simply that altering corporate law is a comparatively poor mechanism for the expression of individual rights. Thus, to the extent that efficiency considerations should figure in legislative and judicial decisions to expand individual autonomy—a question that is not answered here—we might concede in the case of corporate religious rights and the elimination of corporate fiduciary duties that any individual autonomy gained is small relative to the likely economic cost.

Finally, the Article defends the use of distinct entity types or forms in business organizational law and even within corporate law. There is nothing inherently unjust or inefficient about limiting any given business entity to certain purposes or certain users. For example, restricting the rights and goals of profit-seeking corporations to those relating to economic activity is not necessarily arbitrary, antiquated, or government overreach. Corporate law cannot be, and should not seek to be, everything to everyone.

The Article proceeds as follows. Part I describes the use of forms in business organizational law, focusing particularly on the corporate form. Part II discusses the efficiency considerations underlying the use of forms and assesses how corporate law manages the tensions between individual incentives and group decision-making. Parts III and IV apply these lessons to two recent examples in which corporate law has been altered to expand individual rights or autonomy: (1) the recognition of a for-profit corporation's right to exercise religion and (2) the elimination of management fiduciary duties in corporate law.

I. Defining the Corporate Form

A. Lingering Questions in Corporate Law

In a 2001 essay, Henry Hansmann and Reinier Kraakman famously declared "the end of history" for corporate law, pointing to convergence worldwide on the view that corporations should be managed to maximize long-term shareholder value.[9] While dominant in the United States, this view of corporate governance is not unanimously held. Proponents of "stakeholder theory" argue that corporations should be managed to maximize the aggregate value allocable to all corporate stakeholders—including creditors, employees, customers, suppliers, local communities, and even society as a whole.[10] The recent introduction in most U.S. states of a new type of business entity, the "benefit corporation"—which requires management to take into account the interests of all stakeholders, rather than just shareholders—suggests that popular opinion does not necessarily share the business and legal establishment's support for shareholder-value maximization.[11]

Even if one accepts shareholder value maximization as the primary aim of corporate governance, however, the work of corporate law is not finished. In particular, it does not clearly dictate the extent to which corporate law should defer to the private arrangements of corporate stakeholders. While

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[9] Henry Hansmann & Reinier H. Kraakman, *The End of History for Corporate Law*, 89 Geo. L.J. 439, 439 (2001).

[10] *See generally* Edward R. Freeman. Strategic Management: A Stakeholder Approach (1984).

[11] *See* J. Haskell Murray, *Corporate Forms of Social Enterprise: Comparing the State Statutes* (January 15, 2015), available at https://ssrn.com/abstract=1988556 (finding that thirty U.S. states have enacted statutes recognizing some form of public benefit corporation).

the shareholder value approach tends to be associated with contractarian views of the corporation, the former does not require total deference to private bargaining.[12] In particular, if there is reason to believe that private ordering might exacerbate management agency costs, opportunism, and other inefficiencies that detract from shareholder value maximization, then there is room for a more regulatory approach to corporate law.

This Article considers two areas in which the lingering uncertainties associated with contractarianism lead to pressing problems for corporate law and examines how corporate law scholars have responded. First, it considers the question of what rights society should grant to the corporation itself. In deciding whether or not to grant corporations a particular right that has already been granted to individuals, the courts have resorted to different theories of the corporation, on a seemingly ad hoc basis.[13] In *Burwell v. Hobby Lobby Stores, Inc.*, the Supreme Court held that a closely held corporation could exercise religion and on the basis thereof avoid being subject to laws of general applicability.[14] If shareholders wish for a corporation to exercise religion by looking through to the religious views of individual shareholders, should the courts honor this bargain and allow it to alter the corporation's rights and duties to third parties under the law?

Second, the Article considers modifications to the traditional corporate governance arrangement between shareholders and management. Nevada's corporate law eliminates mandatory fiduciary duties of directors and officers to the corporation and requires shareholders to contract affirmatively for such fiduciary duties should they want them. If shareholders waive or simply fail to contract for management fiduciary duties, should the law defer to this arrangement or instead impose such duties by fiat?

As I will argue, both *Hobby Lobby* and the change to Nevada's corporate statute represent alterations to the traditional corporate form. In order to see this, it is first helpful to examine the use of forms in business organizational law generally and to identify what makes the corporate form distinctive. We turn to this task in the next section.

B. Forms in Business Organizational Law; The Corporate Form

Over time, the law of business organizations in the United States has evolved from a prohibitive regime to a largely facilitative one. State law provides a menu of different entity types that entrepreneurs can select to

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[12] Nor does the principle of shareholder wealth maximization specify what should be treated as a bargained-for outcome in the first place.

[13] *See* Darrell A.H. Miller, *Guns, Inc.: Citizens United, McDonald, and the Future of Corporate Constitutional Rights*, 86 N.Y.U. L. Rev. 887, 908 (2011) (describing the corporate rights jurisprudence as shifting between three theories of the corporation—as real entity, as legal entity, and as association). *See also* Brandon L. Garrett, *The Constitutional Standing of Corporations*, 163 U. Pa. L. Rev. 95 (2014) (arguing that in corporate rights cases involving constitutional law, the question is one of standing, rather than corporate personhood).

[14] 134 S. Ct. 2751, 2767–69 (2014).

conduct their business.[15] These statutory forms—each typically governed by its own statute—include the corporation, unincorporated entities such as limited liability companies, general partnerships, limited partnerships, and limited liability partnerships, as well as a hodge-podge of other entities such as business trusts. Each form can be understood as a set of terms governing the relationship among investors, managers, and the business entity itself. Furthermore, many or most of the terms within each form are *default* terms, meaning that they may be modified by the relevant parties if they so choose.[16] The terms supplied by the statute will apply only if the parties do not modify them.[17]

In setting the default terms, the implicit statutory objective is to divine the terms that users of the form would be most likely to select if they were to spend the time and money required to negotiate them.[18] The hope is thus that the default terms will represent the optimal set of terms (the "efficient" terms) for a large portion of the market. As we will see, by anticipating the needs of investors and managers in this way, organizational law facilitates business enterprise and encourages investment by dramatically reducing the transaction costs (including negotiation costs and information costs) of forming, operating, and governing business entities, while at the same time affording the parties considerable freedom to set their own terms.[19]

This default-based approach is rightly touted as a defining feature of contemporary organizational law.[20] Yet it obscures the fact that each form also imposes, and is characterized by, a smaller set of mandatory terms—those that cannot be modified by the parties under any circumstances[21]—and of "sticky" default terms—those that are highly unlikely to be modified, given procedural or other practical hurdles.[22] In corporate law, for example, directors' and officers' fiduciary duty of loyalty to the corporation is a mandatory term in most states, while the board of directors' exclusive au-

[15] *See* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1417 (1989) (describing the choices offered to management in forming a new business entity).

[16] *See* Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (And Europe) Face*, 30 DEL. J. CORP. L. 673, 674–75 (2005) (noting that Delaware corporate law includes very few mandatory terms and that some mandatory terms may even be overridden under certain circumstances).

[17] *Id.*

[18] *See* Easterbrook & Fischel, *supra* note 15, at 1444–45.

[19] *See infra* Part II.A.

[20] *See* Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1391, 1416 (1992).

[21] *See* John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1618 (describing U.S. corporate law as "partly enabling, partly mandatory").

[22] *See* Yair Listokin, *What Do Corporate Default Rules and Menus Do? An Empirical Analysis*, 6 J. EMPIRICAL LEGAL STUD. 279 (2009) (finding that certain default rules in corporate law are highly unlikely to be modified by the parties, particularly those that favor management over investors).

thority to manage the corporation's affairs is considered a sticky default.[23] Because they may not be, or are highly unlikely to be, modified, these mandatory and sticky-default terms in fact represent the core, defining feature of each business entity form. *Table 1* in the Appendix provides a non-exhaustive sample of mandatory and sticky-default terms applicable to the corporation under Delaware law.

In addition to state business-association statutes, contemporary organizational law in the United States is substantially determined by the common law.[24] Particularly in states such as Delaware, where the majority of large U.S. firms are chartered, judges create much of the law of business organizations. This is particularly true for terms such as the fiduciary duties of directors and officers and for specific applications, such as control transactions and takeover contests.[25] The legal doctrines established by the courts and applicable fiduciary law can thus be understood as an additional set of mandatory terms applicable to business associations.

Taken together, therefore, the state business-organization statutes and the common law define and characterize the organizational forms available for conducting business in the United States. Thus, the considerable flexibility of business organization in the U.S. is not unlimited. It is grounded in several distinct forms, each having a core of fixed or relatively rigid terms and rules, as well as a comprehensive set of default terms, that collectively facilitate and shape the fundamental relationships of business entities.

Relative to other entity types, the corporate form is characterized by five fundamental features that are the product of its mandatory or default terms: (1) limited liability for investors, (2) continuity of existence, (3) free transferability of equity interests, (4) centralized management, and (5) the election of management by equity investors.[26] Other entities share some—but not all—of these characteristics. In most cases the terms of the limited liability company may be modified in such a way as to replicate each of these characteristics.[27] However, there are transaction costs in using a limited liability company to replicate the archetypal corporation, because one must draft around the default terms, and investors must take the time and make

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[23] *See* Brett H. McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. Rev. 383, 414–15, 427–28 (2007).

[24] *See* Leo E. Strine Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft*, 60 Bus. Law. 877, 878–79 (2005) (discussing the important role of the common law in Delaware corporate law and providing examples of important corporate law questions that have been answered by the common law).

[25] *See id.* at 878–79, 884–86 (discussing the role of the common law in defining management fiduciary duties).

[26] *See* Robert Charles Clark, Corporate Law 4-24 (1986).

[27] *See* Saul Levmore, *Uncorporations and the Delaware Strategy*, 2005 U. Ill. L. Rev. 195, 199 (2005) (claiming that "[a]nything a corporation can do, a partnership can do better.").

the effort to become comfortable with the drafting.[28] In addition, the common law of corporations and the common law of limited liability companies continue to differ, and there is no guarantee that a court would treat the parties' arrangement as equivalent to a corporation.[29] Thus, only the corporation presents each of the five above-listed features as either mandatory or default options. Of these, the governance mechanism of the corporation—the use of a board of directors elected by the shareholders to manage the corporation—is the most unique feature of the corporation. It is the sticky default term that truly defines the corporate form.[30]

To complicate matters, as will be discussed in Part IV, in a very real sense the set of forms available for conducting business is not limited to the discrete legal entity types defined by state statutes. The "corporation," for instance, may be viewed as a compendium of different forms of organization, rather than as a single form. While these different forms comprise many overlapping terms and judicial doctrine, each has a core of distinct terms, supplied both by statute and by the common law. The clearest examples are (1) the for-profit corporation and (2) the nonprofit, nonstock corporation, both of which are typically governed by the same state corporate statute.[31] (Nonprofit entities are often also governed by a separate state statute.)[32] The remainder of this Article focuses on the for-profit corporation.

The explanation for this multiplicity of forms within a single organizational statute has to do, once again, with the facilitative approach taken by modern business organizational law. That approach remains highly agnostic as to the uses to which its forms are put and, in many cases, to the key features of governance selected by the relevant parties. Once a particular use is selected and evidenced by the organization's activities, or a particular governance structure is elected, however, the elected form may impose additional restrictions and structure.[33]

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[28] *See* Peter Molk, *How Do LLC Owners Contract Around Default Statutory Protections?*, 42 J. CORP. L. 503, 505 (2017) (discussing the flexibility provided through the LLC form and noting that "[b]ecause traditional corporate protections impose costs on the firm and its owners, waiving them can be desirable when parties adequately protect themselves through other, more efficient means").

[29] *See* Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1621–23 (2004) (noting that it is unsettled whether disputes that arise in the LLC context should be answered with reference to corporate law, agency law, or contract law, or in some other fashion).

[30] *See* Brett H. McDonnell, *Professor Bainbridge and the Arrowian Moment: A Review of the New Corporate Governance in Theory and Practice*, 34 DEL. J. CORP. L. 139, 149 (2009).

[31] *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 101–115 (2018).

[32] *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW §§ 101–1515 (McKinney 2017).

[33] *See infra* Part IV.

II. Efficiency Considerations in the Use of Forms

A. *To Form or Not To Form*

The considerable flexibility afforded by each business organizational form raises the question of why forms are needed at all. Why go to the trouble of defining particular entity types such as the corporation, the limited liability company, and so forth, when so many of their terms are defaults that may be modified by the parties? Conversely, if forms are indeed useful legal innovations, why not multiply them ad infinitum, creating a different form for each arrangement that any party or set of parties could conceivably adopt, rather than steering parties to a limited set of forms? Finally, under what circumstances should the terms of a particular form be changed by law, as opposed to simply creating a new form? This subpart briefly addresses each of these questions, from the sole standpoint of efficiency considerations. (As we shall see, however, cost-benefit analysis is by no means the sole or even the primary explanation for where current law rests).

The most significant development in the history of organizational law in the United States was acceptance of the "legal fiction" that gave entities independent legal significance from their members.[34] Dating back several centuries, the general partnership was the earliest recognized form of business association.[35] The general partnership was initially viewed as the simple aggregate of its partners, without independent legal significance, but over time was increasingly treated as a legal object distinct from its partners, with the right to own assets, to enter into contracts, and to sue and be sued.[36] The path of organizational law has since followed a pattern of increasing the number of legal entities available for conducting business. For centuries, the progress was halting, with the only available options being the general partnership, the trust, the corporation (which appeared in its modern incarnation in the 18th century), and the limited partnership (from the mid-19th century).[37] In the last four decades alone, however, there has been a burst of new entity creation, including the limited liability company, the limited liability

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[34] *See* Martin Petrin, *Reconceptualizing the Theory of the Firm—From Nature to Function*, 118 Penn St. L. Rev. 1, 20 (2013) (noting that "separate legal personality and limited liability are universally considered bedrock corporate law principles"); Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 Yale L.J. 387, 390 (2000) (describing how the doctrinal fiction of the business association as a separate legal entity serves to facilitate capital lock-in).

[35] *See* Larry E. Ribstein, *Close Corporation Remedies and the Evolution of the Closely Held Firm*, 33 W. New Eng. L. Rev. 531, 534 (2011).

[36] The most recent revision to the Uniform Partnership Act, promulgated by the National Conference of Commissioners for Uniform State Laws in 1997, finally abandons the remaining partnership law provisions relying on the conception of a partnership as an aggregate of its partners rather than as an entity.

[37] *See* Hansmann & Kraakman, *supra* note 34, at 390; Henry Hansmann, Reinier Kraakman & Richard Squire, *The New Business Entities in Evolutionary Perspective*, 2005 U. Ill. L. Rev. 5, 6–7 (2005).

partnership, the limited liability limited partnership, and the benefit corporation, among many others.[38]

Given this evolution, there is a case to be made that the use of definite forms for conducting business is a simple matter of historical path-dependence, rather than the product of a deliberate cost-benefit analysis. If that is the case, why specify different entity types at all today, rather than allowing private parties to create any entity of their choosing? The use of predetermined forms is thought to be welfare-increasing because it can dramatically lower the transaction costs associated with both forming a business entity and regulating it.[39] If contracting among entrepreneurs, investors, and managers were costless, and all parties had perfect information, there would be no advantage to selecting an existing entity form for their joint business arrangement (although there might still be an advantage to using forms from regulators' perspective).[40] In the real world, however, negotiating the terms of a joint business endeavor is a highly complex task, involving substantial uncertainty about future developments and imperfect information about the various parties' incentives and behavior.[41] Given that, there should be substantial transaction costs associated with negotiating a business arrangement entirely from scratch.

Contemporary organizational law thus offers a set of templates from which to choose, with the goal of capturing or even anticipating in separate forms the various popular modes of organizing businesses. For example, the partnership form provides investors with the opportunity for equal management rights whereas the corporate form offers passive investment opportunities. On this view, the default terms of each form should be those most likely to be adopted by the parties, if they were to actually go through the costly exercise of negotiating all of the terms.[42] Equivalently, the default terms are intended to be the set of "efficient" terms—that is, the terms that maximize the parties' aggregate social surplus—for the majority of the likely users of the form.[43] By simply forming a corporation, for example, the parties avoid having to consider and negotiate every aspect of the investors' economic rights and the governance and management of the business in advance. They simply defer largely to the wisdom presumably embedded in the terms of the

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[38] *See* Hansmann, Kraakman & Squire, *supra* note 37, at 6 (listing examples of the new business forms that have emerged in the last four decades).

[39] *See* Easterbrook & Fischel, *supra* note 15, at 1421–22; Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1827 (1989).

[40] *But see, e.g.*, Bernard S. Black, *Is Corporate Law Trivial? A Political and Economic Analysis*, 84 NW. U.L. REV. 542 (1990) (arguing that business organization statutes are irrelevant because parties simply contract around default terms for whatever arrangement they desire).

[41] *See generally* Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

[42] *See* Bebchuk, *supra* note 39, at 1827 (noting that default terms should be those that most parties would find to be value-maximizing).

[43] *See* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91 (1989).

corporate form.[44] If they find that certain terms happen to be ill-suited to their particular arrangement, so long as such terms are mere defaults, they can be modified by the parties by common agreement.[45]

If the goal of the form is to anticipate the needs of most of its users, it follows that there is some minimum number of forms that will maximize aggregate social welfare. If too few forms are offered, the default terms of each are less likely to be optimal for the vast majority of users. This, in turn, will either constrain economic activity or force the parties to engage in costly negotiations to drastically modify the form into which they were ushered. The general partnership model is surely not optimal for all joint business endeavors.

Why not then offer to the public as many different forms as there are conceivable business arrangements? If forms are useful, why not offer one thousand, rather than ten? Why not multiply the number of forms ad infinitum? The answer comes from returning to the original goal of offering forms, which is to reduce the transaction costs associated with forming and regulating businesses. Business forms, much like contract provisions, benefit from certain network effects: the more users choose to adopt the form, the more predictable the form becomes, and the more economically beneficial it becomes.[46] The Delaware corporation, for example, arguably benefits from its predictability, given that it has long-standing case law and an established bar familiar with the form.[47] If the efficiency of forms is based on network effects, there is some minimum threshold number of users of the form required for it to be efficient.[48] Increasing the number of users of a given form will also increase economic efficiencies.

Moreover, recall that forms serve an informational purpose: for less experienced parties, forms have the advantage of steering parties toward the arrangement that is most likely to be efficient for that type of business.[49] For example, without knowing any organizational law, small business owners are likely to choose an entity type such as the limited liability company for their business, simply because they are aware that most similar businesses

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[44] *See generally* Ian Ayres, *Menus Matter*, 73 U. Chi. L. Rev. 3 (2006).

[45] For example, Delaware corporate law allows for either the certificate of incorporation or the by-laws to specify the quorum requirement for voting provided it is not less than one third. However, the statute requires a majority for a quorum if the certificate of incorporation or by-laws do not specify otherwise. Del. Code Ann. tit. 8, § 216 (2007).

[46] *See* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 Va. L. Rev. 713, 718–40 (1997) (discussing network effects from standardized contractual provisions); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 Va. L. Rev. 757 (1995) (same).

[47] *See* Klausner, *supra* note 46, 842–43, 846 (explaining the decision of an out-of-state business to incorporate in the choice of Delaware in terms of network effects).

[48] *See id.* at 793 ("The value of a contract term to a firm adopting it at a given time is an increasing function of the number of firms that have adopted or that will adopt it.").

[49] *See, e.g.*, Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 Cornell L. Rev. 608, 612 (1998) (arguing that individuals tend to assume that the default options are better than the alternatives).

do the same. A small number of forms also lowers the transaction costs of regulation because problems that arise can be more easily identified and corrected. For all of these reasons, there are likely to be considerable efficiency benefits to using forms in business organizational law. Additionally, there is some optimal number and set of forms that balances the competing considerations of flexibility for business parties and network effects.

The optimal number of forms and the optimal set of terms offered in each form is highly likely to change over time as economic, technological, and institutional conditions change. Indeed, it is no surprise that the modern stock corporation is intimately linked with the Industrial Revolution, in which large amounts of capital were sought to develop new technologies such as railroads.[50] How, then, should legislatures and the courts determine when to update a form (by changing its mandatory or default terms, for example) or to create new forms? A form should be altered or a new form created when the existing form's terms are no longer efficient for the bulk of users, or when there is a regulatory or public-policy reason for not permitting the default term(s) that users would select.[51]

In Parts III and IV, however, we will see that the *Hobby Law* decision and the changes to Nevada's corporate law both alter traditional features of the corporate form. From an efficiency perspective, such a move can only be defended if the terms of the corporate form have become inefficient, requiring that the form either be modified or subsumed into another existing form. In fact, the recent changes do not appear to be prompted by efficiency concerns. Rather, they seek to maximize individual rights or autonomy, even at the expense of efficiency. As we shall see in Part II.B, however, a core goal of corporate law is to coordinate or constrain individual behavior. For this reason, it is a comparatively poor choice of regime in which to expand individual rights.

B. *Individual Versus Group Action in Corporate Law*

How should we think about individual rights and autonomy in corporate law? The pursuit of economic self-interest, for example, already figures prominently in the corporate framework: shareholders' individual profit motive can lead them to monitor management, to sell their shares when management performs poorly, and so forth, all of which aid in corporate governance. Yet even such individual "economic" rights are not left unfettered. Corporations are necessarily vehicles for collective action: by implica-

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[50] *See* Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility*, 30 DEL. J. CORP. L. 767, 793 (2005).

[51] *See* Larry E. Ribstein, *Why Corporations?*, 1 BERKELEY BUS. L.J. 183, 187–88 (2004) (discussing the benefits provided by forms, including efficiency and "the development of interpretive case law associated with distinct business associations rather than simply with individual contract terms").

tion, a primary function of corporate law is to coordinate and constrain individual behavior—even profit-motivated behavior.[52]

Consider first the design of corporate law. From the time of Ronald Coase, we have understood that firms exist precisely to avoid pure market transactions.[53] The costs associated with contracting on a one-off basis for factors of production and financing are such that in many cases the most efficient arrangement will be a collective endeavor in which governance and agency replace individual spot contracting.[54] This collective endeavor is referred to as a "firm."

As discussed, the for-profit corporate form imposes a very particular form of governance—described as the separation of ownership and control—in which shareholders (who hold certain economic rights to residual cash flows from the business) appoint a board of directors to manage the business.[55] This is so, because the corporation is a device that has been optimized for collective action of a specific type, namely large-scale economic activity. In contrast to the classic general partnership, for example, in which each individual partner may be necessary to the firm's success, the corporation is intended to survive the departure of any individual shareholder, director or officer. Crucially, then, the device of centralized management in the corporation is used for the express purpose of coordinating and constraining individual shareholder behavior and incentives.[56] A centralized management structure allows for decisions to be reached and actions to be taken even when there is disagreement among shareholders, and it prevents opportunistic individual shareholders from holding up the firm, withdrawing productive assets, or otherwise harming the firm's value.[57] In most states, for example, merging one corporation with another requires the vote of only a simple majority of shareholders of each corporation.[58] Thus, corporations

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[52] *See, e.g.*, Donald C. Langevoort, *Rereading* Cady, Roberts*: The Ideology and Practice of Insider Trading Regulation*, 99 COLUM. L. REV. 1319, 1328–29 (1999) ("[S]upport for insider trading regulation probably correlates positively with attitudes about the policing of managerial self-dealing . . . ."); Randy J. Holland, *Delaware Directors' Fiduciary Duties: The Focus on Loyalty*, 11 U. PA. J. BUS. L. 675, 683 (2009) (noting that the Delaware Supreme Court has long held that officers and directors are prohibited from exploiting their positions for personal gains).

[53] *See* Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 390–93 (1937).

[54] *See* OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS 20–40 (1975).

[55] *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 277–79 (1933).

[56] *See* Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1657 (2001) ("[E]ven in close corporations or corporations with a controlling shareholder group, the limitations on shareholders' ability to intervene, combined with the very small number of opportunities to vote beyond voting on directors, protects the structure of centralized management by making it impossible for shareholders qua shareholders to exercise the power of residual control over the corporation's assets.").

[57] *See id.* (noting that centralized management also prevents shareholders from acting out of self-interest).

[58] *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(c) (2017).

may merge over the objections of even a substantial minority of shareholders, which in turn prevents individual shareholders from seeking to hold up value-increasing transactions in the hopes of extracting side payments.

Thus, corporate law serves to quash individual voices and actions *by design*, in the interests of the group.[59] Stated differently, shareholder voting and board management serve as a mechanism for aggregating competing individual interests—a mechanism that the parties can agree to ex ante, even if there is some risk that they will not like the result ex post. It is not surprising, therefore, that corporate law sanctions individual action and voice only in specific, highly formalized ways. Shareholders are called on to vote to elect the board and on a handful of major corporate events—and they may act self-interestedly in doing so—but otherwise do not generally participate in the governance or operations of the corporation.

Contemporary corporate law constrains individual behavior by facilitating private ordering or through direct regulation. This premise provides a framework for thinking about the effects of current moves to increase individual rights and autonomy within the corporation.[60] The claim is that where such individual rights or actions conflict with fundamental principles of the underlying corporate form, or disrupt its mechanisms for channeling individual interests into firm behavior, the result will be little improvement in individual autonomy and a large efficiency cost.

Thus, movements to increase individual rights or autonomy may prove to be efficient or inefficient, and the history of corporate law bears this out. In keeping with the principle of classical liberalism, for example, certain increases in individual autonomy in corporate law have clearly proved value-enhancing. In the 19th century, many states abandoned the practice of requiring specific legislative acts for the chartering of corporations and instead began to grant incorporations as a matter of right.[61] This change amounted to a clear expansion of individual freedom, as any would-be entrepreneur could thenceforth make use of the corporate form. But this decision was almost certainly economically efficient as well, by untethering economic activity from the discretion of the state.[62] On the other hand, certain changes in corporate law that restricted individual autonomy within the corporation have also yielded significant efficiency gains. The corporation's right to own property in its own name and to enter into contracts are both now viewed as necessary preconditions to large-scale business activity,[63] yet

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[59] *See generally* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 Harv. L. Rev. 1735, 1745–46 (2006).

[60] For the comprehensive account of the clash between individual and group interests in corporate law doctrine and prominent theories of the firm, see generally William W. Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 Cornell L. Rev. 407 (1989).

[61] *See* Christopher Grandy, New Jersey and the Fiscal Origins of Modern American Corporation Law 33–53 (1993).

[62] *See* Note, *The Corporation and the Constitution: Economic Due Process and Corporate Speech*, 190 Yale L.J. 1833, 1845 (1981).

[63] *See* Hansmann & Kraakman, *supra* note 3, at 407–10.

both effectively limit individual autonomy within the corporation. For example, the first prevents individual shareholders from removing assets from the business or from using such assets for personal purposes. The second prevents individual shareholders from directing or preventing corporate actions. To illustrate, *Table 3* below summarizes the likely welfare effects of certain developments in corporate law, according to whether they expanded or restricted individual rights or autonomy.

TABLE 3. WELFARE EFFECTS OF SELECTED CHANGES TO INDIVIDUAL AUTONOMY IN CORPORATE LAW.

	Expansion of individual autonomy	**Restriction of individual autonomy**
(Probable) increase in economic welfare	• Incorporation available by right to all persons • Incorporation permitted for any lawful purpose	• Corporation permitted to own property in its own name • Corporation permitted to enter into contracts • Shift from unanimous to majority shareholder approval requirement for mergers
(Probable) decrease in economic welfare	• Shareholders permitted to exercise religious rights through the corporation[64] • Elimination of all mandatory fiduciary duties of directors and officers[65]	• Staggered boards recognized as permissible (thus enabling firms to prevent shareholders from voting on the full board each year)[66]

The point is simply that there are surely diminishing marginal returns to expanding individual autonomy within a given area of law, and that the recent changes in corporate law addressed herein may have moved us to the

[64] *See infra* Part III.
[65] *See infra* Part IV.
[66] *See* Paul Gompers et al., *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107, 115 (2003) (finding a negative association between staggered boards and firm value); Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 784–85 (2009) (same). *But see* K.J. Martijn Cremers & Simone M. Sepe, *The Shareholder Value of Empowered Boards*, 68 STAN. L. REV. 67 (2016) (critiquing the methodology of prior empirical studies of staggered boards).

realm of negative returns.[67] Of course, if one rejects utilitarianism, it is a valid response to state that efficiency should be irrelevant when individual rights are at issue. To the extent that society views efficiency outcomes as material, however, as it generally appears to do in corporate law, legislators and judges should be made aware of the calculus.

The push to maximize individual autonomy in corporate law may now stand at cross-purposes with its purpose of coordinating and constraining individual behavior in the most efficient manner. This clash of goals and mechanism design has three implications, each illustrated in the applications discussed in Parts III and IV below. First, in most cases the expansion of individual autonomy is likely to be little more than nominal. Second, the efficiency cost of accommodating such individual rights where they fit poorly is likely to be material. Third, the resulting pressure on certain fundamental principles of corporate law doctrine may lead to a significant increase in regulatory complexity or presence, despite the original liberalizing motive of expanding autonomy.

III. Corporate Religious Rights

A. *Corporate Rights or Individual Rights?*

In November 2013, the normally staid field of corporate law was thrown into the spotlight, when the Supreme Court granted *certiorari* for a group of cases dealing with the assertion of corporate religious rights. In *Burwell v. Hobby Lobby Stores, Inc.*,[68] the Supreme Court held for the first time that for-profit corporations could claim certain exemptions from laws of general applicability on the grounds of religion. The case was brought under the federal Religious Freedom Restoration Act of 1993 (RFRA),[69] which states in relevant part that:

> Government shall not substantially burden a person's exercise of religion even if the burden results from a rule of general applicability . . . [unless it demonstrates that] application of the burden to the person (1) is in furtherance of a compelling governmental interest; and (2) is the least restrictive means of furthering that compelling governmental interest.[70]

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[67] This takes into account only economic effects, however. It may still be the case that these changes generate positive utility in aggregate, taking into account non-monetary benefits such as the personal utility created by exercising religion in corporate form.

[68] Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751 (2014).

[69] Religious Freedom Restoration Act of 1993, 42 U.S.C. § 2000bb-1 (2013).

[70] 42 U.S.C. § 2000bb-1(b) (2013).

Because the statute does not define the term "person," the issue raised in *Hobby Lobby* was whether a for-profit corporation should be deemed a person capable of exercising religion for this purpose.[71]

At the time, Hobby Lobby, Inc. was a private corporation that operated a for-profit, national chain of arts-and-crafts stores, employing over 13,000 people.[72] The corporation's stock was controlled by five members of the same family.[73] The corporation brought suit under RFRA, objecting on religious grounds to a provision in the Affordable Care Act of 2010 (ACA) requiring employers' health insurance plans to include coverage for certain contraceptive methods.[74] In its majority opinion, written by Justice Alito, the Court held that RFRA free exercise rights may apply to certain for-profit corporations and concluded that Hobby Lobby, Inc. should be exempt under RFRA from the ACA's requirement of contraceptive coverage.[75]

This Part III argues that widespread disapproval of the *Hobby Lobby* decision among corporate law scholars reveals a shared vision of the corporation along certain dimensions. It suggests that centralized management of the corporation by the board of directors and the separation of shareholders from the corporation are and should remain central features of the corporate form, for the sake of efficiency, even where shareholders may wish otherwise. The conflict between this vision and the Supreme Court's in *Hobby Lobby* is stark.

Consider first the powerful assertion of individual rights in *Hobby Lobby*. The recognition of a corporation's free exercise rights was justified by the Court as a mechanism for the expression of the religious rights of *individuals*—rights deemed so fundamental that they demand exemption from laws of general applicability.[76] In Justice Alito's words, "[w]hen rights, whether constitutional or statutory, are extended to corporations, the purpose is to protect the rights of these people" who use corporations as "a form of organization . . . to achieve desired ends."[77]

The Court's suggestion that corporate rights are always tied to individual rights is misleading, however, as it does not hold for many of the most fundamental corporate rights that have been recognized in law. For example, the corporation's longstanding right to own property in its own name is not

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[71] *See Hobby Lobby*, 134 S. Ct. at 2768 (concluding that Congress included corporations in RFRA's definition of "persons").

[72] *See Hobby Lobby*, 134 S. Ct. at 2765.

[73] *See id.*

[74] *Id.* at 2759. More precisely, the statute required coverage of preventive care specified by the Department of Health and Human Services (HHS), which in turn had issued regulations requiring coverage of contraception methods approved by the Food and Drug Administration. *Id.* at 2762.

[75] *Id.* at 2785.

[76] *Id.* at 2768.

[77] *Id.*

based on the rights of its individual owners.[78] In fact, the corporation's right to own property is often asserted *against* claims by its shareholders that they have rights to assets of the business, as we have seen.[79] Recognizing the corporation as the owner of any assets contributed to the business by the shareholders is one of the defining features of the corporation and the key to its success in fostering economic growth precisely because it prevents individual shareholders from removing productive business assets at will.[80] In this case, recognizing a corporation's right to own property is the economically efficient rule specifically because it *impinges* on individual rights.

The same is true of other fundamental corporate rights such as the right to enter into contracts:[81] the right is not based on the individual rights of the shareholders, and once again is commonly asserted in opposition to the desires of individual shareholders. An individual shareholder cannot repudiate a corporate contract simply because the shareholder did not wish for the corporation to enter into it. This result would hold even where shareholders unanimously opposed the contract so long as the board of directors gave its approval.[82]

Some of the earliest and most important common law and constitutional or statutory rights granted to corporations are therefore expressly designed to *bind* individuals to particular outcomes or decision rules that favor the group. While such outcomes or rules are doubtless in shareholders' collective interest ex ante—given that they are voluntarily adopted or acquiesced to—they undeniably serve to restrict the rights of individual shareholders ex post, when their incentives may diverge from the collective interest, in a quasi-Rawlsian system. Thus, as we have seen, the remarkable success of the corporation in Western capitalism is attributable at least in part to a conscious quashing of individual freedom—to prevent the problems of holdup, opportunism, and other inefficient behavior by individual shareholders.[83]

B. The Clash with Corporate Law

Of course, the *Hobby Lobby* opinion is correct that *some* corporate constitutional or statutory rights are best understood as rights originating in the underlying rights of individuals who are related to the corporation in some

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[78] The Supreme Court has ruled that the Equal Protection Clause of the Fourteenth Amendment applies not just to individuals but also to corporations. *See* Santa Clara County v. S. Pac. R.R., 118 U.S. 394 (1886).

[79] *See* Hansmann & Kraakman, *supra* note 3, at 410–11.

[80] *See id.*

[81] *See* Trs. of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518 (1819) (recognizing the corporation's right to enter into contracts subject to constitutional protection).

[82] The sole exception is if the contract pertains to the mere handful of major corporate events requiring a shareholder vote, such as a merger. Even in such cases, individual shareholders are bound by the will of the majority in virtually all states. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(c) (2017) (requiring a majority shareholder vote to approve mergers).

[83] *See* WILLIAMSON, *supra* note 54.

fashion.[84] For example, the recognition of a corporation's Fourth Amendment right against unreasonable searches and seizures[85] is justified as a device to protect the Fourth Amendment rights of the corporation's employees and of other persons associated with the corporation.[86] Yet the *Hobby Lobby* decision is distinguishable even from this small line of cases recognizing corporate constitutional rights as derivative of individual rights in that it is the lone instance of fundamental corporate rights being tied specifically and exclusively to the rights of its *shareholders*. In this way, *Hobby Lobby* represents a doctrinal departure from *Citizens United v. FEC*,[87] despite the fact that the two cases are frequently analogized.

In *Citizens United*, the Supreme Court held that the government may not prevent corporations from spending money to support or denounce individual candidates in elections.[88] The Court's opinion vigorously asserted the corporation's right to engage in and affect political speech.[89] While justified by the majority as a means of fostering speech, the *Citizens United* opinion did not (and could not) equate *corporate* speech with *shareholder* speech. This is because corporate political speech, just like corporate advertising or any other corporate speech, is made at the direction of the board of directors or its officers rather than at the direction of shareholders. In a very real sense corporate speech occurs independently of shareholders' will.[90] Shareholders could be unanimously opposed to a particular instance of corporate political speech, yet the Court would uphold the corporation's right to engage in it at the board's instruction.[91] Consistent with this view, *Citizens United* recognizes the right to political speech of even large public corporations whose shareholders necessarily hold widely divergent political views.[92]

Whether or not *Citizens United* is an effective and advisable device to advance freedom of speech, the allocation of authority in the modern corporation ensures that, in practice, corporate speech cannot be a simple conduit for the speech of its individual shareholders.[93] From a corporate law perspec-

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[84] *See* Margaret M. Blair & Elizabeth Pollman, *The Derivative Nature of Corporate Constitutional Rights*, 56 Wm. & Mary L. Rev. 1673, 1674 (2015) (describing certain corporate constitutional rights as "derivative" because they are recognized solely in order to protect individual rights).

[85] *See* Hale v. Henkel, 201 U.S. 43, 75–76 (1906) (holding that corporations may claim Fourth Amendment protections against unreasonable searches and seizures but may not claim the Fifth Amendment privilege against self-incrimination).

[86] Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751, 2768 (2014).

[87] 558 U.S. 310 (2010).

[88] *See id.*

[89] *See id.* at 371–72.

[90] *See, e.g.*, Anne Tucker, *Flawed Assumptions: A Corporate Law Analysis of Free Speech and Corporate Personhood in Citizens United*, 61 Case W. Res. L. Rev. 497, 530–31 (2010) (noting that political expenditures are authorized by management or the board of directors, and shareholders do not get to vote on such decisions).

[91] *See id.*

[92] *Citizens United*, 558 U.S. at 342 (observing that the Court has repeatedly extended First Amendment protections to corporations).

[93] *See* Tucker, *supra* note 90, at 530–31.

tive, any suggestion that corporate speech captures the speech of individual shareholders is simple error: individual shareholders and even shareholders acting collectively do not and may not direct corporate speech.[94]

Nonetheless, and without taking any position on its merits, the *Citizens United* decision does not flout the existing corporate form in any way. Corporate law has a ready means of ascertaining what constitutes identifiable and legitimate corporate speech, where legitimacy here refers solely to the authority to make speech, rather than to its content. The board of directors, typically by majority vote, directs corporate actions, but may delegate much day-to-day management decisions (including, potentially, the decision to engage in political speech) to individual corporate officers.[95] So long as this chain of command is respected, corporate speech at the direction of management is legitimate under corporate law.[96] In other words, *Citizens United* does not alter corporate law because it does not purport to give shareholders the right to direct corporate speech.

The *Hobby Lobby* decision, by contrast, directly ties the corporation's religious rights to the individual religious rights of the underlying shareholders.[97] In doing so, *Hobby Lobby* clashes with fundamental principles of the corporate form. This is so because the *Hobby Lobby* Court seems only to permit a corporation to exercise its religious rights when the expression thereof is coextensive with the views of its shareholders, or at least of its controlling shareholder(s).[98] Indeed, the Court suggests that the exercise of religious rights would be inappropriate for public corporations, in marked contrast to the holding in *Citizens United*, which expressly applied to all corporations.[99] The implication is that, unlike the right to engage in political expenditures recognized in *Citizens United*, the board of directors does not control the corporation's right to exercise religion, notwithstanding corporate law's directive that management of the corporation rests exclusively with the board, rather than with the shareholders. An unstated implication of the *Hobby Lobby* opinion is that its holding would not extend to a corporation seeking a religious exemption under RFRA over the objection of its control-

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[94] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2016) (allocating to the board of directors the exclusive authority to manage the corporation).

[95] *Id.*

[96] *See* Joseph K. Leahy, *Are Corporate Super Pac Contributions Waste or Self-Dealing? A Closer Look*, 79 MO. L. REV. 283, 286–87 (2014) (noting that corporate law "provides no mechanism" for shareholders to influence political corporate speech or political spending).

[97] *See* Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751, 2775 (2014) (holding that requiring the shareholders and their companies to comply with the HHS mandate would burden their exercise of religion).

[98] *See id.* at 2774.

[99] *See id.* ("For example, the idea that unrelated shareholders—including institutional investors with their own set of stakeholders—would agree to run a corporation under the same religious beliefs seems improbable. In any event, we have no occasion in these cases to consider RFRA's applicability to such companies. The companies in the cases before us are closely held corporations, each owned and controlled by members of a single family, and no one has disputed the sincerity of their religious beliefs.").

ling shareholders,[100] whereas *Citizens United* clearly recognizes the corporation's right to make political expenditures under precisely the same circumstances.[101]

While the Court offers no explanation for its differing treatment of rights in these two cases, the practical result is that corporate religious rights as recognized in *Hobby Lobby* remain the rights of individual shareholders, whereas corporate speech and political spending rights under *Citizens United* are truly those of the corporation, expressed and controlled by the managers thereof in accordance with applicable state corporate law. *Hobby Lobby* thus represents the greater interference with corporate law because it disregards corporate law's bedrock principle of separation of ownership and control.

Accordingly, the *Hobby Lobby* decision has been criticized by corporate law scholars more often than it has been defended.[102] Indeed, the conflation of corporate action with shareholder action permitted by *Hobby Lobby* has serious potential unintended consequences under corporate law. The separation of shareholders from the corporation is the basis for the recognition of the limited liability of shareholders relative to outside creditors. Without the guarantee of limited liability, investors would be hard-pressed to commit capital to large business entities, effectively precluding passive investment, and therefore the bulk of large-scale economic activity in the United States.[103] Nonetheless, there are circumstances in which corporate law does not recognize shareholder limited liability, namely where a controlling shareholder fails to respect the separateness of the corporate entity.[104] Thus, where shareholders use the corporation to exercise their personal religious rights, it is at least arguable that creditors should in turn be permitted to "pierce the veil" of shareholders' limited liability and pursue shareholders'

[100] *See* Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639, 690 (2016) ("*Hobby Lobby* is a landmark decision because, for the first time, the Court allowed business corporations to opt out of generally applicable federal regulation because of the beliefs of the shareholders.").

[101] *See* Leahy, *supra* note 96, at 285.

[102] *See, e.g.*, Amicus Curiae Brief of Corporate and Criminal Law Professors in Support of Petitioners, Sebelius v. Hobby Lobby Stores, 134 S. Ct. 2751 (2014) (No. 13-354) [hereinafter Amicus Curiae Brief]; Leo E. Strine, Jr., *A Job Is Not a Hobby: The Judicial Revival of Corporate Paternalism and Its Problematic Implications*, 41 J. CORP. L. 71 (2015) (arguing that Hobby Lobby is inconsistent with existing corporate law).

Even among corporate law scholars, however, there were exceptions to the widespread critique of *Hobby Lobby*. *See, e.g.*, Stephen M. Bainbridge, *A Critique of the Corporate Law Professors' Amicus Brief in Hobby Lobby and Conestoga Wood*, 100 VA. L. REV. ONLINE 1 (2014); Lyman Johnson & David Millon, *Corporate Law after Hobby Lobby*, 70 BUS. LAW. 1 (2015) (defending the *Hobby Lobby* majority's conclusion that state law does not require corporations to pursue profit); Brett H. McDonnell, *The Liberal Case for Hobby Lobby*, 57 ARIZ. L. REV. 777 (2015).

[103] *See* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 94–97 (1985).

[104] *See, e.g.*, Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1044–45 (1991).

personal assets,[105] a result that would surely be intolerable to the shareholders of Hobby Lobby, Inc.

A further point of doctrinal tension is the *Hobby Lobby* court's failure to explain why the religious rights of shareholders should be privileged over the religious and other rights of all other individual stakeholders of the corporation.[106] If the religious rights of the corporation are derived solely from those of its shareholders, such rights can be exercised without regard to—or even in direct opposition to—the religious views of the corporation's employees, for example. Moreover, given that *Hobby Lobby* permits a corporation to claim an exemption from laws of general applicability, it further permits the religious rights of individual shareholders to override otherwise applicable legal rights of the corporation's employees.[107] No rationale is given by the Court for so privileging shareholders over other individuals associated with the corporation. Such a rationale is in contrast to the approach taken for other corporate constitutional and statutory rights such as the Fourth Amendment right against unreasonable searches and seizures, which protects certain corporate employees, among others.[108] The Court simply resorts to the claim that shareholders "own and control" the corporation,[109] notwithstanding that this statement is inexact both as a matter of law and as a matter of practice.

Indeed, with respect to ownership, the corporation itself is the owner of its assets, as we have seen. From an economic standpoint, shareholders are one of several groups (including creditors and employees)[110] having a claim on the corporation's assets. Shareholders are commonly described as having a "residual" claim on the corporation's cash flows: they are entitled to what

[105] *See* Amicus Curiae Brief, *supra* note 102, at 14. (noting that the Court has held "corporations and their controlling shareholders cannot invoke the corporate veil on the one hand and ask courts to disregard it on the other").

[106] *See* Elizabeth Pollman, *Corporate Law and Theory in Hobby Lobby*, in THE RISE OF CORPORATE RELIGIOUS LIBERTY 157 (Micah Schwartzman et al., eds. 2016).

[107] *See* Pollman, *supra* note 100, at 689–90 ("Because state corporate law does not include employees within the governance framework, give them a voice in the corporation, or protect their interests, it is particularly important that external employee-protective laws be given effect. . . . Yet giving effect to external employee-protective law is exactly what *Hobby Lobby* failed to do—it put the interests of five shareholders above those of over 13,000 employees.")

[108] Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751, 2768 (2014) (holding that a corporation's Fourth Amendment right protects employees and other stakeholders of the corporation).

[109] *Id.*

[110] From a practical standpoint, shareholders may play a special role in the life of the corporation, in that the original shareholders—the founder(s)—may have developed the idea for the business, formed the entity, contributed capital or sought other investors, and may even have imbued the corporation with a clear sense of mission or identity. But among the key defining features of corporations are continuity of existence and, relatedly, the free transferability of its shares. Thus, founders may come and go, but the corporation remains. In particular, the identity of shareholders is ever-changing, and they need not share any common characteristics or interests other than their ownership of interests in the same entity. For this reason, the somewhat romantic tendency to equate shareholders with founders is a conceptual error.

remains of the corporation's assets after all creditors have been paid off.[111] However, even this limited claim is fragile: both the timing and the amount of distributions to shareholders—such as dividends—are at the discretion of the board of directors.[112]

Further, shareholders do not "control" the corporation in anything other than an indirect, limited sense. The distinguishing feature of shareholders relative to other corporate stakeholders, of course, is that they have voting rights, although even this is not required for all classes of shareholders.[113] Most states limit the matters on which a shareholder vote is required to the election of directors and approval of a handful of fundamental corporate changes (which must first be proposed by the board of directors) such as charter amendments and mergers.[114] Shareholders cannot act on behalf of the corporation, nor can they direct the actions of the corporation. Instead, another defining feature of the corporation—in contrast to other business entities such as partnerships—is the mandatory allocation and centralization of control to a board of directors, which is given the exclusive authority to manage the corporation's business.[115] Thus, contrary to common assertions, the board of directors is not the agent of shareholders.[116] Rather, the board of directors has independent authority and may not be compelled to act by the shareholders—even by the controlling shareholder or the shareholders acting unanimously.[117]

Instead, shareholders affect corporate policy primarily in two ways. First, shareholders who have voting rights elect the directors, typically annually.[118] (Once appointed, recall that directors must exercise independent judgment and cannot be forced to do shareholders' bidding.) Second, the

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[111] *See, e.g.*, Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & Econ. 327, 338 (1983).

[112] *See* Douglas K. Moll, *Shareholder Oppression & Dividend Policy in the Close Corporation*, 60 Wash. & Lee L. Rev. 841, 862 (2003) (noting that the decision to pay out dividends is within the discretion of the board and that courts have typically refused to interfere absent a showing of fraud or other complete abuse of discretion).

[113] States such as Delaware permit the corporation to issue non-voting stock. Recently, several major technology companies including Google and Facebook have issued a significant proportion of their stock to the public as non-voting shares. *See generally* Joseph Ciolli, *Zuckerberg Borrows Google Tool Splitting Stock for Control*, Bloomberg (Apr. 27, 2016), https://www.bloomberg.com/news/articles/2016-04-27/zuckerberg-borrows-google-tactic-in-splitting-stock-for-control.

[114] *See* Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. Davis L. Rev. 605, 609–14 (2007) (discussing the limited voting rights of shareholders, including the right to vote on fundamental corporate changes, and concluding that the limited voting rights are even further restricted by management's ability to control the "voting agenda").

[115] *See* Del. Code Ann. tit. 8, § 141(a) (2016) (allocating exclusive authority to manage the corporation to the board).

[116] *See* Deborah A. DeMott, *Forum-Selection Bylaws Refracted Through an Agency Lens*, 57 Ariz. L. Rev. 269, 270 (2015).

[117] Various state corporate statutes permit stockholders of close corporations to opt out of the board-managed corporate governance regime, but these alternative forms have thus far proven unpopular. *See, e.g.*, Del. Code Ann. tit. 8, § 341 (2016).

[118] *See, e.g.*, Del. Code Ann. tit. 8, § 211(b) (2009).

board of directors owes fiduciary duties to the corporation, and such duties to the corporation are variously described as being owed "also to the shareholders" or "for the benefit of the shareholders."[119] There remains substantial debate as to whether, in the case of for-profit corporations, such fiduciary duties require the board to privilege shareholders' economic interests above all else (subject to a substantial range of discretion or margin of error provided by the business judgment rule).[120] In all events, such fiduciary duties do not require the board to divine the religious interests of the shareholders, either collectively or individually, nor to seek to exercise or assert them.

As a purported vehicle for the protection of individuals' religious rights, the *Hobby Lobby* decision is thus oddly incomplete: the most that can be said is that it allows *certain* shareholders of *certain* for-profit corporations to obtain religious exemptions for their corporations from federal laws of general applicability.[121]

C. Separate Law for For-Profit Corporations?

In reaching its decision, the *Hobby Lobby* Court made much of the fact that state corporate statutes permit corporations to be formed for *any* lawful purpose under state law.[122] From this, the Court concluded that corporations that engage in profit-seeking activities are not subject to any requirement to do so to the exclusion of other activities such as, presumably, exercising religion.[123] Stated differently, the Court effectively made a determination that state law does not subject for-profit corporations to any explicit or implicit mandate to maximize shareholder value. To be sure, the corporate form is adopted by organizations of wildly different missions. This includes governmental units such as counties, cities, and towns; not-for-profit organizations such as religious institutions, hospitals, colleges and universities, and charities; for-profit commercial enterprises; shell holding companies; and special-purpose vehicles that hold financial assets without conducting any business.[124] In fact, the for-profit commercial enterprise with which we now

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[119] *See, e.g.*, Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280, 1287 (Del. 1989); Loft, Inc. v. Guth, 2 A.2d 225, 238 (Del. Ch. 1938), *aff'd*, 5 A.2d 503 (Del. 1939).

[120] *See infra* Part IV.C.

[121] Justice Alito's opinion concluded, based on the facts of the case, that there was no need to consider the application of religious exemptions to large publicly-traded corporations. Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751, 2774 (2014)

[122] *See Hobby Lobby*, 134 S. Ct. at 2770–71. *See, e.g.*, DEL. CODE ANN. tit. 8, § 101(b) (2018) ("A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes . . . .").

[123] *See Hobby Lobby*, 134 S. Ct. at 2771.

[124] *See* Margaret M. Blair, *Corporate Personhood and the Corporate Persona*, 2013 U. ILL. L. REV. 785, 818 (2013) (noting that special-purpose vehicles are corporations set up for the purpose of securitizing financial assets); Daniel Farbman, *Reconstructing Local Government*, 70 VAND. L. REV. 413, 485 (2017) (noting that municipal incorporation has been used "to escape from larger governing politics"); Henry B. Hansmann, *Reforming Nonprofit Cor-*

tend to associate corporations was a relative late-comer to the form, with the earliest incorporations in the British colonies often going to cities, towns, and colleges, for example.[125]

Although the corporate form embraces organizations of all types and purposes, not all corporations have the same rights and duties under corporate law. Instead, the modern corporation should be understood as itself comprised of a menu of forms from which one must select.[126] Not-for-profit organizations, for example, are typically formed as nonstock corporations.[127] Thus, they have no residual claimants, precisely because they are prohibited by state not-for-profit statutes and by Internal Revenue Code provisions from distributing any profits to owners, directors, or officers.[128] Thus, none of the provisions in the state corporate statute dealing with shareholders applies to such organizations, effectively creating separate forms for stock and nonstock corporations.[129]

The implications are significant. First, the board of directors of a nonstock corporation is not appointed by, or beholden to, stockholders, creating a very different set of incentives and duties.[130] Second, although all corporate directors and officers have fiduciary duties, there is no private mechanism for their enforcement when the corporation lacks shareholders. Instead, public enforcement by the IRS and the relevant state attorney general, stand in lieu of a private right of action, entailing vastly different procedures, incentives, and concerns.[131] Necessarily, then, the fiduciary duties of the board and officers, though stated in precisely the same terms, lead to very different practical outcomes as between for-profit and nonprofit corporations. In for-profit corporations, shareholders may sue the corporation to compel it to bring suit against the relevant director(s) or officer(s) for breaches of their

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poration Law, 129 U. Pa. L. Rev. 497, 502–04 (1981) (discussing various types of enterprises that utilize the nonprofit corporate form).

[125] *See* James Willard Hurst, The Legitimacy of the Business Corporation in the Law of the United States, 1780-1970, at 3 (1970) (observing that "the first English treatise on corporations [in 1794] has little to say, and scant authority to cite, concerning use of the corporation for economic enterprise").

[126] *See infra* Part I.A.

[127] *See, e.g.*, Del. Code Ann. tit. 8, § 102(b)(1) (2018) (permitting "nonstock corporations" to include in their certificate of incorporation additional provisions for the management of the business).

[128] *See* James R. Hines Jr., Jill R. Horwitz & Austin Nichols, *The Attack on Nonprofit Status: A Charitable Assessment*, 108 Mich. L. Rev. 1179, 1179 (2010) ("American nonprofit organizations receive favorable tax treatment, including tax exemptions and tax-deductibility of contributions, in return for their devotion to charitable purposes and restrictions not to distribute profits.").

[129] *See* Del. Code Ann. tit. 8, § 114 (2018) (applying distinct provisions to nonstock corporations). Note also that the Delaware General Corporation Law distinguishes between nonstock corporations (corporations not authorized to issue stock), nonprofit nonstock corporations (nonstock corporations lacking membership interests) and charitable nonstock corporations (nonprofit nonstock corporations exempt from taxation under § 501(c)(3) of the Internal Revenue Code).

[130] *See, e.g.*, Del. Code Ann. tit. 8, § 141(j) (2018).

[131] *See* Weil, Gotshal & Manges LLP, The Guide to Not-for-Profit Governance 1-2 (2012).

fiduciary duties.[132] No other corporate constituency such as employees, customers, or suppliers is given the same right.[133]

By giving shareholders the sole means of enforcing directors' fiduciary duties, as well as making them solely responsible for electing the board of directors, corporate law ensures as a practical matter that the board is incentivized to favor shareholders over other corporate constituencies.[134] It is for this reason that management's fiduciary duties are said to be owed to the corporation *for the benefit of shareholders*. What benefit do shareholders expect? If the corporation is engaged in commercial activity, shareholder wealth maximization would seem to be the logical default expectation. In order to modify this default expectation, the corporation would need to explicitly state an alternative mission in its charter, such that shareholders and future shareholders would be put on notice that the corporation could pursue alternative objectives.[135]

To be sure, directors in for-profit corporations are given substantial leeway to authorize corporate actions that do not appear to be profit-maximizing. For example, the law has long recognized that some portion of corporate assets may be contributed to charity,[136] that corporations may pay above-market wages to their employees, and that they may reject takeover offers even where they would result in shareholders receiving a substantial premium over the current market price.[137] This permissiveness should not be

[132] Shareholders are not permitted to bring suit directly for a breach of fiduciary duty, given that such duties are nominally owed to the corporation itself. Instead, such rights are enforced indirectly, through the mechanism of a shareholder *derivative* suit against the corporation, to compel it to bring suit for the alleged breach.

[133] A limited exception exists when the corporation has crossed the threshold into insolvency. In that case, the board of directors' fiduciary duties are deemed to be for the benefit not only of shareholders, but also of creditors. *See* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007). The rationale is that when shareholders have little or no expectation of recovery, their incentives are no longer to maximize the value of the corporation, which would inure solely to the corporation's creditors. Rather, their incentive is either to be careless with the corporation's remaining assets or to take undue risks in the hope that the corporation will escape insolvency. Nonetheless, even in such cases, creditors may not bring direct fiduciary duty claims. *See id.*

[134] *See* Julian Velasco, *The Fundamental Rights of Shareholders*, 40 U.C. DAVIS L. REV. 407, 442 (2006) ("Fiduciary duties and shareholder approval requirements limit director autonomy, and the right to elect directors is intended to keep directors accountable to the shareholders.").

[135] This is not intended to suggest that the longstanding debate over the degree to which so-called "shareholder primacy" has been incorporated into law has been resolved. The competing positions were famously staked out in the classic debate between Professor E. Merrick Dodd of Harvard and Professor Adolf Berle of Columbia in the Depression era. *See* Adolf A. Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932); Adolf A. Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932). For more recent treatments, see William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261 (1992); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); Hansmann & Kraakman, *supra* note 9.

[136] *See* A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 585 (N.J. 1953).

[137] *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

interpreted as a violation of the norm of shareholder profit-maximization, however. Rather, state corporate law's deference to such behavior should be interpreted in one or more of the following ways.

First, such deference reflects the refusal of judges—who primarily determine the content of fiduciary duties in corporate law—to police every managerial decision.[138] By giving management broad latitude to manage the corporation's affairs, courts avoid having to make what are effectively difficult business decisions for which they are not well qualified. Even if it allows some conduct that is not in shareholders' interest, such deference satisfies the broader interest in encouraging qualified individuals to take up management positions and to avoid excessive conservatism in their decision-making on behalf of the corporation.[139] Thus, although the application of this rule to a particular corporation may result in some non-profit-maximizing behavior, it arguably results overall in greater corporate profits.

Second, conduct that does not appear to be profit-maximizing in the short term may well be profit-maximizing in the longer term. Giving donations to charity may breed goodwill among customers, for example, or facilitate the recruiting of employees in a competitive market for skilled labor.[140] Similarly, since the time of Henry Ford, it has been at least a plausible view that paying above-market wages can be profit-maximizing for the firm, because it may generate loyalty among employees.[141]

Thus, the broad latitude for corporate management to behave in ways that are not obviously profit-maximizing does not contradict the previously stated principle that the default assumption for a commercial enterprise should be that its primary objective is to maximize shareholder wealth.[142]

In the specific context of corporate takeovers, there is a line of court decisions and, in some states, statutory provisions (referred to as "constituency statutes") explicitly permitting managers to take into account the interests of constituencies and stakeholders other than shareholders.[143] Unlike the case law discussed above, these are truly departures from the norm of shareholder wealth maximization. Yet they are limited to a specific, politically charged context. Corporate managers often have incentives to resist an unsolicited takeover bid because it puts them at risk of losing their position

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[138] *See generally* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 87 (2004) (arguing that the business judgment rule is best understood "as a doctrine of abstention").

[139] *See, e.g.*, Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996) (stating that "[s]hareholders don't want (or shouldn't rationally want) directors to be risk averse").

[140] *See A.P. Smith Mfg.*, 98 A.2d at 585 (noting that corporate charitable donations may have "indirect benefit accruing to the corporations").

[141] *See* Tim Worstall, *The Story of Henry Ford's $5 a Day Wages: It's Not What You Think*, FORBES (Mar. 4, 2012), https://www.forbes.com/sites/timworstall/2012/03/04/the-story-of-henry-fords-5-a-day-wages-its-not-what-you-think/#400289ab766d.

[142] *See* Strine, *supra* note 102, at 76 (stating that "[u]nder existing corporate law, at least in Delaware, the duty of the board of directors is to maximize profit for stockholders").

[143] *See Unocal*, 493 A.2d at 955; Comm. on Corp. Laws, *Other Constituency Statutes: Potential for Confusion*, 45 BUS. LAW. 2253 (1990).

within the target company. During the height of corporate takeovers in the 1980s, managers began lobbying state legislatures to grant them additional authority to resist such bids.[144] In turn, state legislatures and judges were often receptive to these appeals, due to the political saliency of local companies being acquired by out-of-state "corporate raiders," who might engage in major layoffs to cut costs.[145] States' varied responses included court decisions giving managers wide latitude to reject hostile takeover bids, to adopt poison pills and other ex ante takeover defenses, or to consider the interests of other corporate stakeholders (such as employees and local communities) in considering takeover bids.[146] In light of their specific context and limited purpose, constituency statutes should not be interpreted as permitting managers to depart wholesale from the norm of shareholder wealth maximization.

In Delaware, the reigning champion in the competition to attract corporate charters,[147] the jurisprudence has not been especially clear on the extent to which directors and officers must pursue shareholder wealth-maximization, in large part because it is unwilling to acknowledge the seeming conflict between the court's takeover cases and the larger context of the corporation's ordinary business operations. Nonetheless, even within the context of corporate takeovers, the Delaware courts have recently suggested that managers of for-profit corporations *are* bound to maximize shareholder wealth.[148]

One need not resolve the extent to which the norm of shareholder wealth-maximization is in fact incorporated into and enforceable under state corporate law, however. Nor need one resolve precisely how the courts do or should determine whether a particular corporation should be deemed a for-profit business. For our purposes, it is enough to conclude that, in practice, there *is* a distinction in both governance and fiduciary duties under state corporate law between nonprofit and for-profit organizations, and that the latter owe *some* measure of privileged allegiance to shareholders. Thus, within the vast umbrella of state corporate law, for-profit corporations

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[144] *See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 24–25 (1992).

[145] *See id.* (discussing the political considerations of the Pennsylvania legislature, the first state to adopt a constituency statute).

[146] *See* Allen, *supra* note 135, at 275–76.

[147] *See* Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 389–91 (2003) (providing evidence that Delaware attracts vastly more incorporations of large enterprises than any other state).

[148] The Delaware courts have at times been willing to tether directors' fiduciary duties explicitly to a standard of shareholder wealth maximization. *See, e.g.*, eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (Del. Ch. 2010) ("Directors of a for-profit Delaware corporation cannot deploy a [poison pill takeover defense] to defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the director's fiduciary duties under Delaware law.").

should be understood as constituting a separate form, notwithstanding the *Hobby Lobby* Court's conclusion to the contrary.[149]

D. *The Effects of Recognizing Corporate Religious Rights*

The *Hobby Lobby* ruling is likely at odds with economic efficiency, a point that even the Court might well concede. *Hobby Lobby* creates an uneven playing field among for-profit corporations and provides a potentially serious competitive advantage to firms whose particular governance structure and shareholder identities enable them to claim exemptions from laws of general applicability on religious grounds. When the legal burden that a corporation seeks to avoid is costly, the competitive advantage of obtaining an exemption from such laws can be significant. In other contexts, by contrast, concerns about unfair competition among corporations with different legal rights and obligations have been addressed by attempting to eliminate the uneven playing field. Complaints about the unfair advantage of tax-exempt firms engaging in ordinary commerce led to the tax principle that such firms must pay tax on all income that is "unrelated" to their tax-exempt mission.[150]

To be sure, there is a theoretical efficiency argument for permitting religious exemptions for corporations. If it were the case that large swaths of the population avoided for-profit economic activity entirely due to the unavailability of religious exemptions from federal rules of general applicability, then this ex ante chilling of business could serve as an efficiency rationale for awarding corporations religious rights. Yet our modern economy belies this claim, by attracting broad participation from individuals of most all religious persuasions.[151] In addition, recall that the *Hobby Lobby* decision protects only the rights of *certain* individuals when engaged in commerce, namely those of controlling shareholders, even when in conflict with those of the corporation's far more numerous employees.[152]

Finally, granting corporations religious exemptions from laws of general applicability effectively guarantees an increase in regulatory complexity. The *Hobby Lobby* case itself prompted HHS to propose a new round of regulations addressing claims for religious exemption from the ACA's requirement of insurance coverage for contraception.[153] Nor did litigation over

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[149] The remainder of this Article considers only for-profit corporations, and references to corporate law are to the law of for-profit corporations.

[150] *See* I.R.C. § 512 (2018) (subjecting to income taxation the "unrelated business taxable income" of otherwise tax-exempt entities).

[151] The Amish community presents a notable exception. *See* Stephen T. Knudsen, *The Education of the Amish Child*, 62 CAL. L. REV. 1506, 1506 (1974) (describing the Old Order Amish as living in "self-contained agrarian communities insulated from the larger society").

[152] *See supra* Part III.A.

[153] *See* 45 C.F.R. § 147.132 (2018).

religious exemptions from the ACA end with *Hobby Lobby*.[154] Henceforth, not only will legislators and regulatory agencies need to account and plan for the possibility that for-profit businesses will seek exemption from their laws and regulations on religious grounds, but the courts will have to grapple with a wave of difficult cases involving such claims. Further, the uncertainty over whether a for-profit corporation's exercise of religious rights should permit creditors to "pierce the veil" of shareholder limited liability is likely to cast a shadow over corporate law for some time to come.[155]

IV. The Elimination of Corporate Managements' Fiduciary Duties

A. *The Case for Fiduciary Duties*

Any business activity involving more than one person faces the problem of agency costs.[156] Employees may not work as diligently as their employer would like. One partner in a business may subject the other partners to liability for her tortious conduct. Corporate managers may pay themselves bigger salaries than what shareholders deem justified. Agency costs arise whenever one party (the agent) is expected to do something for another party (the principal) or act on behalf of that party. They arise because the incentives of the principal and the agent necessarily differ to some degree, and the principal lacks perfect information about the agent's effort and ability.[157]

This mismatch in incentives and information creates three types of costs.[158] First, the principal may incur costs in order to better align the agent's behavior with the principal's wishes (referred to as "monitoring costs"), such as security cameras for employees or incentive compensation for management.[159] Second, the agent itself may incur costs in order to signal his or her quality or good behavior to the principal (referred to as "bonding costs"), such as where lawyers choose to associate with a reputable law firm.[160] Finally, because monitoring and bonding cannot ensure that agents will perfectly fulfill the principal's wishes, there will always be some residual loss in social welfare—referred to as the deadweight loss.[161]

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[154] *See, e.g.*, Zubik v. Burwell, 136 S. Ct. 1557 (2016). *See* Leo E. Strine, Jr., *Corporate Power Ratchet: The Courts' Role in Eroding We the People's Ability to Constrain Our Corporate Creations*, 51 Harv. C.R.-C.L. L. Rev. 423, 458 (2016) (describing the "litany of legal challenges" that has resulted from the *Hobby Lobby* decision).

[155] *See generally* Stephen M. Bainbridge, *Using Reverse Veil Piercing to Vindicate the Free Exercise Rights of Incorporated Employers*, 16 Green Bag 2d 235 (2013).

[156] *See* Jensen & Meckling, *supra* note 5, at 309 (defining agency costs).

[157] *See generally* Jean-Jacques Laffont & David Martimort, The Theory of Incentives: The Principal-Agent Model (2002).

[158] *See* Jensen & Meckling, *supra* note 5, at 308 (describing the three types of agency costs).

[159] *See id.*

[160] *See id.*

[161] *See id.*

The corporate form imposes a particular agency cost that has generated a vast literature. As discussed, one of the distinctive features of the corporation compared to other types of business association is its governance structure with centralized management and delegation to the board of directors.[162] Rather than manage the affairs of the business themselves, corporate shareholders elect a board of directors, which is given exclusive management authority, subject to a very limited set of mandatory shareholder approval rights. In turn, the board of directors may delegate some management authority to officers, who in addition are charged with executing the board's directives.

The distinctive quality of corporate-style delegated management among business entities is perhaps best illustrated by contrast with the traditional model of the general partnership. In a general partnership, the partners not only have economic stakes in the business but also manage it as co-equals.[163] By contrast, the corporation has long been characterized by the "separation of ownership and control": shareholders hold rights to the residual profits of the business, but do not control the business.[164] Instead, they delegate management to the board, which is given independent authority to direct the corporation's actions.[165]

In an economic sense, then, shareholders of a corporation may be viewed as principals, and "management" (a term used very loosely to refer to both the board of directors and executive officers) is their agent. As a legal matter, however, the board of directors is assuredly not the agent of shareholders, because shareholders cannot issue direct orders to the board or otherwise control its behavior—the hallmarks of an agency relationship recognized in law.[166] Once the board has been appointed, shareholders have no ability to intervene in the firm's management beyond a very limited set of veto rights with respect to major corporate events, such as mergers, charter amendments, and liquidation, the power to elect and remove directors, and the right to amend the corporation's by-laws.[167] This insulation of boards from shareholder control, combined with the vast chasm that can exist between information about the firm held by management versus shareholders, significantly increases the potential for management conduct to deviate from shareholders' wishes.

The greater the number of passive shareholders and the greater the size and complexity of the corporation, the greater the potential for such agency costs of management, as the asymmetry between shareholder and manage-

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[162] *See* Clark, *supra* note 26.

[163] *See* Revised Uniform Partnership Act § 401 (Nat'l Conference of Comm'rs on Unif. State Laws 1997).

[164] *See* Berle & Means, *supra* note 55.

[165] Del. Code Ann. tit. 8, § 141(a) (2018) (allocating to the board of directors the exclusive authority to manage the corporation).

[166] *See* Restatement (Third) of Agency §1.01 (Am. Law Inst. 2006) (limiting agency relationships to ones in which the agent acts "subject to the principal's control").

[167] *See* Velasco, *supra* note 114, at 609–14.

ment's information grows and the ability and incentives of individual shareholders to monitor management declines.[168] Thus, large, public corporations, in which shareholders are thought to be relatively dispersed, present the prototypical illustration of the agency costs inherent in delegated management.

While contractual and other private-ordering solutions abound for mitigating the agency costs of management, corporate law provides a powerful tool: directors' fiduciary duties.[169] Such duties are typically defined and refined by state common law rather than by corporate statutes. Fiduciary duties impose broad standards of conduct on directors and allow for their enforcement through shareholder lawsuits.[170] The two principal duties that directors owe to the corporation are the duty of care and the duty of loyalty.[171] The duty of care requires directors to act prudently and attentively in managing the corporation's affairs.[172] Although resembling a simple negligence standard as stated, the duty of care is in fact subject to a much stricter threshold for liability—more akin to gross negligence or recklessness—by application of the "business judgment rule," which imposes both procedural and substantive limitations on liability for a breach of the duty of care.[173]

The duty of loyalty simply requires directors to act in the interests of the corporation, and in particular to place the corporation's interests above their own.[174] Behavior that could give rise to a violation of the duty of loyalty includes self-dealing transactions, taking a business opportunity away from the corporation (the "corporate opportunity" doctrine), diverting corporate assets, taking actions to entrench one's position as director or officer of the corporation, or providing false or deceptive information to shareholders.[175] With notable exceptions (discussed below), directors are held personally liable for breaches of their fiduciary duties to the corporation.[176]

The fiduciary duties imposed on corporate directors and officers may smack of romantic notions of fairness or stark paternalism. Over time, how-

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[168] *See* Lucian Bebchuk & Jesse Fried, Pay Without Performance: The Unfulfilled Promise of Executive Compensation (2006).

[169] This Article focuses on the fiduciary duties of corporate directors. Corporate officers are subject to the same fiduciary duties as directors as well as to additional fiduciary duties, because unlike directors they are true agents of the corporation. *See* Deborah DeMott, *Corporate Officers as Agents*, 74 Wash. & Lee L. Rev. 847, 848 (2017).

[170] *See* Megan Wischmeier Shaner, *Officer Accountability*, 32 Ga. St. U. L. Rev. 357, 368–69 (2016).

[171] *See* Principles of Corporate Governance: Analysis and Recommendations §§ 4.01, 4.16 (Am. Law Inst. 1994).

[172] *See id.* § 4.01.

[173] *See id. See generally* D. Gordon Smith, *The Modern Business Judgment Rule*, *in* Research Handbook on Mergers and Acquisitions 83 (Claire A. Hill & Steven Davidoff Solomon eds., 2016) (describing the role of the business judgment rule as presumption, standard of care, abstention doctrine, and substantive rule of law).

[174] *See* Guth v. Loft Inc., 5 A.2d 503, 510 (Del. Ch. 1939) (stating that the duty requires an undivided and unselfish loyalty to the corporation).

[175] *See* Kelli A. Alces, *Larry Ribstein's Fiduciary Duties*, 2014 U. Ill. L. Rev. 1765, 1772–74 (2014) (describing the duty of loyalty).

[176] *See* Del. Code Ann. tit. 8, § 102(b)(7) (2017) (prohibiting corporations from eliminating personal liability for breaches of the duty of loyalty).

ever, the justification for fiduciary duties has been grounded in efficiency rationales.[177] The idea is that it would be infeasible to specify in perfect detail the optimal relationship between shareholders and corporate management. Whether or not one adopts the view that corporate charters and bylaws are best analogized to contracts between shareholders and directors, they are not *complete* contracts.[178] It is not possible for the "parties" to foresee every event in their ongoing relationship and to specify what the outcome should be, particularly given that both shareholders and managers come and go over time. Even if it were possible, the transaction costs of doing so would vastly outweigh the benefits.

Thus, either corporate organizational documents are incomplete contracts or they are not contracts at all,[179] because they leave open material questions regarding the relationship between shareholders and management. As with other ongoing commercial relationships involving uncertainty (such as long-term supply contracts), there are ways to mitigate this problem. For example, the documents can include standards, rather than bright-line rules, as gap-fillers to be interpreted and enforced by the courts ex post.[180] In substance, this is the approach taken by corporate law in imposing fiduciary duties on management for the benefit of the corporation. Such duties amount to broadly-worded standards of conduct for management, the precise application of which will be determined by the courts.[181] Thus, while the "duty of loyalty" may have the ring of lofty ideals far removed from the hard-nosed reality of modern businesses, it is offered as a practical legal solution to a pernicious problem in corporate governance that at least arguably maximizes economic efficiency.

How so? The ideal case is as follows. If investors know that management fiduciary duties are a mandatory term in the corporate "contract," they can invest their money in the firm with considerably less fear of losing their investment due to bad behavior by management. This safety net will thereby encourage capital-raising and its efficient allocation. Further, investors can expend significantly fewer resources on conducting due diligence on management ex ante and monitoring management's behavior ex post, both of which are necessary preconditions to massive capital-raising from dispersed,

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[177] *See, e.g.*, Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 Yale L. & Pol'y. Rev. 265, 329 (1998).

[178] *See* Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 Econometrica 755, 755–56 (1988).

[179] *See generally* Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 Geo. L.J. 583 (2016) (arguing that corporate charters and bylaws are not contractual).

[180] Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 Yale L.J. 814, 845 (2006).

[181] *See* E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 Bus. Law. 761, 763–64 (2008) ("The standards of conduct and liability already incorporate the necessary flexibility to balance the potentially competing duties of constituency directors with protection of the interests of the corporate entity or other corporate constituencies under most circumstances.").

passive investors. Thus, the argument goes, fiduciary duties dramatically lessen the transaction costs of raising capital.[182] Finally, they facilitate the locking-in of capital contributed to the business: investors can commit their funds to the corporation indefinitely, secure in the knowledge that even as individual directors and officers come and go over time, they will always be bound to serve shareholder interests rather than their own private interests.[183] Were this not the case, investors might only trust managers with whom they were familiar and had previously vetted, rather than potentially entrusting their capital to several different cohorts of managers as yet unknown to them.

B. Curbing or Eliminating Fiduciary Duties

Through an early analogy of the corporation to a trust, the law has imposed fiduciary duties in corporate management ever since the modern corporation arose.[184] Increasingly, however, state corporate law has proved willing to allow business entities, including now the corporation, to waive their managers' fiduciary duties to varying degrees. The push began with the duty of care. In *Smith v. Van Gorkom*,[185] a famous Delaware takeover case, the directors of a major corporation were held personally liable for breaching their duty of care to the corporation because they approved a takeover bid based only on a cursory presentation from the potentially self-interested chief executive officer.[186] In response, the Delaware legislature revised its corporate statute so as to permit directors to be fully exculpated from the duty of care through a provision in the corporate charter.[187] Ever since, it has become the standard practice for public corporations to waive directors' duty of care in this manner.[188] The change in law does not appear to have had a material effect on management behavior, however, perhaps in part due to the fact that corporations were already permitted to indemnify directors for most breaches of this duty and to purchase insurance policies against director and officer liability.[189]

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[182] *See* Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1550–51 (1989) (noting that the inclusion of fiduciary duties as a term in corporate law reduces transaction costs).

[183] Steven A. Bank, *A Capital Lock-in Theory of the Corporate Income Tax,* 94 GEO. L.J. 889, 905–10 (2006); *see* Hansmann & Kraakman, *supra* note 3, at 392–93, 433–34 (describing how the doctrinal fiction of the corporation as a separate legal entity serves to facilitate capital lock-in).

[184] *See* J. Travis Laster & Michelle D. Morris, *Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act*, 11 DEL. L. REV. 71, 85–86 (2010).

[185] 488 A.2d 858 (Del. 1985).

[186] *Id.* at 893–94.

[187] *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2017).

[188] Tamar Frankel, *What Default Rules Teach Us About Corporations: What Understanding Corporations Teaches Us About Default Rules*, 33 FLA. ST. U. L. REV. 697, 697 (2006).

[189] *See* DEL. CODE ANN. tit. 8, § 145 (2017).

The drive to pare back fiduciary duties did not end there, however. Most notoriously, states such as Nevada permit corporations to eliminate virtually all of managers' fiduciary duties to the corporation—that is, not only the duty of care, but also the duty of loyalty.[190] Nevada subsequently took this approach one step further, by setting this option—that is, the waiver of all fiduciary duties—as the default for Nevada corporations.[191] Thus, unless Nevada corporations draft their charters so as to affirmatively impose fiduciary duties, all such duties are automatically eliminated by operation of state corporate law. In keeping with the wealth of studies in behavioral economics suggesting that setting default options has a material impact on final outcomes,[192] this change in Nevada's default alone resulted in a major increase in the share of Nevada corporations in which fiduciary duties were eliminated entirely.[193]

Based on legislative history, the impetus for eliminating all fiduciary duties is two-fold. The first is a desire to reduce the amount of shareholder litigation affecting public companies, on the view that it amounts to a tax on business with little or no offsetting benefits. The second (and related) goal is simply to grant entrepreneurs and managers more autonomy. As discussed below, however, while individual managers and founders may well wish to avoid the albatross of fiduciary duties, shareholders collectively may be worse off when fiduciary duties are eliminated entirely, as discussed in the next section.

C. *The Effects of Eliminating Fiduciary Duties*

As a group, corporate law scholars are generally highly supportive of private ordering. However, they display more unease over Nevada's steps to eliminate all mandatory fiduciary duties than over prior steps to liberalize management fiduciary duties, such as by allowing exculpation of the duty of care or allowing targeted waivers of the corporate opportunity doctrine. What is proving particularly troubling to scholars about this development? The near-total elimination of fiduciary duties in Nevada corporate law recalls many of the characteristics of the *Hobby Lobby* decision: it alters the traditional corporate form; it expands individual autonomy (in this case, for entrepreneurs and managers, rather than shareholders); its economic effects are highly uncertain; and, it is likely to lead to an increase in regulatory complexity or involvement.

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[190] For a detailed description of the relevant Nevada statutory provisions and their history, see Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935 (2012).

[191] *See id.* at 951–52.

[192] *See, e.g.*, James J. Choi et al., *For Better or Worse: Default Effects and 401(k) Savings Behavior, in* PERSPECTIVES ON THE ECONOMICS OF AGING 81–126 (David A. Wise ed., 2007).

[193] *See* Barzuza, *supra* note 190, at 953.

As an initial matter, there are many reasons why even shareholders might not wish for an expansive duty of care. Subjecting directors to the risk of personal liability for negligent decision-making comes with associated costs. For example, directors will be more risk-averse than is warranted to maximize shareholder value; qualified candidates will be discouraged from becoming directors or will require substantial additional compensation or insurance; and the potential for judicial error in enforcement is high, given that courts are poorly equipped to judge the merits of business decisions and are subject to hindsight bias.[194] Moreover, the courts' longstanding application of the business judgment rule already dramatically diminishes the duty of care as a check on board action.

The case for the duty of loyalty in the corporate context is considerably stronger than for the duty of care, however. If managers are not acting with the corporation's interests in mind, what is their conceivable purpose or role? It is worth noting that *all* corporate employees are subject to a duty of loyalty—directors are hardly being singled out for heightened standards of conduct. One response is to argue that the burden of shareholder litigation over fiduciary duties outweighs any advantage to imposing fiduciary duties on directors. There is a widespread sense that a non-negligible proportion of shareholder litigation is meritless, and evidence is mixed as to whether shareholder litigation is an effective means of disciplining management.[195] Yet in contrast to claims of breach of the duty of care, the potential for error in duty of loyalty cases is much lower, because courts need not weigh the merits of business decisions.[196] Rather, they are simply asked to determine whether the board was disloyal, such as by succumbing to a serious conflict of interest—a task far better suited to judges' institutional competence.[197]

Notwithstanding, there are situations in which an unmitigated and ill-defined duty of loyalty need not be optimal for investors. The most common example is that of the corporate opportunity doctrine discussed above.[198] Typically, the duty of loyalty would require directors to refrain from usurping business opportunities that could plausibly have been pursued by the corporation and generally to avoid competing with the corporation.[199] Nonetheless, there are discrete situations in which it would be at least arguably

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[194] *See*, *e.g.*, Julian Velasco, *A Defense of the Corporate Law Duty of Care,* 40 J. Corp. L. 647, 659–66 (2015) (discussing potential undesirable consequences of the duty of care); Gagliardi v. Trifoods Int'l, Inc., 683 A.2d 1049 (Del. Ch. 1996).

[195] *See* James D. Cox & Randall S. Thomas, Addressing Agency Costs through Private Litigation in the U.S: Tensions, Disappointments, and Substitutes (September 2, 2015) (unpublished manuscript) (on file with the Duke Law Scholarship Repository).

[196] *See, e.g.*, Rock & Wachter, *supra* note 56, at 1662.

[197] *See, e.g.*, *id.* (noting that the duty of loyalty has been narrowly defined in order to reduce the "potential for error").

[198] *See* Gabriel Rauterberg & Eric Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 Colum. L. Rev. 1075 (2017) (finding that more than one thousand U.S. public companies have adopted corporate opportunity waivers, and offering an efficiency rationale for such waivers).

[199] *See* Guth v. Loft, 5 A.2d 503, 510–11 (Del. 1939).

advantageous for shareholders to waive this duty.[200] Imagine, for example, uniquely skilled entrepreneurs, each involved in their own existing businesses, who decide that they would like to collaborate on a project. Potential investors in the new project may well decide that they are willing to allow the entrepreneurs to continue their existing businesses, and even to pursue new business opportunities in the same industry, so long as they devote a certain level of time and attention to the project being considered. Similarly, in the investment management context, investment principals of private investment funds may wish to form new funds with the same investment strategy as one or more of their existing funds. If they have a successful enough track record, investors may decide that being given the opportunity to invest with these managers is valuable enough that they will grant managers the right to form such successor funds.

Yet the situations described above, in which a waiver of the prohibition on usurping corporate opportunities may be warranted, all involve discrete fact patterns that are foreseen up front, are acknowledged as part of the business deal between managers and investors, and can be expressly contracted for. Current law in key jurisdictions already permits precisely this type of waiver.[201] Such tailored waivers, obtained with informed, express shareholder pre-approval, are a far cry from a blanket elimination of the entire duty of loyalty. The latter exculpates conduct that need not be foreseen or even foreseeable by shareholders, including a host of self-dealing transactions that could only harm shareholder interests. Further, given the dramatic effect that simply reversing the default option had on the number of Nevada corporations waiving all fiduciary duties, one cannot reasonably claim that all such waivers were specifically negotiated with shareholders and received their express blessing. Rather, the implication is that the shareholders of most such corporations likely had no inkling of the issue whatsoever.

To be sure, many unincorporated entities such as limited liability companies and limited partnerships also permit such broad waivers of fiduciary duties.[202] Whether or not this is advisable as a public policy matter, there are relevant distinctions between corporations and alternative entities that must be considered. In contrast to corporations, alternative entities typically require considerable affirmative contracting to set up because the default terms will often be totally unsuitable to the proposed business arrangement. In contrast to corporate charters and by-laws, which tend to be short and almost entirely standardized, limited liability company agreements or limited partnership agreements may be extraordinarily complex, lengthy documents.[203]

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[200] H. Justin Pace, *Contracting Out of Fiduciary Duties in LLCs: Delaware Will Lead, but Will Anyone Follow?* 16 Nev. L.J. 1085, 1090 (2016) (discussing potential beneficial reasons for waiving the duty of loyalty).

[201] *See, e.g.*, Del. Code Ann. tit. 8, § 122(17) (2017).

[202] For a summary of state-law developments in this direction, see Pace, *supra* note 200.

[203] *See, e.g.*, Susan Kalinka, *Dissociation of a Member from a Louisiana Limited Liability Company: The Need for Reform*, 66 La. L. Rev. 365, 371–72 (2006) (noting that most operat-

Alternative entities thus put the investor on notice that their terms are non-uniform and may be bargained-for, and that there is little judicial, equitable backstop to the relationship.[204] With corporations, by contrast, the primary purpose of the form is to obviate investors' need to inquire into the precise terms of the arrangement.

Thus, while there is an efficiency justification for eliminating fiduciary duties (namely, the desire to decrease shareholder litigation), there are also considerable efficiency justifications for retaining at least the core of the duty of loyalty.[205] Given how recently these changes in state law have been implemented, there is limited empirical evidence on the question, and the available results are mixed. On the one hand, there is evidence that smaller, lower-quality corporations may be self-selecting into Nevada as a result of its heavily management-friendly corporate law.[206] On the other hand, there is also evidence that such firms' value may actually *increase* under a regime without fiduciary duties.[207] The suggestion is that the costs of fiduciary duties may outweigh the benefits for certain small, insider-dominated firms.[208] If that is so, then there is at least the possibility of a relatively efficient outcome overall. Firms that benefit from fiduciary duties may remain in jurisdictions that impose them, while firms that do not benefit from fiduciary duties can incorporate in jurisdictions such as Nevada that eliminate them, which would result in the optimal outcome for shareholders collectively.

Yet there are reasons to believe that such a regime would not provide a stable equilibrium in the long run. First, and most importantly, there is no assurance that the trend of waiving or eliminating fiduciary duties will remain confined to smaller entities. Managers (and the law firms that represent them) have a strong incentive to reduce their potential for personal liability (and the distraction of shareholder litigation) regardless of the effect on firm value, and so may be inclined to eliminate fiduciary duties if given the choice. Similarly to what occurred with waivers of the duty of care, it seems almost inevitable that if Delaware were to permit corporations to waive the duty of loyalty, management would take up the offer. Thus, over time the standard practice may be for even the largest firms to eliminate all of management's fiduciary duties, whether or not it is value-maximizing for shareholders.

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ing agreements are lengthy and complicated and that some individuals avoid entering into such agreements due to the agreements' complexity).

[204] *See* Ribstein, *supra* note 51, at 230 (noting that investors may distrust new forms due to uncertainties regarding the protections afforded by such forms).

[205] *See, e.g.*, Reza Dibadj, *The Misguided Transformation of Loyalty into Contract*, 41 TULSA L. REV. 451, 474–76 (2006) (discussing the negative implications of allowing parties to eliminate the duty of loyalty through contractual waivers).

[206] *See* Michal Barzuza & David C. Smith, *What Happens in Nevada? Self-Selecting into Lax Law*, 27 REV. FIN. STUD. 3593, 3594 (2014).

[207] *See* Ofer Eldar, Can Lax Corporate Law Increase Shareholder Value? Evidence from Nevada (August 9, 2017) (unpublished manuscript) (on file with author).

[208] *Id.*

Second, for small enterprises, as we have seen, there are valid alternative forms of organization that would accomplish precisely the same purpose. The parties could form a limited liability company, for example, as many states permit the elimination of fiduciary duties in such entities.[209] And if the investors in these businesses prefer the corporate model of having a board of directors, limited liability statutes permit them to precisely replicate the corporate governance structure by contract in the operating agreement.[210]

The push to eliminate corporate management's fiduciary duties entirely is a push to alter the existing corporate form, even though alternative forms exist to achieve this purpose. The corporation's clearest advantage and crowning achievement is the facilitation of large-scale, private economic activity. Thus, although they represent a relatively small share of the overall population of corporations, large corporations do and should hold disproportionate sway on corporate law and corporate governance.[211] Modifying the corporate form to satisfy the desires of a small segment of corporate activity—when the same end is already available by other means—makes for bad corporate law.

A different case could be made if fiduciary duties were demonstrably value-decreasing for large corporations. Fiduciary duties are mixed blessings, even for large corporations. Large, public companies are plagued with lawsuits, and even the staunchest defenders of shareholder rights would be hard pressed to suggest that there is currently a strong connection between shareholder suits and the merits.[212] At a minimum, such suits are a distraction for management, and they likely alter some executives' preferences for taking jobs at public companies versus private ones.[213] Further, such suits may prompt founders to keep their firms private. Yet as we have seen, there are significant efficiency gains from subjecting managers to fiduciary duties, as this allows shareholders to remain entirely passive with respect to their investment in the corporation, which after all is the condition precedent to capital-raising from the general public.[214] At the very least, it remains uncertain whether the benefits of reducing shareholder litigation over fiduciary duties would offset the efficiency losses in drafting corporate charters. This is simply an empirical question, and it is unlikely to be resolved in the near future. In the meantime, the scholarly criticism of Nevada's corporate statute

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[209] *See* Bebchuk & Fried, *supra* note 168; Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded LPs and LLCs*, 37 J. Corp. L. 555, 561–62 (2012).

[210] *See, e.g.*, Del. Code Ann. tit. 6 § 18-402 (2017).

[211] *See* Hansmann & Kraakman, *supra* note 9, at 454–56.

[212] *See* Cox & Thomas, *supra* note 195.

[213] *See* Reinier Kraakman, Hyun Park & Steven Shavell, *When are Shareholder Suits in Shareholder Interests?*, 82 Geo. L.J. 1733, 1738 (1994) (noting that derivative suits increase the expenses incurred by corporations in attracting top management candidates).

[214] *See* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. Corp. L. 239, 262 (2009) ("According to agency cost theories, the purpose of fiduciary duties is to preserve the efficiency gained by delegating powers to someone more qualified."); Easterbrook & Fischel, *supra* note 103.

suggests that even among contractarians, there are limits to what private ordering is viewed as efficient or as to what is recognized as a truly bargained-for outcome in the first place.

Finally, it is not necessarily clear that eliminating fiduciary duties in large, public corporations would materially decrease shareholder litigation or overall regulatory intervention in corporate affairs.[215] What precisely does it mean for a director to have no duty of loyalty whatsoever to shareholders or to the corporation? Taken literally, it would suggest that directors could simply gamble away the corporation's money, or use corporate property to advance the director's private business interests. Absent a duty of loyalty, charlatans could abuse the corporate form, thereby increasing the number of disputes between shareholders and managers, whether they gave rise to justiciable claims or not. It is doubtful that courts or legislatures would simply stand by and permit such behavior on a large scale, particularly where unsophisticated parties were involved. Thus, while the law may nominally permit waivers of the duty of loyalty, in the end, the courts are likely to intervene through other doctrines[216] or to develop new doctrine to plug the gaping holes in the dyke.[217] Not only would this have the paradoxical effect of increasing regulatory intervention, it would create substantial legal uncertainty in the interim, which, as we are so often told, is bad for business.

Conclusion

At a time when business organizational law largely defers to private ordering, one might reasonably ask whether it is still possible to ascribe any substance to "the corporation" as a legal form, or whether there is any justification for maintaining distinct business entity types at all. The negative reactions to certain recent developments in corporate law suggest that most corporate law scholars would answer both questions in the affirmative. There is indeed such a thing as the corporate form, and it has content beyond what any or even all interested parties may provide. Today, the for-profit corporation is best understood as a governance model with a particular goal, which is to facilitate large-scale economic activity.

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[215] *See* Dibadj, *supra* note 205, at 476 ("In corporate law, the unintended consequence of relaxing fiduciary duties has been to impose increasingly burdensome layers of mandatory regulation to stem malfeasance . . . .").

[216] Eliminating the duty of loyalty would likely result in the courts giving greater substantive content to directors' and officers' duty of good faith, particularly given the lingering uncertainty over whether such a duty exists independently of the duty of loyalty. *See, e.g.*, Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (holding that the duty to act in good faith "does not establish an independent fiduciary duty that stands on the same footing as the duty of care and loyalty").

[217] *See* John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 Colum. L. Rev. 1618, 1620 (noting that while the U.S. permits greater contractual freedom in corporate law than other common law jurisdictions, this approach is necessarily coupled with "greater judicial activism in reading implied terms into the corporate contract and in monitoring for opportunism").

As a device for efficient capital-raising and profit-seeking activity, the corporate form necessarily promotes collective action: it organizes or constrains individual action and voice so as to yield better outcomes for the group. Given this premise, increasing individual autonomy or rights ex post by altering the corporate form can eventually prove counter-productive. What little autonomy gains are to be had in this context may come at the cost of inefficiency, greater regulatory complexity or involvement, doctrinal uncertainty, and the loss of an identifiable, rational regulatory design.

Corporate law cannot be everything to everyone. While individuals may chafe at various prohibitions, isolated cases need not detract from the merits of an efficient regulatory design. If for-profit corporations are a net social benefit, then we have reason to preserve the elements of the form and defend its boundaries, rather than bend it to accommodate individual preferences ex post. Whether corporate law has gone too far—or not far enough—in deferring to private ordering is ultimately an empirical question. Time will tell. Yet the debate over corporate religious rights and the elimination of fiduciary duties confirms an important, unifying view in the field: that efficiency is the primary lens through which such questions should be addressed, and that the primary role of corporate law is to ensure the efficient conduct of economic activity, whether through regulation or private ordering.

APPENDIX

TABLE 1. MANDATORY AND STICKY-DEFAULT TERMS SUPPLIED BY DELAWARE CORPORATE LAW.[218]

Mandatory terms	• Directors and officers subject to duty of loyalty, the duty to act in good faith, the duty not to engage in intentional misconduct or a knowing violation of law; [§ 102(b)(7)] • Directors may not declare dividends in excess of minimum required capital [§ 173] • Directors personally liable for impermissible dividends [§ 174] • Stockholders have (non-exclusive) right to amend bylaws [§ 109(a)] • Stockholders have the power to remove directors [§ 141(k)] • Directors must be natural persons [§ 141(b)] • Directors elected by the stockholders [§ 216(3)] • Corporation must reimburse directors, officers, employees, and agents of the corporation for legal proceedings if the person acted in good faith and without reasonable cause to believe that conduct was unlawful [§ 145(c)] • Directors permitted to issue additional shares up to the amount authorized in the certificate of incorporation [§ 161] • Corporation must hold annual meeting of stockholders [§ 203(b)]
"Sticky" default terms	• Board of directors has exclusive authority to manage the corporation [§ 141(a)] • Shareholders not personally liable for liabilities of the corporation [§ 282(c)] • One share, one vote [§ 212(a)] • Perpetual existence [§ 102(b)(5)] • Board acts by majority vote [§ 141(b)] • Distributions to shareholders within the same class on a pro rata basis [§ 151(a)] • Board of directors has exclusive authority and discretion to declare dividends [§ 170] • Remaining directors have sole authority to fill vacancies on the board [§ 223]

[218] All section references in the table are to the corresponding sections of the Delaware General Corporation Law, DEL. CODE ANN. tit. 8.