Fallacies of Corporate Analysis

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The Purpose of Corporations

Corporations today are the subject of much focus, analysis, and criticism. Throughout the twentieth century, there was a debate about “the purpose” or “the goal” of a corporation, a debate that continues unabated today. Should the goal be maximizing shareholder value or should the goal be some wider notion of social concerns? Should a corporation just serve the shareholders or a broader set of stakeholders, e.g., employees, customers, and suppliers? In January of 2010, a now legendary Supreme Court case called Citizens United added to the controversy. Decided by a 5–4 vote, the reasoning among the justices and subsequently of critics and supporters alike ushered in a new debate that is in need of clarification.

I will argue that on these and other questions about corporations and the underlying rights of capital, there are numerous fallacies and sins of both omission and commission. The Citizens United case is a good starting point.

Citizens United and Corporate Personhood

Was Corporate Personhood the Basis for Citizens United?

The Citizens United case was *not* decided on the basis the corporation being a legal person and thus as a person qualified for First Amendment rights of free speech. Justice Stevens’ dissenting opinion noted that the majority opinion was based not on corporate personhood but on the rights of associational speech. In theory, a corporation is an association of people, the members,[1] and thus the members, like in a trade union or NGO, may exercise their First Amendment rights through their association. His dissent was based more on the fancifulness of viewing corporate political speech as being in any sense the associational speech of the shareholders.

> It is an interesting question “who” is even speaking when a business corporation places an advertisement that endorses or attacks a particular candidate. Presumably it is not the customers or employees, who typically have no say in such matters. It cannot realistically be said to be the shareholders, who tend to

> be far removed from the day-to-day decisions of the firm and whose political preferences may be opaque to management. Perhaps the officers or directors of the corporation have the best claim to be the ones speaking, except their fiduciary duties generally prohibit them from using corporate funds for personal ends. Some individuals associated with the corporation must make the decision to place the ad, but the idea that these individuals are thereby fostering their self-expression or cultivating their critical faculties is fanciful. It is entirely possible that the corporation's electoral message will *conflict* with their personal convictions. Take away the ability to use general treasury funds for some of those ads, and no one's autonomy, dignity, or political equality has been impinged upon in the least. (Stevens 2010)

It is interesting to place these arguments alongside the arguments over corporate social projects and charitable donations in the name of corporate social responsibility. Here the liberal view has generally been supportive of corporate charity-giving while the conservatives, like Milton Friedman (1970), have been adamant that the business of corporations is to make a profit, not to choose which charities to support. Conservatives argue that since the shareholders would disagree on specific charitable uses, the money otherwise given to charities should be distributed to the shareholders who can then choose which charities, if any, to support. Those same conservatives will now probably support the other side of the argument allowing corporations to make political donations (but not charity donations), even though the shareholders would also have quite different ideas about which issues and candidates to support and thus might well prefer to have any such funds distributed to them to make individual decisions.

Is Corporate Personhood Based on an 1886 Supreme Court Decision?

Associated with the misconception that Citizens United was based on corporate personhood is that idea that such personhood was the result of a court reporter's head note on the 1886 Supreme Court case of *Santa Clara County v. Southern Pacific Railroad Company*[2] asserting that corporations in addition to natural persons fell under the equal protection rights of the Fourteenth Amendment. In fact, corporations and their characterization as legal or fictitious persons dates back to Roman and medieval law.

> Legally a corporation (*universitas*) was conceived of as a group that possessed a juridical personality distinct from that of its particular members. A debt owed by a corporation was not owed by the members as individuals; an expression of the will of a corporation did not require the assent of each separate member but only of a majority. A corporation did not have to die; it remained the same legal entity even though the persons of the members changed. In a famous phrase of the thirteenth-century canonists a corporation was described as a 'fictitious person'. Such a concept, it proved, could be used to define many types of ecclesial and political community. (Tierney 1982, 19)

Is ‘Shareholder Democracy’ the Answer?

In response to Justice Stevens’ question of “who” does a business corporation represent, one might suppose, for the sake of argument, that a corporation was a ‘shareholder democracy’ (e.g., in small or medium-sized private company) instead of a managerialist oligarchy. Would it then be like a democratic trade union? This raises the deeper question of who are the people governed in a conventional corporation so that the notion of democracy-as-self-government could be applied. In the course of its business activities, the management of a corporation does not exercise managerial authority over the shareholders (qua shareholders), only over the property of the shareholders, and democracy is a system for governing people, not property. The only people over whom management exercises authority (within the scope of the business activities) are the employees of the corporation.

> Yet in fact there is democracy in the typical investor-owned firm; it is just that the investors of capital do the voting rather than the workers. Converting to worker ownership means not only enfranchising the workers but also disenfranchising the firm’s investors while continuing to deny the franchise to the firm’s consumers. (Hansmann 1996, 43)

In a similar vein, one might say that the American Revolution enfranchised the Americans but also disenfranchised the English while continuing to deny the franchise to the French to elect the government of the Americans.

Thus, the reference to shareholders actually exercising control over the managers and workers as “shareholder democracy” is not even valid in theory.

> The analogy between state and corporation has been congenial to American lawmakers, legislative and judicial. The shareholders were the electorate, the directors the legislature, enacting general policies and committing them to the officers for execution. … Shareholder democracy, so-called, is misconceived because the shareholders are not the governed of the corporation whose consent must be sought. (Chayes 1966, 39–40)

The concept of “shareholder democracy” is analogous to the people of Russia going through the motions of running multi-party ‘democratic’ elections of the government of Poland. And if a corporation was run as a democratic firm (i.e., self-government by those who are governed) as in a Mondragon worker cooperative,[3] then viewing a political opinion expressed by the cooperative as associational speech would not at all be “fanciful” (to use Justice Stevens phrase).

Is Abolishing Corporate Personhood the Answer?

The Citizens United decision and the difficulties in holding managers legally responsible for corporate crimes has led some to call for abolishing corporate personhood, e.g., the book by Tombs and Whyte (2015) entitled: *The Corporate Criminal: Why Corporations Must Be Abolished*.

It should first be noted that the whole use of the *personhood* language is actually not necessary to describe the legal characteristics of a corporation. The essential point is that the corporation is a *separate legal party* from the members as individuals. This also highlights the fallacy in referring to individual income taxes on after-corporate-tax dividends as "double taxation." Such so-called "double taxation" is only the flipside of "limited liability." The liabilities as well as the income (which is taxed) of the corporation are separate from the liabilities and income of the individual members of the corporation. Two separate legal parties implies two separate liabilities and two separate income taxations, one for each legal party. Moreover, the term "limited" liability is misleading since a corporation is fully liable for its debts to the full extent of its assets, and the shareholders as individuals have no liability for corporate debts.

In fact, contrary to complaints from the left, the corporation is an important social invention that allows non-rich people to join together and make an investment in a risky venture without jeopardizing their personal assets. Associations of citizens (i.e., nonprofit corporations) allow non-rich people to have an amplified political voice that they would not have individually. Although the call for abolishing corporate personhood is often made by people sympathetic to progressive values, it would have the opposite effect of restricting investments of any size to rich people. Similarly, it is hard to imagine any change more politically favorable to the rich 1% than restricting the exercise of political voice to natural persons. Such a change would rule out associational speech by trade unions, NGOs, and other civic associations, all of which are not natural persons. Then John Q. Public and Charles Koch would each have the right to as much political voice as they could individually afford. The road to saving political democracy is not to abolish corporate personhood and associational speech but to completely regulate the role of money in elections and in Congress, e.g., Lessig (2011, 2019).

Stakeholder Theory and the Affected Interests Principle

Is Maximizing Shareholder Value Legally Mandated?

Much of the discourse about corporations seems to assume that there is some sort of a legal mandate for corporate directors to maximize shareholder value. Some states have created a special “benefit corporation” or “B Corp” where other corporate goals are explicitly allowed. But that strategy involves a number of difficulties.

> First, there are no legal consequences for a B Corp if it fails to provide public benefits. Its charter merely gives it license to do so. Second, the B Corp is solving an imaginary problem, because there is no requirement to maximize shareholder payouts even for a conventional corporation, or “C Corp.” There is nothing that the benefit corporation legally allows that is not already allowed to conventional corporations. (Ciepley 2019)

Ciepley further points out the third problem that the creation of B-corps seems to confirm the invalid assumption that C-corps are mandated to maximize solely shareholder value; otherwise B-corps would not be necessary.

The unified company law of Great Britain is quite explicit in allowing broader goals. For instance, the 2006 Companies Act, section 172(1) reads:

> ‘(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
>
> the likely consequences of any decision in the long term,
>
> the interests of the company’s employees,
>
> the need to foster the company’s business relationships with suppliers, customers and others,
>
> the impact of the company’s operations on the community and the environment,
>
> the desirability of the company maintaining a reputation for high standards of business conduct, and
>
> the need to act fairly as between members of the company.’ (quoted in: Hannigan 2012, 183–184)

This reinforces Ciepley’s point that there is no legal requirement to maximize shareholder value in the Anglo-American or Anglo-Saxon (Dore 2000) conception of the corporation.

Distinguishing Positive and Negative Control Rights

There is an old maxim in Roman law: “What touches all is to be approved by all” (Tierney 1982, 21). Today this idea is often formulated as the “Principle of Affected Interests… Everyone who is affected by the decisions of a government should have the right to participate in that government.” (Dahl 1970, 64) and is often used to support a stakeholder theory of corporate governance. The valid component of this principle is that people should have the right and the means to protect their legitimate interests. But the usual use of the principle suffers from a sin of omission—the failure to differentiate between two very different ways to protect one's affected interests.

There is the (1) *negative* or *decision-constraining control right* to constrain the decision of another party that will affect one's interests. In a market economy, this usually takes the form of the decision to not buy a product or not supply a service. Conventional economics criticizes a monopoly seller or a monopsony buyer as leading to inefficiency, but there is the additional problem that it effectively neutralizes the buyer's or seller's negative control rights. Moreover, negative externalities (e.g., pollution) also adversely affect one's interests outside of a market relationship so there needs to be other means to protect those interests.

There is the (2) *positive* or *decision-making control right* to participate in the decision of another party to protect one's interests. This is the form of the Affected Interests Principle that is usually evoked to argue for all stakeholders (i.e., all whose interests are affected) to somehow participate in a corporation's decision making. This application of the principle is plagued by both practical and theoretical difficulties.

The practical problem is the lack of any plausible form of representation of all whose interests are affected. For instance, when a cell phone manufacturer makes design or pricing changes, that affects all users throughout the world using those phones, but there hardly seems to be any way for the consumers to elect representatives to "protect their interests." Their best protection is provided by competition in the marketplace, i.e., by their negative control rights. Hence the representational notion of stakeholder control is usually set aside in favor of a fiduciary notion—which suffers from a similar problem of the accountability of the fiduciaries to their beneficiaries as well as the legitimacy of those beneficiaries having decision-making rights in the first place.

In economics, the decisions facing a consumer are modeled as a choice among all the commodity bundles that fall within the consumer's budget constraint. When a seller raises the price of a commodity, that will move the budget constraint and affect the consumer if that commodity was being purchased from the seller. But that leaves an infinity of other choices open to the consumer and hardly constitutes an argument that the consumer should 'participate' in the seller's decision other than stopping the purchase from that seller.

Even in theory, there is the 'law of one majority' in majoritarian decision-making. When several opposing interests are depending on their voting power in some representative decision-making body (e.g., the board of a corporation), then each opposing interest group can't have a majority. Hence a minority interest group may get consistently outvoted so their representation would be ineffective to protect their interests. Their real protection is, again, their negative control rights. Of course, a seat or at least an informational window on the board of a corporation may provide the information to more effectively utilize an interest group's negative control rights—but that should not be considered as a valid argument for exercising the positive decision-making rights in a corporation.

The fundamental flaw in stakeholder theory or the affected interests principle is that it considers some hypothetical positive control rights as the solution to the very real problem of negative control rights that are *ineffective* due to monopoly/monopsony power, negative externalities, lack of information about corporate plans, and government regulations that are inadequate or poorly enforced. Rather than asserting ineffective claims for asserting positive stakeholder governance rights, energy should be redirected toward campaigning for stronger anti-trust, environmental, and corporate transparency measures.

The Corporate Governance Debate

At least since the classic book by Berle and Means (1932) documenting the "separation of ownership and control" in sizable publicly traded companies, there has been an active debate about the legitimacy of effectively unconstrained managerial power. Many see the solution in somehow having "shareholder democracy" but we have already noted that this is a misappropriation of the notion of "democracy" since the shareholders are not the *people* governed or managed by the corporate management. Even if there is a small group of large institutional shareholders (e.g., mutual investment funds or private equity firms), there is no argument that the managers of those large institutions have any more legitimacy than the managers of the corporation itself. The ultimate natural-person shareholders rely on the "Wall Street Rule" to protect their interests, i.e., on exercising their *negative* control rights by selling the shares of a company or those of an intermediary institution—all of which still leaves open the question of who should have the positive decision-making control rights in corporations.

The notion that the shareholders are the owners, members, and residual claimants in a corporation did not originate in Milton Friedman's newspaper polemic (1970) or in the neoliberalism of the Chicago School of Economics. Indeed, it was the reason why Berle and Means findings on the separation of ownership and control were considered problematic.

On the management side of the managerial versus shareholder capitalism debate, one idea was that management should be treated as a profession (like being a doctor or lawyer), e.g., Berle (1959). In the large publicly traded corporations, the managerialist thesis was that managers are the custodians of essentially 'social' resources and should be bound by a professional code of ethics and by their fiduciary duty to respect the 'social' interests of all stakeholders. The perspective of managers as managing or governing *people* inside firms was ignored in favor of formulating the problem as one of *asset* management in the interests of 'society' as a whole. This idea differed from 'democratic socialism' only in that the managers were not the employees of a politically democratic government but were independent professionals bound by their own 'Hippocratic Oath' to further 'social' interests. But the managerialist conception did not include any actual accountability mechanisms or positive control rights on the part of 'society.' By being accountable to everyone, the reality would be that management, as a private sector version of the *nomenklatura*, would be accountable to no one but themselves.

The corporate governance debate between the managerialist and shareholder conceptions of capitalism came to some sort of turning point in the 1990s when managers found that they could sufficiently further their own interests through stock options (and stock buybacks) while all the time pledging or at least feigning fealty to the idea of shareholder primacy. And accordingly, some legal theorists unconscionably declared "the end of history" by the victory of shareholder primacy in the corporate governance debate, e.g., Hansmann and Kraakman (2000). Of course, the managers' true allegiance was shown in the ballooning top-to-bottom ratios (300+) in corporate compensation and in their willingness to use corporate investment funds for stock buybacks to ensure that their own stock options were in the money, e.g., Lazonick (2018).

Now it seems that many elite corporate managers are getting tired of acting as if they were the hired hands of the shareholders and the agents of shareholder primacy. They seek a more dignified role. The stakeholder theory provides them with an alternative cover story as they discover new 'social responsibilities' to the various interest groups—all without any hint of actual effective accountability mechanisms or source of legitimacy for that role, e.g., Business Roundtable (2019).

What About Cooperative Corporations?

The contemporary conception of a corporation (which has Roman and medieval roots) was a group of natural persons engaged in certain joint activities "that possessed a juridical personality distinct from that of its particular members." (Tierney 1982, 19) But the original idea of these joint corporate activities *carried out by the members* was completely corrupted by having those activities actually carried out by the employees of the corporation.

Many see the cooperative corporation as the revitalization of the idea of people joining together to carry out certain cooperative activities and to democratically govern those joint activities.

> A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise. (International Co-operative Alliance 2015, ii)

But this noble idea was quickly undercut by the similar use of employees to carry out the actual cooperative activities—with the exception of worker cooperatives where the work is carried out by the members.

Consider a consumer cooperative. What is the cooperative activity carried out by the members? It is not consumption; that would be a commune or kibbutz. The activity carried out by a consumer cooperative is the running of a distribution business for food and other consumer goods. But those activities are carried by the employees of the consumer cooperative—aside from the vestigial "work requirement" for members such as handing out cheese samples to customers for a few hours each month.[4] In an upscale consumer cooperative, many members were scandalized when it was discovered that some members were having their work requirement performed by their nannies or servants—seemingly without any recognition that all the members have the same relationship to the employees of the cooperative.

The corruption of the cooperative ideal is even more pronounced in the agricultural marketing and processing cooperatives (e.g., Land O'Lakes or Ocean Spray), sometimes called 'producer cooperatives,' where the members are the 'farmers' selling their raw products through the cooperative. The problem is not just that the 'farmers' may be agribusinesses running on hired labor but that the 'cooperative' activities in the huge processing facilities of the cooperative corporations are all carried out by employees.

Only in worker cooperatives are the actual activities of the corporation carried out by the members and the people governed by the management are the same members of the company.

Who Can Legitimately and Effectively Control Corporate Management?

We have seen that the stakeholder notion of affected interests as well as the call for "shareholder democracy" fail to address the theoretical and practical questions of: (1) who should legitimately control corporate management, and (2) who can do so effectively? The democratic answer to the first question is: "the people who are managed by the corporate management," and the answer to the second question is: "The only cohesive, workable, and effective constituency within view is the corporation's work force." (Flynn 1973, 106) In spite of Robert Dahl's mention of the affected interests principle (1970), when it came to later specifying the "alternative," he made no use of that principle or the stakeholders theory. He advocated instead "a system of economic enterprises collectively owned and democratically governed by all the people who work in them."[5] (Dahl 1985, 91)

But these answers are clearly beyond the pale of almost all 'responsible' legal, economic, and political thinkers, so the kabuki theater of the 'corporate governance debate' will continue.

What Are the Rights of Capital?

The Ownership of a Corporation

In the apparent attempt to weaken the claim of shareholder primacy, a number of legal and political thinkers have emphasized that the shareholders only own their shares, not the corporate assets, as their private property, e.g., Stout (2012), Ciepley (2013, 2019), or Robé (2011). The fact that the shareholders do not own the corporate assets as their personal property is only the other side of the balance sheet from the fact that the shareholders do not owe the corporate liabilities as their personal liabilities.

But the members of, say, any nonprofit incorporated association also do not own the association's assets as their private property. People play many different organizational roles. When the Secretary-Treasurer is authorized to buy the paper cups for the Annual Picnic of the local Birdwatcher's Society, that organizational role is easily and clearly differentiated for the same person buying paper cups for their family's picnic. Such distinctions go back to at least the Middle Ages.

> For civil and canon lawyers one distinction between a *universitas* and a mere crowd of individuals consisted precisely in the fact that the *universitas*, but not the individuals, could create a ruling official, having ordinary jurisdiction over the community. (Tierney 1982, 36)

The community in question consisted of the members of the corporation, and the jurisdiction was over their organizational roles as members, not over their private lives as individuals. The expenditure of the Society's funds on the paper cups would need to be authorized by the ruling officials of the organization, while the same person's private expenditure on paper cups requires no such authorization. It is true that the Secretary-Treasurer does not own the Society's funds as their private property, but that fact is quite irrelevant to the governance structure of the Society and its elected officials based on the members of the Society. In a similar manner, the point that the members of a conventional corporation, i.e., the common shareholders, do not own the corporate funds or other assets as their private property is quite irrelevant to governance structure of the company and its elected Board of Directors based on the members (i.e., shareholders) of the company.

It is also asserted that the particular legal aspects of a corporation (e.g., limited liability and separate juridical personality) are enabled or chartered by the government, and thus a corporation should have a 'social' function (e.g., stakeholder primacy) sanctioned by the government. It is certainly true that the legal aspects of a corporation are created by the government, but that is true of all legal rights (e.g., private property) and all legal institutions; they do not exist as part of the natural world. It is hardly an argument that all private legal institutions must bend to the government's will.

On Personal Rights and Property Rights

Perhaps a few words are necessary about membership and 'ownership.' People have many membership rights that are personal rights while other rights are property rights. For instance, one's voting rights in a city (or municipal corporation) are based on having the functional role of residing in the city, but those rights may not be bought or sold so they are personal rights, not property rights. In a cooperative corporation, the membership rights are based on the functional role of 'patronage' in the cooperative (e.g., working in a worker cooperative or shopping in a consumer cooperative). When membership rights are supposed to be based on having a certain functional or patronage role, then it makes no sense to treat them as alienable property rights. A 'buyer' may not have the functional role, and if the person had the functional role, there would be no need to 'buy' the rights.

It is easy to distinguish personal from property rights in terms of inheritability (or 'bequeathability'). When a person dies, personal rights like one's vote in municipal elections are extinguished while property rights like the votes of one's corporate shares are passed on to one's estate and heirs. When membership rights, as in a conventional corporation, may be inherited or in general, may be bought and sold, then they are property rights so then the members are referred to as "owners."

Is a Conventional Corporation a "Capital-Managed Firm" or a "Capital-Suppliers' Cooperative"?

Does physical or financial capital play any special role vis-à-vis the corporate membership rights? For instance, labor certainly plays a special role in a worker cooperative with the assignment of the membership rights to those who work in the firm. Is there some similar structure for the shareholders as "capital suppliers" in the conventional joint stock[6] company?

In some of the literature of economics, a democratic firm like a worker cooperative is called a "labor-managed firm" or LMF (Vanek 1977). Some researchers have tried to set up a neat symmetry between labor-managed firms and "capital-managed firms" (KMFs) in which the latter are identified with the conventional joint stock company, the "capitalist" corporation, e.g., Dow (2003). The membership rights in the KMFs supposedly go to the "capital suppliers" just as they go to the labor suppliers in the LMFs. Similar ideas seem firmly planted in the popular and academic consciousness. Somehow, the corporate ownership rights are based on the ownership of capital goods.

The rights of the shareholder are supposedly based on the shareholder's supply or investment of capital in the company.

Perhaps the most explicit development of this theme is Henry Hansmann's (1990, 1996) treatment of the conventional joint stock corporation. To understand Hansmann's approach, we need to look at the general structure of cooperatives that assign the "membership rights" to the "patrons." The patrons are different in different types of cooperatives. In a consumer co-op, the members patronize the co-op by buying there. In a marketing co-op, the members sell their outputs through the cooperative. In a worker cooperative, the members patronize the cooperative by working there. Hansmann's theory is that the conventional corporation is essentially a "capital cooperative" or "lenders' cooperative" (1996, 14).

> The members of the capital cooperative each lend the firm a given sum of money, which the firm uses to purchase the equipment and other assets it needs to operate (say, to manufacture widgets—or cheese). The firm pays the members a fixed interest rate on their loans, set low enough so that there is a reasonable likelihood that the firm will have net earnings after paying this interest and all other expenses. The firm's net earnings are then distributed pro rata among its members according to the amount they lent, with the distributions taking place currently, as dividends, or on liquidation. Similarly, voting rights are apportioned among members in proportion to the amount they have lent to the firm. To supplement the capital that it obtains from its members, the firm may borrow money from lenders who are not members but who simply receive a fixed rate of interest (which may be different from the fixed rate paid to members) without sharing in profits or control. (Hansmann 1996, 14)

Hansmann goes on to argue that this is "precisely the structure that underlies the typical business corporation" (1996, 14) in which we interpret the lender-members as the shareholders and their fixed interest rate as zero.

Hansmann is clear that shareholders who bought shares on the secondary market are not direct suppliers of capital, but for the sake of argument we can join him in a generous interpretation of a secondary shareholder as being an indirect "capital supplier." Also, one should note that shareholders who buy higher valued new shares have the same share rights as those who bought them cheaply.

The real problem in the thesis is that shares can be obtained for any of the reasons that any property is transferred—such as in return for labor, nondurable inputs, managerial or technological know-how, and political goodwill or as a bequest or gift. To attract a prized employee, a company might issue new shares as a signing bonus. Workers might receive new shares in lieu of or in addition to cash wages. Or one could receive shares for any consideration whatever. And one can receive shares in return for no consideration, that is, as a gift or inherited property. These shareholders have the same rights as the shareholders who are directly or indirectly capital suppliers, so it is hard to sustain the "capital cooperative" hypothesis without generalizing the definition of *capital* to include any consideration whatsoever, or indeed, no consideration.

What is the alternative hypothesis? Start with the idea of a cooperative in which the membership rights are assigned to those who have a certain patronage role, as in a worker, consumer, or marketing cooperative. Then, take the limit as the patronage role goes to zero. In the limit, the membership rights would become free-floating with no patronage prerequisite necessary to qualify one for membership. With the patronage requirement null, one could sell the shares for whatever they would fetch or give them away as a gift. The conventional joint stock corporation is not a "capital cooperative" or capital-patronage cooperative; it is the *'zero-patronage cooperative'* corporation. The shares in the so-called "capitalist" corporation are simply free-floating property rights. The joint stock company is not like a cooperative in which the "patronage" is supplying capital; it is the limiting case of no patronage.

In this manner, one arrives at the notion of a *universal corporation* whose shares are free-floating property unattached to any role of supplying labor or capital or patronizing the company in any way or being related to the company in any other way (than as "shareholder"). A little more thought reveals that this is indeed what the joint stock company has become. This, in part, accounts for the flexibility and staying power of this legal form. This approach shows the unique limiting role, and hence, universality of the so-called "capitalist" corporation. If it did not exist, it would be soon reinvented in the current legal system.

Membership Is the Basic Analytical Concept; 'Ownership' Is Only the Limiting Case

Hansmann's work reminds us that "membership" is the basic concept that cuts across associations, cooperatives, and conventional joint stock corporations, or as Hansmann put it recently, "All firms are cooperatives" (2013) in that sense. Membership in a joint stock corporation is the limiting case of being devoid of any qualifying role—unlike, say, residence in a municipality that is required to vote in city elections. Hence corporate membership rights become free-floating property rights that may be freely bought and sold, rather than qualified for or earned.

The current trope about shareholders just owning the share certificates is somewhat misleading.

> The shareholders can do as they please with their shares: give them, sell them, destroy their share certificates, etc.; they *own* them. (Robé 2011, 27)

It is the membership rights in a conventional corporation that are owned by the shareholders, not just the certificates that evidence the membership rights which are recorded in the corporate books. To treat membership rights in terms of the ownership of share certificates is like treating citizenship rights in terms of the ownership of passports or national identity cards.

This notion of corporate ownership as the limiting case of organizational membership is key to deciphering the endless debates about corporate ownership and governance. It has become something of a fad lately to emphasize the asset side of the corporate balance sheet, i.e., that the members of a corporation do not own the corporate assets as their personal assets (Stout 2012; Ciepley 2019; Robé 2011). But this is true of all incorporated associations and cooperatives where the membership rights are not free-floating property rights. And yet the most remarkable conclusions are drawn from the fact that the members in any of these associations do not own the association's assets as their personal assets.

For instance, it is concluded that the members in a conventional corporation do not "own the corporation"—but this seems to be at best a linguistic argument since corporations in the Anglo-American world are routinely bought and sold.

More importantly, it is concluded that the Board of Directors and the managers are not the agents of the members in a principal-agent relation, e.g., Robé (2011). Yet this conclusion does not survive looking at the broader picture of associations and cooperatives (with conventional corporations as the limiting case) where the Boards and managers clearly are the representatives and agents of the *members* as principals. The employment relation and the separation of ownership and control in publicly-traded companies has reduced that agency relation to little more than a fiction and mockery, but that does not change the legal *theory* of incorporated associations, cooperatives, and corporations. And it does not vouchsafe the argument that since the members do not own the corporate assets (true in any incorporated association), that the Board members are not the agents of the members.

The Fundamental Myth About the "Ownership of the Means of Production"

For at least a century, the 'great debate' about economic systems has been between capitalism and socialism/communism. But one point of near-universal agreement was that the central property right in capitalism was "the private ownership of the means of production" (not the ownership of items of personal property). It is often said that Marx did not give specifics about his vision of socialism or communism. But if one spends one's adult life condemning X (e.g., *private* ownership of the means of production), then it is clear that one's image of a better society will not have X. Hence the alternative of socialism or communism in the Marxist tradition *had* to have social, public, or state ownership of the means of production along with substantial non-market allocation—as indeed was the case in every Marxist country.

Marx also popularized the capital-based phraseology of "capitalist" and "capitalism." To understand Marx's concept of the "rights of capital" embodied in the "ownership of the means of production," one must go back to the medieval notion of dominion based on the ownership of land. What today we might call the "landlord" was then the Lord of the land exercising both political/juridical control over the people living on the land and the rights to the fruits of their labor. As the legal historian, Frederic Maitland (1850–1906), put it: "ownership blends with lordship, rulership, sovereignty in the vague medieval *dominium*…." (Maitland 1960, 174). Or as the German legal scholar, Otto von Gierke (1841–1921), put it simply: "Rulership and Ownership were blent." (Gierke 1958, 88).

It is this medieval notion of dominion associated with the ownership of land or 'landism' that Marx carried over to the ownership of capital in his conception of 'capitalism.'

> It is not because he is a leader of industry that a man is a capitalist; on the contrary, he is a leader of industry because he is a capitalist. The leadership of industry is an attribute of capital, just as in feudal times the functions of general and judge were attributes of landed property. (Marx 1977, Chap. 13, 450–451)

Marx's blunder has been a staple of socialist thought ever since as was pointed out by Bo Rothstein.

> It is astonishing that a hundred years of socialist thought have not confronted the basic capitalist idea—that owners of capital have the right of command in the relations of production. The idea behind nationalization, wage earner funds, and the like is in fact fundamentally the same idea as that on which capitalism is based, namely, that ownership of capital should give owners the right to command in the production process (be they democratically elected politicians, state bureaucrats/planners, workers' representatives, or union officials). Indeed, this is a nice example of what Antonio Gramsci called bourgeois ideological hegemony. (Rothstein 1992, 118)

The defenders of 'capitalism' are more than happy to accept this view that the management rights ("leadership of industry") and the rights to the product are all "an attribute of capital," of the "ownership of the means of production." Then any change in the employer's role can be pitched as a violation of "property rights."

The idea that management and product rights are attached to capital is actually false in the legal system of a private property market economy, and thus it might be called the *fundamental myth*. It is asserted by thinkers, left, right, and center as in the following quote from an English Liberal.

> The owner of capital resources, or the agent who acts on behalf of the owner or a number of associated owners, controls and determines, *in virtue of such ownership*, the process of production and *the action of the workers* who are

> engaged in the process. In its unqualified form, capitalistic organization is a form of autocracy or absolutism. (Barker 1967, 105–106, emphasis added)

But this is factually incorrect; there are no such rights of capital in the so-called "capitalist system." In spite of Marx's imprimatur and the constant ideological assertion of the "rights of capital," it takes nothing more than an understanding of the *renting out of capital* to see the fallacy.

Suppose capital assets are *rented out* to another legal party, such as Frank Knight's "entrepreneur," who buys, hires, or already owns the other inputs and who undertakes a productive process. Then that entrepreneur by virtue of being the hiring party (not the owner of the capital assets) exercises the discretionary management rights within the limits of the input contracts (i.e., the management rights) over that process and has ownership of whatever product is produced. In addition to banks and other financial firms in the business of loaning out financial capital, real estate companies, equipment rental companies, and computer hardware companies are also in the business of hiring, renting, or leasing out physical capital assets.

Let us consider some simple examples. When an individual owns, say, a widget-making machine, then it is easily understandable that the machine could be rented out. But if the individual forms a corporation and puts in the machine and other capital as initial capital, then many people think that the individual's ownership of the corporation somehow makes a fundamental difference in the logic of rentability as if the machine can no longer be rented out. But the machine, of course, may still be rented out in which case the owner of the corporation does not have the management or product rights in the going concern operation using that machine. The process of incorporation does not miraculously transubstantiate the ownership of a capital asset into the ownership of the net results produced using the capital asset in a going concern.

The ownership of capital gives the owner the negative control rights over the use of the capital as in: "No, you may not use this machine, building, or land." This right is sufficient to make those who nevertheless use the machine, building, or land into trespassers—but it does not automatically make them into employees.

> Central to ownership is the right to exclude others from contact with an item. Ownership thus gives the owner of an item the right to control the uses to which others put it in the sense that he may veto any use of it proposed by someone else. But it does not give him any right to tell anyone to put that property to the use that he wants. It is not a right to command labor. (McMahon 1994, 16)

The positive discretionary control or management rights over employees come from the employer-employee contract, not the ownership of the capital the employees are using. This is a conceptual point about the structure of property rights in the current system and is not about the bargaining power (typically in the hands of capital owners) or transaction costs involved in renting capital out of a corporation or renting people into a corporation.[7]

The Briggs Manufacturing Example

It is the pattern of contracts (who hires what or whom) that determines who owns the product produced using some of the corporation's assets (which could be leased out). In addition to the fundamental myth being involved in a common misunderstanding of the "ownership of a corporation," it is also expressed in the usual notion of "owning a factory." But the simple logic of the rentability of capital does not stop at the ownership of a whole factory. In the early 1950s, an automobile manufacturer, the Studebaker-Packard Corporation, had the Packard bodies produced in a Detroit plant of the Briggs Manufacturing Company. After the Briggs founder died, all twelve of the U.S. Briggs plants were sold to the Chrysler Corporation in 1953. "The Conner Ave. plant that had been building all of Packard's bodies was leased to Packard to avoid any conflict of interest." (Theobald 2004)

This actual example illustrates the vacuity of the usual idea that "being the firm" is determined by "the ownership of the firm." Where was the "ownership of the firm" that included the ownership of the auto bodies coming off the assembly line or the management rights over that production process? Of course, the shareholders in Studebaker-Packard owned that company and similarly for the shareholders in Chrysler, but that did not answer the question of "who is the firm" in that going-concern operation. That was determined by pattern of the new market contracts—by who hires, rents, or leases what or whom. Studebaker-Packard leased the factory from Chrysler. Then the Studebaker-Packard Corporation would hold the management rights over the hired workers and product rights for the operation of the factory owned by the Chrysler Corporation.

In spite of the logical argument and factual examples, most economists and legal theorists seem unwilling to draw out the implications of capital being rentable. Of course, conventional economists and legal thinkers *can* understand that capital can be rented out, but they find no convenience in drawing out the consequences. Out of learned ignorance or intellectual lassitude, they assume the fundamental myth which serves as the *pons asinorum* in the understanding of the "rights of capital" and in the theory of capital and corporate finance theory of the economists. For them, it is a bridge too far.

There Is No "Ownership of the Firm" in the Going-Concern Sense of the "Firm"

Contractual fact-patterns are not 'owned.' In general, consider the common notion of "owning a factory" or "owning a corporation." There is the ownership of factory buildings and the ownership of corporations with such assets, but there is no "ownership" of the going-concern aspect of *operating* a factory since that is a contractual fact-pattern in a market economy. By using the same phrase "owning a factory" or "owning a corporation" to straddle both meanings, one could seem to have an argument that the contractual role of operating as a going-concern firm was "owned."

For instance, when it is pointed out that operating an owned factory or an owned corporation as a productive going-concern is a contractual role, not an extra owned property right, a typical response is: "Yes, but it is that role which we call the 'ownership' role." After thus redefining factory 'ownership' to include the going-concern contractual role (which is not actually owned in any usual notion of "ownership"), the semantics shifts back to conclude that "the product rights are part of the 'ownership' of the factory" or "the 'ownership' of the corporation." Such shifting-semantics fallacies allow the fundamental myth to persist.

The Misnomer of "Capitalism"

In the Middle Ages, there was little or no developed market for renting out land, so those governance and product rights were rolled into the medieval notion of ownership as dominion. But capital assets, including land for that matter, are *routinely* rented out in our so-called 'capitalist' system. Given the central role of the Marxist notion of the "ownership of the means of production," it may be understandable why Marxists cling to the fundamental myth as a matter of quasi-religious dogma. Many defenders of the 'capitalist' system seem equally dogmatic in failing to think through the consequences of capital being rentable in a private property market economy.

Since the management and product rights are not attached to capital in the first place, the whole "Great Debate" between "capitalism" and socialism or communism (as to whether there should be private or public ownership of the means of production) was ill-posed from the beginning.

There is, however, one economist who stands out as the most philosophically and economically sophisticated defender of the so-called "capitalist" system—and he didn't call it by that name. He is Frank Knight (1885–1972), one of the founders of the Chicago School of Economics (see Emmett 2010). Knight was perfectly clear on "capitalism" being a misnomer and on Marx's role in propagating that myth about capital ownership.

> Karl Marx, who in so many respects is more classical than the classicals themselves, had abundant historical justification for calling, i.e., miscalling—the modern economic order "capitalism." Ricardo and his followers certainly thought of the system as centering around the employment and control of labor by the capitalist. In theory, this is of course diametrically wrong. The entrepreneur employs and directs both labor and capital (the latter including land), and laborer and capitalist play the same passive role, over against the

> active one of the entrepreneur. It is true that entrepreneurship is not completely separable from the function of the capitalist, but neither is it completely separable from that of labor. The superficial observer is typically confused by the ambiguity of the concept of ownership. (Knight 1956, 68, fn. 40)

If an economic, political, or legal theorist is such a "superficial observer" as to not think through the consequences of capital being rentable, then there is little hope to get beyond erroneous Marxist tropes and schoolboy libertarian talking-points applauded by right-wing billionaire foundations—or post-modernist sloganeering ("It's all about power") by posturing academics.

The current system is not characterized by capital being unrentable, but by *both* persons and capital goods being legally rentable.

> Since slavery was abolished, human earning power is forbidden by law to be capitalized. A man is not even free to sell himself: he must *rent* himself at a wage. (Samuelson 1976, 52 [his italics])

Similar remarks are made by other economists.

> The commodity that is traded in the labor market is labor services, or hours of labor. The corresponding price is the wage per hour. We can think of the wage per hour as the price at which the firm rents the services of a worker, or the rental rate for labor. We do not have asset prices in the labor market because workers cannot be bought or sold in modern societies; they can only be rented. (In a society with slavery, the asset price would be the price of a slave.) (Fischer, Dornbusch, and Schmalensee 1988, 323)

Given the bargaining power enjoyed by corporations (including entrepreneurs with ample access to capital) and the transaction costs involved in currently reversing the contract between capital and labor, it is almost a truism that people will be rented by the owners of capital, not capital being rented by people.

It is a shame that so many economists and conventional classical liberals think that since they and Marxists all agree on the "rights of capital" that it must be a valid characterization of the misnamed 'capitalist' system. Frank Knight had the intellectual clarity to draw out the consequences of capital being rentable for the "superficial observer" who cannot get beyond easily refuted banalities about the "rights of capital." Capital is rentable in any private property market economy and "in a free society the larger part of the productive capacity employed (as matters stand today in a typical Western nation) consists of the services of human beings themselves, who are not bought and sold but only, as it were, leased." (Knight 1936, 438) And it is that hiring, renting, or leasing of persons that is the characteristic feature of the current system.

The Fundamental Myth in Capital Theory and Corporate Finance Theory

Such a fundamental misunderstanding of the rights of capital is sure to show up in conventional Economics in the theory of capital and corporate finance theory (see Ellerman 1992). Even John Maynard Keynes (1883–1946) was not immune to this sophisticated version of the fundamental myth. He saw the rights to the net returns from using a capital asset in a going concern as being attached to the capital asset—as if the asset could not be rented out.

> When a man buys an investment or capital-asset, he purchases the right to the series of prospective returns, which he expects to obtain from selling its output, after deducting the running expenses of obtaining that output, during the life of the asset. (Keynes 1953, 135)

Corporate finance theory, as well as the older capital theory, are both based on definitions that capitalize the *future* value of the profits or "prospective returns" that would result from being the firm in the going concern sense using a capital asset—into the *current* value of the capital asset (typically a corporation). In the words of two Economics Nobel Prize winners:

> [I]n valuing any specific machine, we discount at the market rate of interest the stream of cash receipts generated by the machine, plus any scrap or terminal value of the machine, and minus the stream of cash outlays for direct labor, materials, repairs, and capital additions. The same approach, of course, can also be applied to the firm as a whole, which may be thought of in this context as simply a large, composite machine. (Miller and Modigliani 1961, 415)

But this assumes that the "machine" owner is running the going concern business (i.e., is the "residual claimant" in the business using the machine) now *and in the future*. The market contracts that amount to future residual claimancy have hardly been made now for the entire future time periods. When such contracts are just assumed, the machine owner or the corporation has no ownership right over their future suppliers or customers to force them to make the "assumed" contracts. Hence there is no *present* property right to those *future* profits and thus that capitalized value cannot be added into the "value of the corporation" (or other capital assets) as if it were currently owned by the capital owners.

Even accountants understand the point that escapes those Nobel laureate economists. The present value of the assumed future profits depends on the contractual behavior of suppliers and customers (all 'unowned' by the corporation being 'valued') and thus it is called "*goodwill*." The remarkable inattention and thus naiveté in conventional Economics about property rights (Ellerman 2017) is well-illustrated by two other Economics Nobel laureates when they assert that the "rights of authority at the firm level are defined by the ownership of assets, tangible machines or money) or intangible (goodwill or reputation)" (Holmstrom and Tirole 1989, 123). This statement combines the fundamental myth about management rights ("rights of authority") and about the rights to future products and profits ("goodwill") all being part of presently owned capital. The example of these four Nobel laureates shows that a failure to follow out the simple consequences of a capital asset being rent out and the non-ownership of future contractual fact-patterns hardly disqualifies one from the so-called 'Nobel Prize' in Economics. And even non-Nobel-Prize-winning accountants realize that there is something dubious about claiming goodwill as a presently owned property right, and thus the standard Generally Accepted Accounting Principles (GAAP) do not allow goodwill to be listed as an asset on the corporate balance sheet.

But even the accounting profession seems unsure what to do with so-called "purchased goodwill" when a corporate asset is purchased at a price above its economic replacement value. But as in the old joke about a country bumpkin coming to New York and being "sold the Brooklyn Bridge," such a transaction does not create a property right that the seller did not have in the first place. Hence there is no logical basis for the usual practice of suddenly treating "purchased" goodwill (or the "purchased" Brooklyn Bridge) as an asset to be depreciated in the future. Some accountants have correctly noted that "purchased goodwill" should be booked as a debit to equity—which would be replaced by the future profits if and when they are earned.

> The amount assigned to purchased goodwill represents a disbursement of existing resources, or of proceeds of stock issued to effect the business combination, in anticipation of future earnings. The expenditure should be accounted for as a reduction of stockholders' equity. (Catlett and Olson 1968, 106).

Conclusions

Our purpose has been to analyze a miscellany of fallacies blaming the corporate form for a litany of problems. But the corporate form itself, at least in its original conception, is not the problem. Blaming "corporations" for the ills of the current system of renting human beings is like blaming glass bottles for alcoholism.

The important idea to preserve is the original and ancient idea of a corporation as a group of natural persons engaged in certain joint activities "that possessed a juridical personality distinct from that of its particular members." (Tierney 1982, 19) This original conception of the corporation is well described in Davis (1961), Raymond (1966), and in Abram Chayes' *Introduction* in the Davis book.

> We can here perhaps note a final irony, at least. The concept of the corporation began for us with groups of men related to each other by the place they lived in and the things they did. The monastery, the town, the gild, the university, all described by Davis, were only peripherally concerned with what its members owned in common as members. The subsequent history of the corporate concept

> can be seen as a process by which it became progressively more formal and abstract. In particular the associative elements were refined out of it. In law it became a rubric for expressing a complicated network of relations of people to things rather than among persons. The aggregated material resources rather than the grouping of persons became the feature of the corporation. (Chayes 1961, xix)

The point that is little, if at all, mentioned in the corporate law literature is that the original joint activity of the members could only be squeezed out since it was replaced by the joint activity of the employees (including managers) of the corporation. Absent the employment relation, an absentee-owned corporation could only be an unpopulated asset holding bin renting out the assets instead of renting in employees—and even that renting out of assets would probably require some employees (if the shareholders are 'absentee'). Conceptually speaking, the *absentee-owned* corporation is a 'wholly-owned subsidiary' of the human rental relation, the employment contract.

The basic problem is not in the idea of a corporation but in the legal institution that has completely corrupted and undermined that original conception of the corporation.

The employment relation: The whole idea of the members of the corporation as carrying out some joint human activity was undermined by the legal institution of the hiring, employing, leasing, or renting people to carry out those actual human activities undertaken by the corporation.

And then with the active members replaced by employees, membership could be debased into 'ownership.' The corruption of the notion of membership in the corporation was carried to its logical conclusion in the modern corporation of the joint stock or limited liability variety. The partaking in the human activities of the corporation (e.g., "patronage" in a cooperative) was reduced to zero thus turning the membership rights into untethered free-floating (i.e., no personal functional role requirement for the members) property rights that could be arbitrarily bought and sold on the market like any other piece of property. And this reduction of the members' personal functional roles to zero was enabled by the above-mentioned human rental institution where the "employees" carry out the corporation's human activities.

Thus, the original conception of the corporate embodiment for people engaged in a joint human activity was turned into a piece of property like a piece of real estate or "a large, composite machine" (Miller and Modigliani 1961, 415) to be bought and sold in the marketplace. When the current occupant of the American White House suggested "buying Greenland," the leading thinkers in political science, economics, and the law as well as various pundits and thought-leaders ridiculed the suggestion and did not accept "it's just a real estate deal" as a justification. Yet, the same thinkers find no problem in the daily purchase and sale of corporations (whose workforce is many times the population of Greenland); after all, it is supposedly just the purchase and sale of a corporatized bundle of assets.

An interesting aspect of the whole corporate governance debate is how so many legal, political, and economic thinkers have completely lost sight of the concept of democracy in the organizations where people spend most of their waking hours. There is no doubt about who are the people who make up an organization (hint: it is not the corporate shareholders). Where ideological conformity is not at stake (as in a mundane accounting text), we may find a statement of the simple facts.

> An organization can be defined as a group of people united together for some common purpose. A bank providing financial services is an organization, as is a university providing educational services, and the General Electric Company producing appliances and other products. An organization consists of *people*, not physical assets. Thus, a bank building is not an organization; rather, the organization consists of the people who work in the bank and who are bound together for the common purpose of providing financial services to a community. (Garrison 1979, 2)

Hence the application of the notion of democratic self-governance to an organization gives a clear answer to the question of who should be the members of the organization. As John Dewey put it:

> [Democracy] is but a name for the fact that human nature is developed only when its elements take part in directing things which are common, things for the sake of which man and women form groups—families, industrial companies, governments, churches, scientific associations and so on. The principle holds as much of one form of association, say in industry and commerce, as it does in government (Dewey 1948, 209).

Yet, the human rental relation and the subsequent debasement of membership into ownership seems to have eclipsed the democratic ideal in so many learned thinkers today who would otherwise pledge their undying allegiance to democratic self-governance in the political sphere. It is only because of this professionally prudent forgetting of democratic ideals in the workplace that the whole question of corporate governance and purpose is “up for grabs” in the first place.

The original Abolitionist Movement led to the elimination of the direct market for the involuntary and even the voluntary buying and selling of other human beings. Instead, we have today the institution for the voluntary renting of other human beings—and that in turn has allowed the complete corruption and debasement of the original idea of the corporate embodiment for people carrying out certain joint activities. The idea of a corporation is not the problem. The root problem is the institution for the employing, hiring, leasing, or renting of human beings and hence the neo-abolitionist call (Ellerman 2015) for the abolition of that human rental institution in favor of all corporations being democratic associations of the people carrying out the activities of the corporations.

Notes

1 "In general, the shareholders are the members of the company and the terms 'shareholders' and 'members' may be used interchangeably." (Hannigan 2012, 304).

2
See https://en.wikipedia.org/wiki/Santa_Clara_County_v._Southern_Pacific_Railroad_Co.

3 See Whyte and Whyte (1991).

4 Most consumer co-ops do not have a work requirement and thus they are perfectly mirrored by non-cooperative supermarkets which give "members" a discount secured by showing a bar-coded "rewards card" at checkout.

5 The footnote reads: "In clarifying my ideas on this question I have profited greatly from a number of unpublished papers by David Ellerman, cited in the bibliography,… ."

6 For our purposes here, the arguments about joint stock companies also apply to limited liability companies (LLCs).

7 The author has been making this distinction between the corporation and the contractually-defined firm-as-a-going-concern for over 40 years (Ellerman 1975). A French legal scholar, Jean-Philippe Robé, has independently made essentially the same distinction between the corporation and "the firm—the organization built via contracts transferring control over resources to the corporations used to legally structure the firm" (Robé 2011, 4)

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