Repricing Limited Liability and Separate Entity Status

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ABSTRACT

In this Article we discuss how U.S. entity law has evolved in recent decades so that (i) limited liability has become available to the owners of any form of business organization, and (ii) all forms of business organizations are now seen as having the status of entities separate from their owners. Those changes have occurred without significant consideration of their consequences or what they mean for the public policies underlying entity law. At the same time, there is an increasing awareness by businesses that promotion of social benefits and/or reduction of externalities is in the firm's best interests. There has recently been development of hybrid business models, but they have been driven by pragmatic concerns rather than an understanding of the theoretical underpinnings for, and restrictions on, those models. This Article strives to point the way toward a new understanding of how the state should frame the requirements for limited liability and separate entity status.

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INTRODUCTION

The principal characteristic that traditionally distinguished a business corporation from any other form of entity organized under state law was the limited liability provided to its shareholders. Section 6.22(b) of the Model Business Corporation Act states, "a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct."[1] Until the enactment of the first limited liability company statute in Wyoming in 1977,[2] no other form of entity that could be created under state law provided equivalent liability protection for every owner of an entity.

While limited liability has obvious value to the shareholders by giving them the comfort of knowing they have at risk only what they have chosen to invest in the corporation, it also has an obvious detriment for those dealing with the corporation because they are limited to looking only to the corporation's assets for amounts they may be owed. The benefits and detriments of limited liability have led commentators to take opposite sides of the question whether limited liability is socially beneficial and should be retained. We survey that debate briefly in Part I.

Related to the corporate characteristic of limited liability was the status of a corporation as a separate entity distinct from its owners. The burden for that separateness was an extra layer of taxation, and the benefit was the right to act as a separate person.[3] Those characteristics were in stark contrast to the way business forms that were not corporations were seen—as aggregates of their owners, passing through income and risk to the individuals,[4] rather than as separate entities. But, as with limited liability, the uniqueness of corporations as separate entities has now all but disappeared.

Regardless of whether there are valid policy arguments on the side of those who argue for limiting or eliminating limited liability, developments in the law of business entities over the last few decades have

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1. MODEL BUS. CORP. ACT § 6.22(b) (AM. BAR ASS'N, amended 2010).

2. Wyoming Limited Liability Company Act, ch. 158, 1977 Wyo. Sess. Laws 537 (enacted Mar. 4, 1977) (codified at WYO. STAT. §§ 17-29-101 to -1105).

3. "C corporations are separately taxable entities under the IRC. Thus, C corporation earnings are subject to double taxation–first at the corporate level and again at the shareholder level upon distribution of dividends." Byron F. Egan, *Choice of Entity Alternatives*, 39 TEX. J. BUS. L. 379, 415 (2004). *See also* Christopher Beam, *Why Do We Tax Corporations?*, SLATE (Oct. 17, 2008, 6:02 PM), http://www.slate.com/articles/news_and_politics/explainer/2008/10/why_do_we_tax_corporations.html [https://perma.cc/DVY2-FY4G].

4. Thomas Earl Geu, *Understanding the Limited Liability Company: A Basic Comparative Primer (Part Two)*, 37 S.D. L. REV. 467, 469–72, 489 (1992).

resulted in pervasive limited liability and, along with that, characterization of all types of business organizations as entities. In Part II we review briefly how limited liability and separate entity status have become the norm for all forms of business entities created under state law.

Almost completely missing, however, from the legislative initiatives that have led to the triumph of limited liability and separate entity status is any consideration of whether these changes have been accompanied by a proper allocation of benefits and burdens between the state and the now-pervasive limited liability/separate identity entities. Originally, corporations compensated the state for at least part of the cost of the externalities created by the corporations through their liability as separate taxpayers.[5] The spread of limited liability and separate identity has been accompanied by changes in tax law,[6] which means that essentially all privately owned businesses have the ability to organize in such a way that they are exempt from taxation as a separate entity, thus leaving the state to shoulder the responsibility for community building and reduction in externalities.[7] In Part III, we begin with a discussion of the debate between two competing legal theories of the corporation and whether that debate remains relevant. We then move to a broader discussion of the basis on which society should require responsible behavior from businesses as the price of limited liability and separate identity. We close in Part IV by offering the benefit corporation form as a better way of understanding how society should expect business to be conducted.

I. IS LIMITED LIABILITY SOCIALLY BENEFICIAL?

The debate about whether limited liability is socially beneficial has been going on for a long time. As early as 1911, Nicholas Murray Butler, the President of Columbia University, said, "I weigh my words when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times. . . . Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it."[8] More recently, Henry Manne argued that limited liability is critical to the widespread use of the publicly held corporation because it assures investors that they are not placing their

5. Beam, *supra* note 3. For a brief discussion of the corporate tax and shareholder tax see also, Egan, *supra* note 3, at 415–16.

6. William J. Rands, *Passthrough Entities and Their Unprincipled Differences Under Federal Tax Law*, 49 SMU L. REV. 15, 17–18, 19 n.9 (1995).

7. *See generally* Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1460 (1998); Egan, *supra* note 3.

8. Roger E. Meiners, James S. Mofsky & Robert D. Tollison, *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 351 (1979) (alteration in original) (quoting WILLIAM MEADE FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 21 (1917)).

personal assets at risk when they buy a share in a corporation.[9] And, Richard Posner argued that limited liability facilitated credit transactions and that, absent limited liability, "the supply of investment and the demand for credit might be much smaller than they are."[10] Both Manne and Posner noted that under the rule of limited liability involuntary creditors might suffer, but they found the benefits of the rule outweighed the undesirable situation of tort creditors.[11] Roger Meiners, James Mofsky, and Robert Tollison subsequently questioned whether Manne and Posner were correct and argued that limited liability does not reduce transaction costs for investors and also does not impose unwarranted costs on involuntary creditors.[12]

On the other side of the issue are scholars who continue to argue that the availability of limited liability should be eliminated, or at least regulated, if it proves too difficult to place effective limits on its availability. A fairly recent example of those who would restrict limited liability are Stephanie Blankenburg and Dan Plesch, who wrote in 2007:

> Limited liability is at the heart of this rise of corporate power: it constitutes a blanket exemption of a special-interest group from accountability for the actions of their companies. While the mantra of "no rights without responsibilities" is used to regulate the behavior of poor people who benefit from social-security payments, "the unaccountable few" enjoy feudal privileges. Owner-shareholders (and by extension manager-directors) are beyond the law to an extent not enjoyed by the central committees of communist parties, similar to the despotic monarchies, dictators and tribal leaders over which liberal western societies claim moral superiority, and akin to the aristocracy in the *ancient regimes* of pre-enlightenment Europe.
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> Adam Smith, the brilliant economist and guru of free-marketeers, was also a staunch opponent of limited liability. In 1776, he wrote: "To establish a joint stock company [shareholding corporation], however, for any undertaking, merely because such a company might be capable of managing it successfully; *or to exempt a particular set of dealers from some of the general laws which take place with regard to all their neighbours, merely because they might be capable of thriving if they had such an exemption, would certainly not be reasonable*." Smith's objection – carefully omitted from the praise

9. *See* Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 262–63 (1967).

10. Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 503 (1976).

11. *See* Manne, *supra* note 9, at 263; Posner, *supra* note 10, at 519–24.

12. Meiners, Mofsky & Tollison, *supra* note 8, at 351.

> heaped on him by free-marketeers with no worries about corporate power – makes a simple but powerful point: a democratic and free society should not exempt some people from general laws simply because their business may thrive as a result.
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> If equality before the law is to have any meaning, it must apply to human beings, not fictitious persons, and organisations must not be handed blanket exemptions from accountability simply on the grounds that they can thrive through privilege. We cannot, on the one hand, treat corporations as if they were just any person, and on the other, invest them with unequal protection. Otherwise, we are guilty of a double blindness to power: disregarding it by setting human beings equal to powerful corporations before the law, and disregarding it again by granting special-interest protection to the powerful through limited liability.[13]

Additionally, Frank Easterbrook and Daniel Fischel have argued that the court-fashioned remedy of piercing the corporate veil strikes a balance between the benefits of limited liability and excessive risk taking.[14] But, veil piercing is only close to being an effective remedy in the context of closely held corporations.[15]

Although interesting from the theoretical perspective of what is the best public policy, the debate about the desirability of limited liability has become largely irrelevant as a practical matter because of the spread of limited liability that we discuss in the next section.

II. The Triumph of Limited Liability

A. The Spread of Limited Liability in Recent Decades

In the last few decades, there has been a pronounced movement away from restricting limited liability to corporations, and limited liability is now available for every type of business entity. Consistent with the aggregate theory of partnership, which sees a general partnership as a collection of individuals doing business together, the partners in a general

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13. Stephanie Blankenburg & Dan Plesch, *Corporate Rights and Responsibilities: Restoring Legal Accountability*, OPENDEMOCRACY (May 9, 2007) (first alteration in original) (emphasis added), https://www.opendemocracy.net/globalization-institutions_government/corporate_responsibilities_4605.jsp [https://perma.cc/NG8K-FTG8]. For a scholarly explication of the authors' views, see Stephanie Blankenburg, Dan Plesch & Frank Wilkinson, *Limited Liability and the Modern Corporation in Theory and in Practice*, 34 CAMBRIDGE J. ECON. 821 (2010).

14. *See* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 93 (1985).

15. Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1, 9 (1997) ("Piercing occurs only within corporate groups or in close corporations with fewer than ten shareholders.").

partnership were personally liable for its obligations.[16] Section 15 of the Uniform Partnership Act (1914), which made all of the partners in a general partnership personally liable for all of its debts and obligations, was the unquestioned rule in the U.S. for close to eighty years.[17] But, the rise of limited liability partnerships in the 1990s[18] made a profound change in the nature of a general partnership.

When limited liability partnerships were first authorized by the states, they provided only a partial liability shield for the partners: the partners were not personally liable for torts they were not involved in, but they remained liable for the non-tort obligations of the partnership.[19]In 1997, the Uniform Partnership Act was amended to provide a full shield for partners in a general partnership.

The change to a full shield followed a trend that had already begun in some states. Most states have now adopted the full shield approach introduced in the 1997 revision of the Uniform Partnership Act[20] and it is to be expected that the remaining states will follow suit in the next few years. As a result, a general partnership—in which the general partners remain personally liable for its debts and obligations—is becoming a rarity[21] and usually reflects a situation in which the partners have sought counsel on this issue or are not concerned about their personal liability because of the nature of the partnership's business.

Traditionally, limited partnerships provided partial, but not complete, liability protection for the partners. The general partners remained personally liable and subject to the same rules as applied to partners in a general partnership.[22] Limited partners were given a liability shield, but it did not apply to liabilities to a third party who reasonably believed while dealing with the partnership that a limited partner was a general partner.[23] Both of those limitations on limited liability have now been removed. The liability shield for limited partners is now absolute in the Uniform Limited Partnership Act,[24] and limited partnerships are now

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16. Nature of Partner's Liability, UNIF. P'SHIP ACT § 15 (1914).

17. *See id.*; *see also* Hamill, *supra* note 7.

18. *See* Kern Alexander, *Lessons from the Rise of the US Limited Liability Partnership: Regulating Risk-taking in the Large Professional Firm*, 6–7 (ESRC Ctr. for Bus. Res., Univ. of Cambridge, Working Paper No. 255, 2010); Hamill, *supra* note 7.

19. *See, e.g.*, DEL. CODE ANN. tit. 6, § 15-306 (1999).

20. *Id.*

21. *Id.*

22. UNIF. LTD. P'SHIP ACT (1985); General Partner's Liability, UNIF. LTD. P'SHIP ACT § 404 (2013).

23. *See* UNIF. P'SHIP ACT § 303.

24. UNIF. P'SHIP ACT § 306 (2001) (amended 2013); UNIF. LTD. P'SHIP ACT § 303 (2001) (amended 2013) ("An obligation of a limited partnership, whether arising in contract, tort, or otherwise, is not the obligation of a limited partner. A limited partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the limited partnership solely

able to elect to be limited liability limited partnerships which has the effect of giving the general partner(s) a liability shield.[25]

Ever since their first invention in 1977, limited liability companies have provided that the owners of the company, known as "members," were entitled to the same liability shield as shareholders in a corporation.[26]

All forms of partnerships have also been redefined as entities.[27] The rejection of the aggregate theory of partnerships was the subject of debate for many years.[28] But when the aggregate theory was rejected, the change came very quickly and with little detailed explanation. The recommendation that led to the change came from a committee of the ABA Business Law Section. In a report issued in 1987, that committee concluded—in largely conclusory fashion and with virtually no analysis—as follows:

> Because the "entity theory" avoids a number of technical problems, such as the authority of a general partnership to sue or be sued in its partnership name, the subcommittee determined that it should be incorporated into any revision of the UPA whenever possible and that the "aggregate theory" should be retained only where it appears to be essential, *e.g*., because of tax considerations.[29]

Today, limited liability and separate entity status are taken so much for granted as a part of entity law that they have even been extended to unincorporated nonprofit associations, which are the effective equivalent

by reason of being a limited partner, even if the limited partner participates in the management and control of the limited partnership.").

25. UNIF. P'SHIP ACT § 404(c) (1997) (amended 2013) ("An obligation of a limited partnership incurred while the limited partnership is a limited liability limited partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the limited partnership. A general partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or acting as a general partner.").

26. UNIF. LTD. LIAB. CO. ACT § 304(a) (2006) (amended 2013) ("The debts, obligations, or other liabilities of a limited liability company, whether arising in contract, tort, or otherwise: (1) are solely the debts, obligations, or other liabilities of the company; and (2) do not become the debts, obligations, or other liabilities of a member or manager solely by reason of the member acting as a member or manager acting as a manager.").

27. United States v. Basye, 410 U.S. 441, 448 (1973) (stating that for [the purpose of calculating partnership income], the partnership is regarded as an independently recognizable entity apart from the aggregate of its partners. Once its income is ascertained and reported, its existence may be disregarded since each partner must pay tax on a portion of the total income as if the partnership were merely an agent or conduit through which the income passed); *see also* WILLIAM S. MCKEE ET AL., FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS 1.02[3] (2d ed. 1990).

28. *See generally* Jeremy E. Goldstein & John Goode, *Entity and Aggregate Theories of Partnership: The Need for Clarification*, 1 PROB. & PROP. 15 (1987).

29. UPA Revision Subcomm. of the Comm. on P'ships & Unincorporated Bus. Orgs., *Should the Uniform Partnership Act Be Revised?*, 43 BUS. LAW. 121, 124 (1987).

of nonprofit partnerships.[30] The Uniform Unincorporated Nonprofit Association Act now defines nonprofit associations as entities[31] and provides that the members of a nonprofit association have limited liability.[32]

B. The Relationship Among Limited Liability, Separate Entity Status, and Taxation

The extension of entity status to general partnerships is particularly surprising because it was not accompanied by a change in how partnerships are taxed. Originally, the fact that corporations were considered a separate legal person meant that it was also easy to see corporations as separate taxpayers.[33] Partnerships, on the other hand, which were not considered a separate entity, were not seen as a taxpayer separate from the partners.[34] The result was that partnerships were exempt from the double taxation that applied to corporations in which the profits of the corporation were first taxed in the hands of the corporation and then, when a dividend of some of the remaining profits was paid to the shareholders, the profits were taxed again as income to the shareholders.[35]

The system under which corporations were taxed separately was logically consistent with the separate entity status of corporations and meant that the corporation was compensating society in exchange for the privileges of limited liability and separate entity status.[36] The link between limited liability, separate entity status, and separate status as a taxpayer was severed some time ago for smaller corporations that were eligible for taxation as "S corporations."[37] But the special s-corp status was subject to

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30. ABA NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, ABA REPORT, http://www.americanbar.org/content/dam/aba/migrated/intlaw/leadership/policy/Uniform_Unincorporated_Nonprofit_Association_Act.pdf [https://perma.cc/4SK3-HR2V].

31. UNIF. UNINCORPORATED NONPROFIT ASS'N ACT § 5(a) (2008) (amended 2013) ("An unincorporated nonprofit association is an entity distinct from its members and managers.").

32. *Id.* § 8(a) ("A debt, obligation, or other liability of an unincorporated nonprofit association is solely the debt, obligation, or other liability of the association. A member or manager is not personally liable, directly or indirectly, by way of contribution or otherwise for a debt, obligation, or other liability of the association solely by reason of being or acting as a member or manager. This subsection applies regardless of the dissolution of the association.").

33. *See, e.g.*, *In re* Fed.-Mogul Glob. Inc., 411 B.R. 148, 164 (Bankr. D. Del. 2008) ("[T]he basic principle of corporate law that corporations are independent legal 'persons,' who, like natural persons, may sue and be sued."); William J. Rands, *Passthrough Entities and Their Unprincipled Differences Under Federal Tax Law*, 49 SMU L. REV. 15, 17–18 (1995).

34. *Sole Proprietorships, Partnerships and LLCs Are Commonly Used Entities*, BIZFILINGS (Jan. 1, 2015), http://www.bizfilings.com/toolkit/sbg/tax-info/fed-taxes/sole-proprietorships-arent-separate-tax-entities.aspx [https://perma.cc/QV7N-XHL5].

35. 14A FLETCHER CYCLOPEDIA OF THE LAWS OF CORPORATIONS § 6953 (2016).

36. Beam, *supra* note 3.

37. *The History and Challenges of America's Dominant Business Structure*, S-CORP.ORG, http://s-corp.org/our-history/ [https://perma.cc/2227-RZYW].

restrictions[38] that limited its utility and was not as beneficial to the owners of a business as the manner in which partnerships were taxed.

The spread of limited liability and separate entity status to forms of unincorporated business entities that are not considered separate taxpayers means that our system of entity law no longer imposes any price on a business in exchange for the grant of limited liability and separate entity status. Those benefits are now conferred by the state essentially free of charge, except for the nominal filing fees required when an entity is first formed and when it files its annual reports with the Secretary of State or other filing office.[39]

The universal availability of limited liability—with both its benefits and limitations—raises the question whether the states—and traditional corporations—have been shortchanged by the rise of entities that do not pay for externalities nor foster social benefit, because they are not subject to double taxation, and yet receive the benefits of limited liability and separate identity. The answer, as we suggest in Part IV, is that society would be justified in repricing the grant of limited liability and separate entity status by requiring responsible behavior from the entities it creates.

III. IS THERE STILL MODERN RELEVANCE TO AN OLD DEBATE?

Among the many ways that people have characterized corporations and the role of the law that governs them are the "contractarian"[40] and "concession"[41] theories. The contractarian theory sees a corporation as a contractual entity and sees corporate law as facilitating the contracting process that creates a corporation.[42] Stefan J. Padfield characterizes those viewing corporations as a nexus of contracts as having a

> laissez-faire approach to corporate regulation [because] the corporation [is] a contract that suffers primarily, if not solely, from agency problems in terms of maximizing utility-agency problems that are best solved by elevating shareholder wealth maximization as the primary directive of corporate directors and letting shareholders and management battle it out over the terms of their contract as they

38. These restrictions include imposition of ongoing fees, confinement to one class of stock, restriction to 100 shareholders, closer IRS scrutiny, and less flexibility in allocating income and loss. *S Corporation Advantages and Disadvantages*, BIZFILINGS, http://www.bizfilings.com/learn/s-corporation-advantages-and-disadvantages.aspx [https://perma.cc/VH2R-BR69].

39. *See, e.g.*, *Annual Report and Tax Instructions*, STATE OF DELAWARE, https://corp.delaware.gov/paytaxes.shtml.

40. *See* Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 799 (2016).

41. Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 MD. L. REV. 80, 85 (1991).

42. Klausner, *supra* note 40, at 782.

> see fit, subject only to default rules provided by the state for those situations where bargaining is too costly or simply overlooked.[43]

To the extent conducting business in the corporate form creates negative externalities, the contractarian advocates that regulatory responses be limited to generally applicable laws.[44]

Antony Page and Robert Katz posit that Corporate Social Responsibility reflects the contractarian view and relies on "extralegal strategies such as self-regulation, external monitoring, and consumer activism"[45] to push corporations to make decisions that are beneficial to society and relegating government to authorizing corporate philanthropy and consideration of nonshareholder interests.[46] They characterize the social enterprise movement as compatible with what they term the "more libertarian" contractarian understanding of corporate law.[47]

The concession theory, in contrast, sees a corporation as the creation of the state, exercising delegated authority.[48] Padfield associates the concession view with those who fear corporate power.[49] This fear plays out in a characterization of Frankenstein-like corporations whose mindless and amoral power must be restrained. This characterization is implied in the dissent of Justice Stevens in *Citizens United*, who posits that corporations have "been effectively delegated responsibility for ensuring society's economic welfare," but they "have no consciences, no feelings, no thoughts, no desires."[50]

In Padfield's view, the regulatory response of those holding a "concession" or progressive view of corporations will "conform corporate law to the shifting cultural and social norms of the time."[51] This, so the argument goes, is because the state grants a corporation its existence, defines its attributes, and dictates the terms and conditions on which it can persist, and thus should be entitled to guide the corporation, just as in the early days when charters were granted so that corporations could promote

43. Stefan J. Padfield, *The Dodd-Frank Corporation: More than a Nexus-of-Contracts*, 114 W. VA. L. REV. 209, 220 (2011) (internal quotations omitted).

44. *Id.* at 221.

45. Antony Page & Robert A. Katz, *Is Social Enterprise the New Corporate Social Responsibility*, 34 SEATTLE U. L. REV. 1351, 1376–77 (2011).

46. *See id.*

47. *See id.* at 1379.

48. Stefan J. Padfield, *Corporate Social Responsibility & Concession Theory*, 6 WM. & MARY BUS. L. REV. 1, 20 (2015).

49. Padfield, *supra* note 43, at 221.

50. Citizens United v. Fed. Election Comm'n, 558 U.S. 310, 465–66 (2010) (Stevens, J., dissenting). Padfield characterizes Justice Stevens's dissent in *Citizens United* as embodying concession theory (even though Justice Stevens himself disclaimed any reliance on corporate law theory). *See* Padfield, *supra* note 48, at 226.

51. Padfield, *supra* note 48, at 214.

specific pro-social goals.[52] Page and Katz similarly characterize progressive (concession) corporate law as a way to restructure corporate law and to alter the decision-makers.[53]

In actuality, however, both historically and currently, the view of corporate law as a *contract* carries with it an understanding of fixed terms and vested rights.[54] As early as the Marshall Court and its decision in *Trustees of Dartmouth College v. Woodward*,[55] the charter of a corporation was recognized as a contract and thus subject to the protection of the Contracts Clause of the U.S. Constitution.[56] In other words, the contractarian view limits the power of the State vis-à-vis the entities it creates—a more Frankenstein vision than any view of corporate law as a concession. As the U. S. Supreme Court explained in *Beer Company v. Massachusetts*:

> Whatever differences of opinion may exist as to the extent and boundaries of the police power, and however difficult it may be to render a satisfactory definition of it, there seems to be no doubt that it does extend to the protection of the lives, health, and property of the citizens, and to the preservation of good order and the public morals. The legislature cannot, by any contract, divest itself of the power to provide for these objects. They belong emphatically to that class of objects which demand the application of the maxim, *salus populi suprema lex*; and they are to be attained and provided for by such appropriate means as the legislative discretion may devise. That discretion can no more be bargained away than the power itself.[57]

Because the concession theory is grounded in an understanding that the state concedes a role to corporations and other limited liability entities,

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52. *Id.* at 217.

53. Page & Katz, *supra* note 45, at 1376–77.

54. *See, e.g.*, Miller v. The State, 82 U.S. 478, 488 (1872).

> Corporate franchises, granted to private corporations, if duly accepted by the corporators, partake of the nature of legal estates, and the grant, under such circumstances, if it be absolute in its terms, and without any condition or reservation, importing a different intent, becomes a contract within the protection of that clause of the Constitution which ordains that no State shall pass any law impairing the obligation of contracts. Charters of private corporations are regarded as executed contracts between the State and the corporators, and the rule is well settled that the legislature, if the charter does not contain any reservation or other provision modifying or limiting the nature of the contract, cannot repeal, impair, or alter such a charter against the consent or without the default of the corporation, judicially ascertained and declared. Subsequent legislation, altering or modifying such a charter, where there is no such reservation, is plainly unauthorized, if it is prejudicial to the rights of the corporators, and was passed without their consent.

Id.

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

56. *Id.*

57. Beer Co. v. Massachusetts, 97 U.S. 25, 33 (1877).

it recognizes that state law is enacted in light of its overarching obligation to provide for its citizens—a view of both the state and limited liability entities that allows for the evolution of both social values and entity responses. Such a view does not require the added leap that corporations are avaricious and otherwise amoral, the perspective apparently held by Justice Stevens. Indeed, much of what is positive in this country—historically and currently—is the result of corporate innovation and productivity, and, to the extent the motivation for that has been profits for the corporation and its investors, those profits are well-earned. The caveat to that value, however, is that if the state is being forced to underwrite externalities or strain the social fabric attributable to the business (whether from environmental degradation, a refusal to employ full-time, benefit-eligible workers, or otherwise), part of the profits properly belong to the state and not the company or its investors.

In other words, drawing on a more benign view of concession theory, a state can act from its respect for the value corporate flexibility can bring rather than from a fear of corporate power, which in turn calls for empowering procedural regulation rather than constraining substantive regulation. As states face changing needs and mores, the entity forms provided by the states for the organization of businesses can adapt to meet those changes better and can more properly be asked to meet those changes if they are seen as operating pursuant to a state concession rather than under the contractarian view.

Justice Stevens's perspective hearkens back to a belief that Berle espoused: if corporate managers had a fiduciary duty to many masters, they would be effectively unconstrained.[58] Although Berle would later revise this view somewhat, there is an intuitive sense—dating back to scripture—that a person cannot serve multiple masters.[59] But that is precisely the problem with framing corporate responsibility in terms of *loyalty to* and *care for* someone. Fiduciary duties presuppose that a confidential relationship exists that permits a beneficiary to repose trust in a trustee to place the beneficiary's interest above all others.[60]

> While it is true that the 1960 Act does not, like the statutes cited in that case, expressly subject the Government to duties of management and conservation, the fact that the property occupied by the United States is expressly subject to a trust supports a fair inference that an obligation to preserve the property improvements was incumbent on

58. *See* A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932).

59. *Matthew* 6:24.

60. *See Fiduciary Duty*, WEX LEGAL DICTIONARY, https://www.law.cornell.edu/wex/fiduciary_duty [https://perma.cc/L5AR-R6A6].

> the United States as trustee. This is so because elementary trust law, after all, confirms the commonsense assumption that a fiduciary actually administering trust property may not allow it to fall into ruin on his watch. One of the fundamental common-law duties of a trustee is to preserve and maintain trust assets.[61]
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> Dominant or controlling shareholders, we held, are "fiduciar[ies] whose powers are powers [held] in trust." We then explained: Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. . . . The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside. [62]

Instead, limited liability entities should be empowered and encouraged to recognize that there is a Venn diagram of categories of benefits to the citizens of a state; a limited liability entity should be at least encouraged to—and perhaps required to—choose what maximizes either the overlap of them all or the intersection of the areas the limited liability entity deems the most important. If, for example, a company provides additional benefits to its employees, including, perhaps, tuition for them and their families, the company will be providing benefits to the community as well. The converse holds true as well: if a corporation demonstrates a commitment to the community it inhabits, that will benefit the employees who live there. The same can be said of a company committed to reducing externalities, whether by buying locally, shifting to sustainable energy sources, or sponsoring cleanup of degraded resources.

With all due respect to Justice Stevens, core corporate law theory presupposes that corporations can and do make such choices. At the least, a corporation is expected to (i) understand and refrain from unlawful or tortious activity;[63] (ii) understand and strategically address market input;[64]

61. United States v. White Mt. Apache Tribe, 537 U.S. 465, 475 (2003).

62. Jones v. Harris Assocs. L.P., 559 U.S. 335, 346–47 (2010) (quoting Pepper v. Litton, 308 U.S. 295 (1939)).

63. *See* INTERNATIONAL ENCYCLOPAEDIA OF LAWS: CYBER LAW § 2, at 868 (Wolters Kluwer 2016) ("Tort law is a branch of the law of civil obligations, where the legal persons, both natural persons and corporations have legal obligations to refrain from harm to another person . . . .").

64. *See* R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 371, 390–92 (1937) ("The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism. . . . [T]he operation of a market costs something and by forming an organization and allowing some authority (an 'entrepreneur') to direct the resources, certain marketing costs are saved.").

and (iii) make decisions in line with constituents' values.[65] It is now time for society to make clear that in return for the grant of limited liability and perpetual existence, business entities are expected to act responsibly and sustainably.

The preceding discussion has suggested that there is a basis in both the contractarian concession theories to require responsible behavior by corporations. It is good that both theories support such a requirement because the differences between the theories lose their relevance when applied to unincorporated entities. Unincorporated entities are universally regarded as arising primarily from the contract made by the owners of the business to conduct business together.[66] But even in the context of entities created principally by private contract, there is a basis for the state to expect certain norms of behavior.

IV. THE EMERGENCE OF A NEW PARADIGM

Beginning in 2010 with the enactment of the first benefit corporation law in Maryland,[67] there has been an increasing recognition that society would benefit from authorizing businesses to conduct their operations in a responsible and sustainable manner. There are now thirty-one jurisdictions in the United States[68] and one foreign country (Italy)[69] that have authorized corporations that have the characteristics described below. Although they are sometimes called by different names in different states,[70] we refer to them in this discussion by the most commonly used name of "benefit corporations."

Benefit corporations share three main characteristics:

1. The purpose of the corporation is redefined as being "triple bottom line," meaning that in addition to the usual purpose of a business corporation to be financially profitable, the corporation also has a purpose of creating "a material positive impact on

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65. *See* William M. Lafferty et al., *A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law*, 116 PENN ST. L. REV. 837, 841 (2012).

66. *See* Joan MacLeod Heminway, *Rationalizing Entity Law: Corporate Law and Alternative Entities (Part II)*, BUS. L. TODAY, Dec. 2013, at 3. ("[F]reedom of contract in the LLC form should still be able to operate in much the way that the DLLCA now provides . . . . Informed venturers with legal capacity should be able to enter into valid and binding contracts that vary statutory or common law duties. They may have other ways of supplying the trust needed to engage in business together.").

67. MD. CODE ANN., Corps & Ass'ns § 5-6C-03 (West 2012).

68. Frederick H. Alexander, *The Capital Markets and Benefit Corporations*, BUS. L. TODAY, July 2016.

69. ALISSA PELATAN & ROBERTO RANDAZZO, THE FIRST EUROPEAN BENEFIT CORPORATION: BLURRING THE LINES BETWEEN "SOCIAL" AND "BUSINESS", http://www.bwbllp.com/file/benefit-corporation-article-june-16-pdf [https://perma.cc/P5TL-VBX8].

70. *See, e.g.*, DEL. CODE ANN. tit 8, § 362 (2015) ("Public Benefit Corporation"); HAW. REV. STAT. §§ 420d-1 to 420d-13 (2011) ("Sustainable Business Corporation").

society and the environment, taken as a whole, form its business and operations."[71] That statement of the expanded purpose of a benefit corporation is taken from the Model Benefit Corporation Legislation that has been the basis for most of the statutes enacted by the states.[72] To the same effect is the requirement in the Delaware statute that a benefit corporation "operate in a responsible and sustainable manner."[73]

2. The duties of the directors are redefined to require them to consider the interests of the nonfinancial stakeholders of the corporation in addition to the interests of the shareholders.[74]
3. The corporation is subject to a new requirement to report on its pursuit of its expanded purpose.[75] The purpose of this requirement is to supplement the financial statements of the corporation so that the shareholders have a full picture of the triple bottom line performance of the corporation and not just its financial performance.

As noted above, Italy has joined the trend in the United States to authorize benefit corporations.[76] More broadly, there is an increasing interest internationally in encouraging businesses to operate in a more responsible manner.[77] A notable example is the Social Impact Investment Taskforce established under the UK's presidency of the G8.[78] That taskforce was supported by four working groups, one of which was the Mission Alignment Working Group.[79] That working group prepared a detailed set of recommendations for how countries could promote

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71. MODEL BENEFIT CORP. LEGIS. § 102 (2016) ("general public benefit").

72. *See, e.g.*, *The Model Legislation*, BENEFIT CORP., http://benefitcorp.net/attorneys/model-legislation [https://perma.cc/U38K-TURE] (explaining Delaware passed benefit corporation legislation in July 2013, and offering more information about the Delaware benefit corporation statute and how it compares to the model statute).

73. DEL. CODE ANN. tit 8, § 362(a) (2015).

74. *Benefit Corporation Director Duties*, BENEFIT CORP., http://benefitcorp.net/businesses/benefit-corporation-director-duties [https://perma.cc/22E3-V3KS].

75. MODEL BENEFIT CORP. LEGIS. § 401 (2016) ("Benefit Director").

76. PELATAN & RANDAZZO, *supra* note 69.

77. *See Business in Society: Making a Positive and Responsible Contribution*, INT'L CHAMBER COM., http://www.iccwbo.org/products-and-services/trade-facilitation/9-steps-to-responsible-business-conduct/ [https://perma.cc/RM4D-K3GL].

78. *Social Impact Investment Taskforce*, GOV.UK, https://www.gov.uk/government/groups/social-impact-investment-taskforce [https://perma.cc/29ZF-EBHU]. The Taskforce was superseded by the Global Social Impact Investment Steering Group. *Global Social Impact Investment Steering Group*, SOC. IMPACT INV., http://www.socialimpactinvestment.org [https://perma.cc/J8B9-RE6E].

79. *See Social Impact Investment Taskforce*, *supra* note 78.

businesses with a broader purpose.[80] Recommendation 6 urges countries to promote the organization of businesses with the three characteristics described above.[81] Recommendation 2 provides that those characteristics "should be available under each of the basic legal forms that may be used in the country to organize a business."[82] While the focus of the taskforce was on social impact businesses, rather than business generally, Recommendation 20 urges countries to encourage the growth and funding of businesses that, more broadly, are seeking to create a positive impact on society and the environment.[83]

The recommendation of the G8 taskforce that all forms of business entity should be able to seek to create positive impacts on society and the environment[84] is already being implemented in the United States. There is the start of a movement to extend the benefit corporation form beyond corporations to unincorporated entities. Maryland, Oregon, and Pennsylvania have authorized the creation of limited liability companies, called "benefit companies," which mimic the benefit corporation form and have the three characteristics described above.[85]

It is customary to refer to Milton Friedman and his classic article "*The Social Responsibility of Business is to Increase its Profits*"[86] for the proposition that a business should be focused solely on maximizing its financial performance for the benefit of its owners. But in that article, Friedman makes the following comment:

> In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible *while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.*[87]

Thus, even in Friedman's view, there is room for society's ethical customs to influence how business is to be conducted.

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80. *See* SOC. IMPACT INV. TASKFORCE, MISSION ALIGNMENT WORKING GRP, PROFIT-WITH-PURPOSE BUSINESSES (2014), http://www.socialimpactinvestment.org/reports/Mission%20Alignment%20WG%20paper%20FINAL.pdf [https://perma.cc/4TNR-4FSW] [hereinafter MISSION ALIGNMENT PAPER].

81. *See id.* at 21.

82. *See id.* at 19–20.

83. *See id.* at 28–29.

84. *See id.* at 23–24.

85. *See, e.g.*, *Maryland Proposes the Benefit LLC*, CHANGEMATTERS (Mar. 14, 2011), http://changematters.com/2011/03/benefit-llc/.

86. Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970 (Magazine).

87. *Id.* (emphasis added).

United States entity law has developed to a state in which all business entities have available to them limited liability that accompanies separate existence as a legal entity. But most entities are now not obligated to pay for their externalities and are not expected to prioritize or address the needs of the larger community as part of a social bargain for entity privileges. We propose that such a bargain is a fair and necessary one. Entities should be expected to engage in responsible and sustainable behavior as the price for limited liability and separate entity status. And benefit corporations demonstrate the viability of such an expectation.