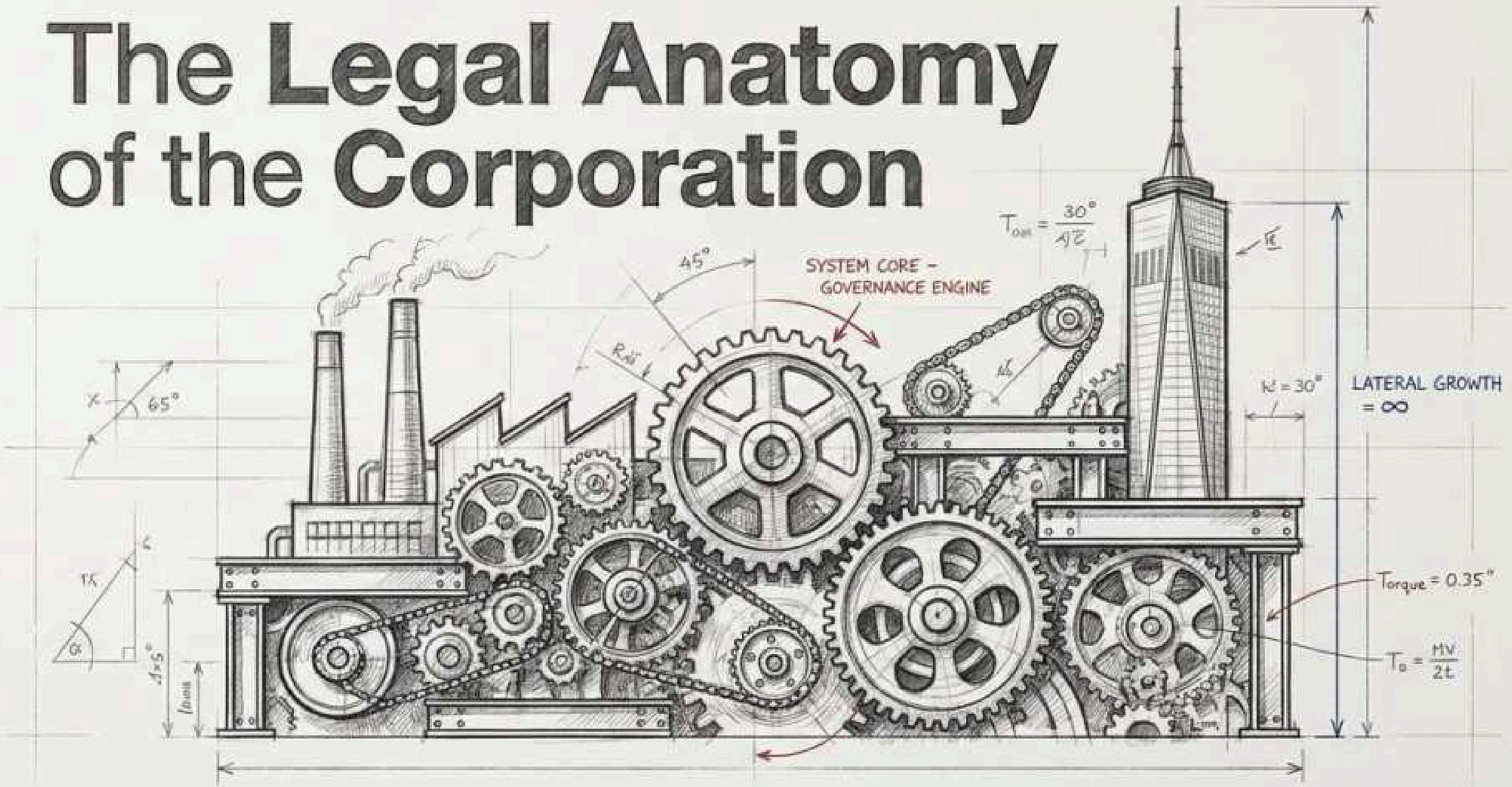
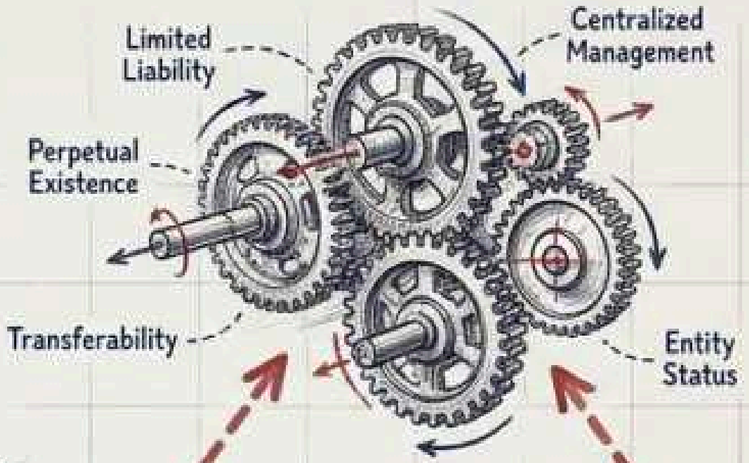
The Legal Anatomy of the Corporation



Deconstructing the cleverest piece of social technology.

Three Questions Defining the Corporate Form

¶ 2.1



Question 1: The Features

(What defines the entity?)

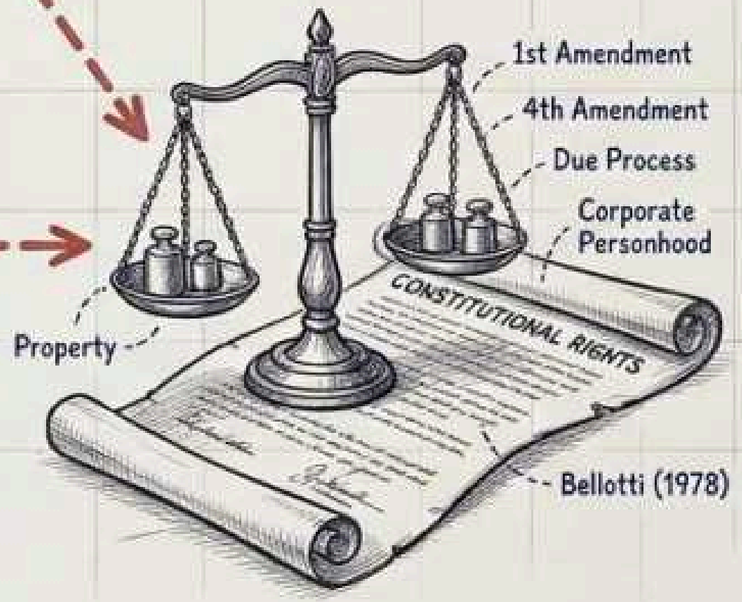
Question 2: The Geography

(Why Delaware?)



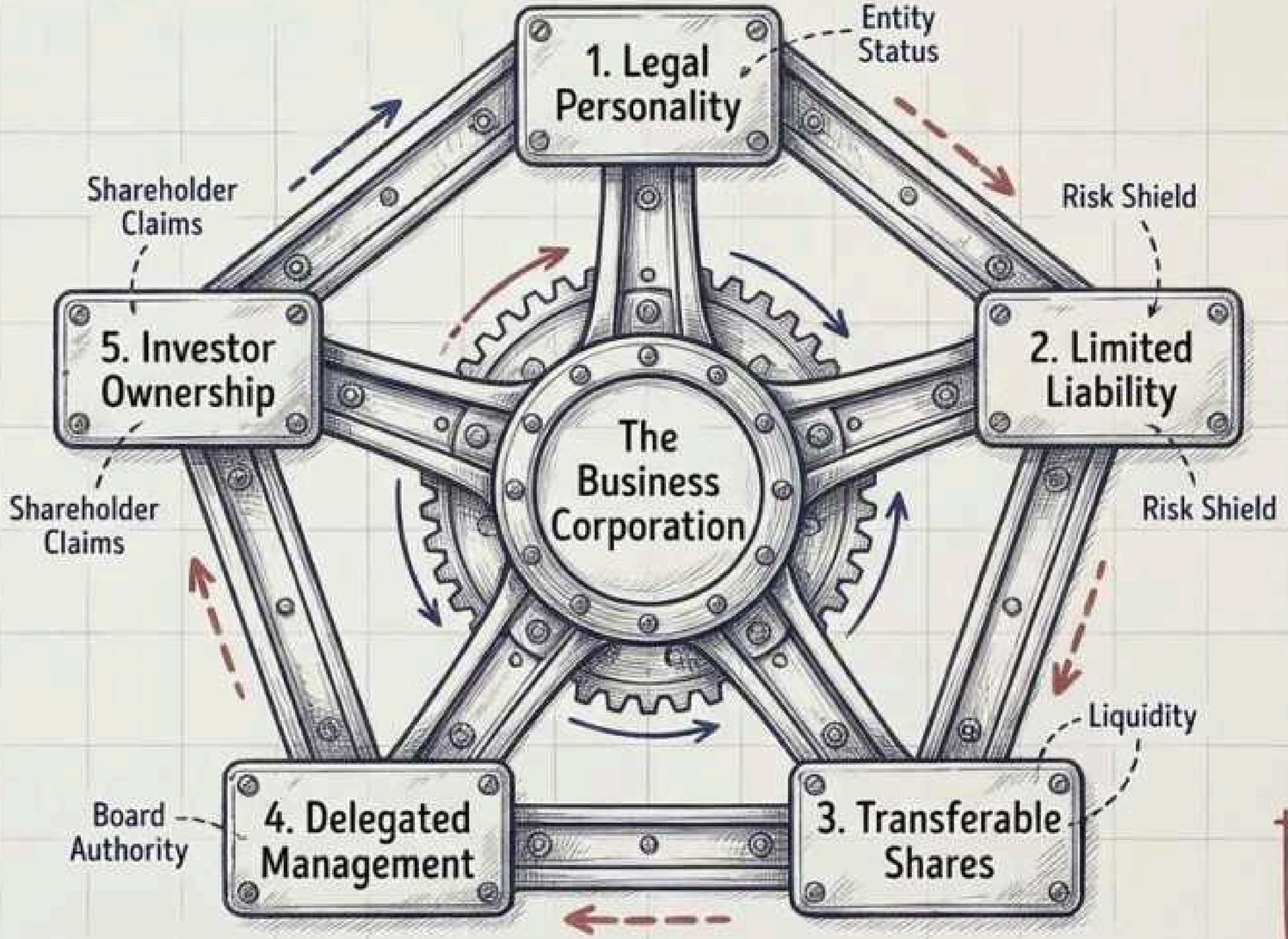
Question 3: The Rights

(Property & Speech for artificial persons)



The Five-Part Blueprint of Corporate Law

¶ 2.2

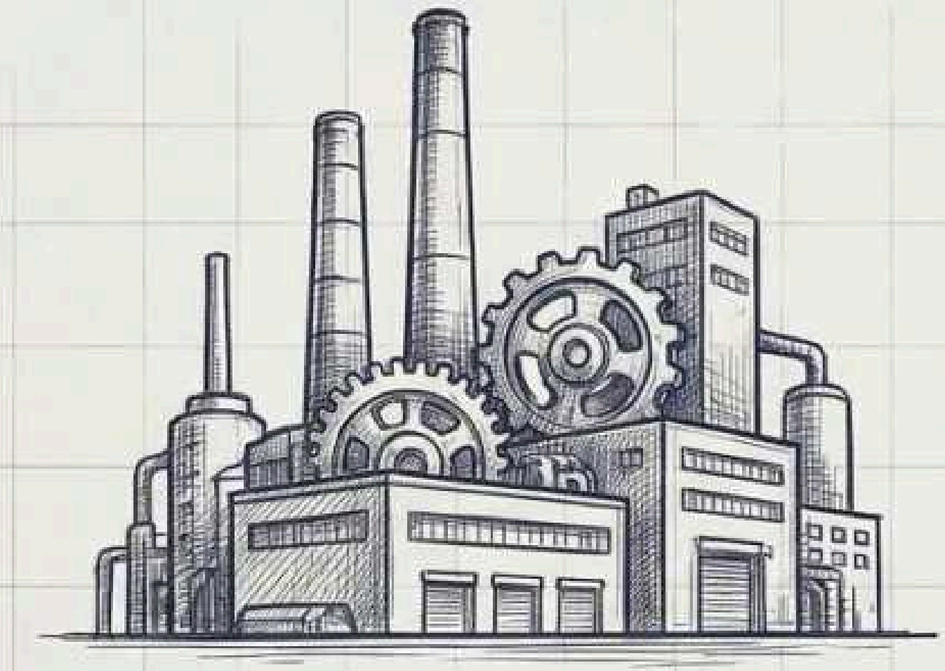


Almost every country's company law provides all five.

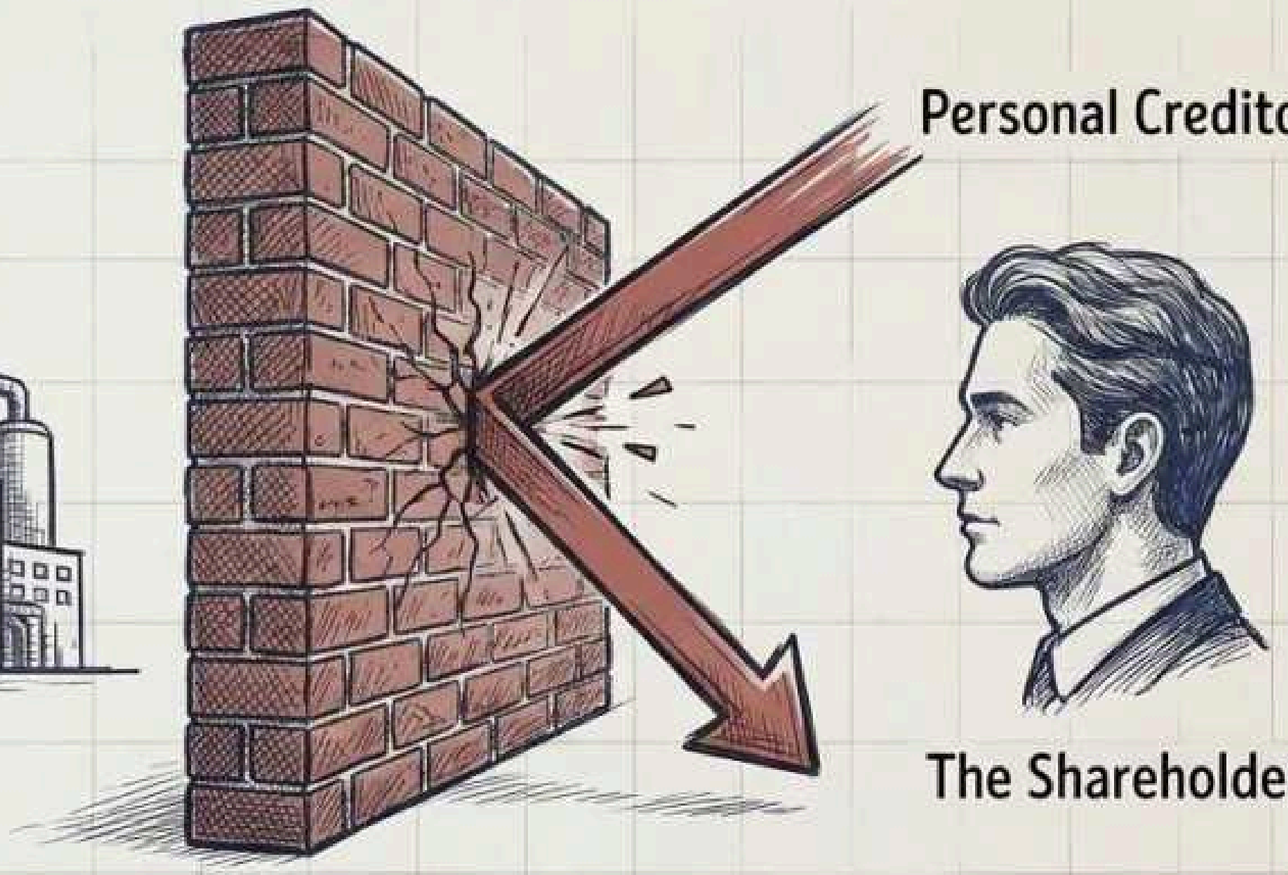
Framework by Armour, Hansmann, Kraakman, et al.

Legal Personality: The Entity Shield

¶ 2.3



The Company
(Corporate Assets)



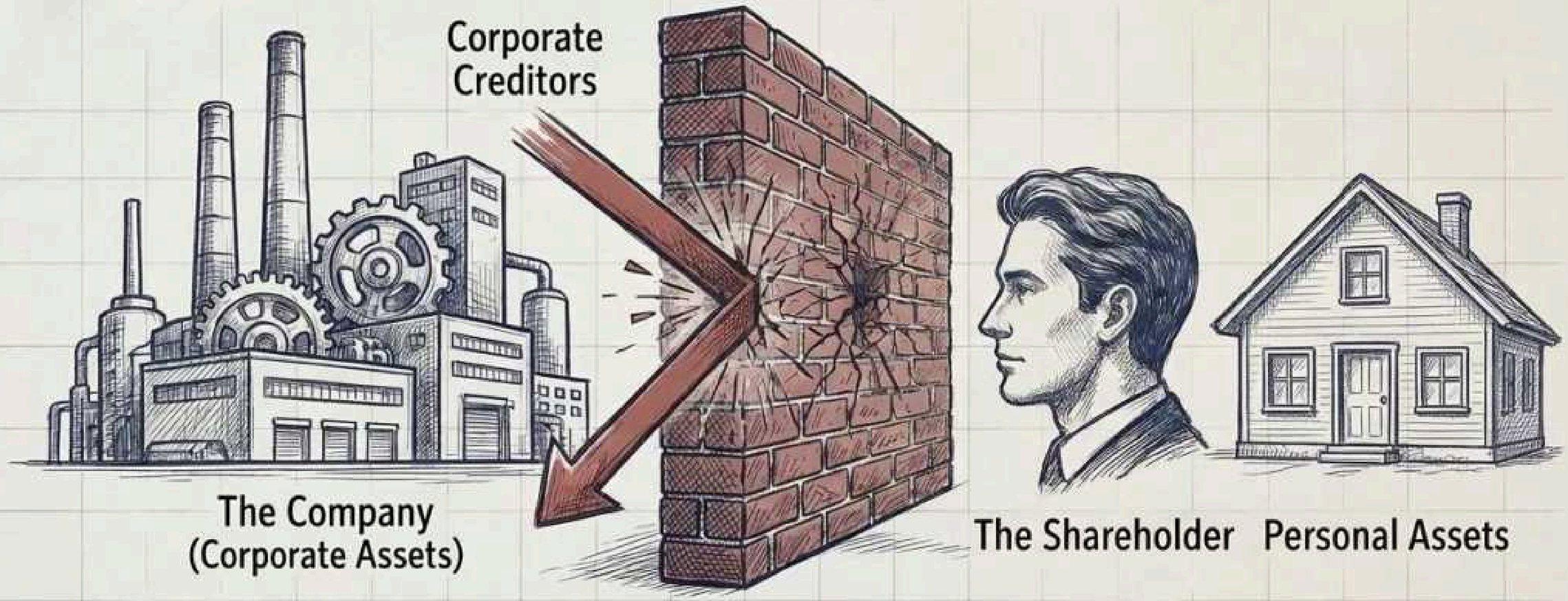
The Shareholder

Formula: Creditor(Personal) $\not\rightarrow$ Assets(Corporate)

Definition: Entity Shielding (Hansmann & Kraakman)
The corporation owns its assets. Personal creditors of a shareholder cannot seize the factory to pay personal debts.

Limited Liability: The Mirror Image

¶ 2.4



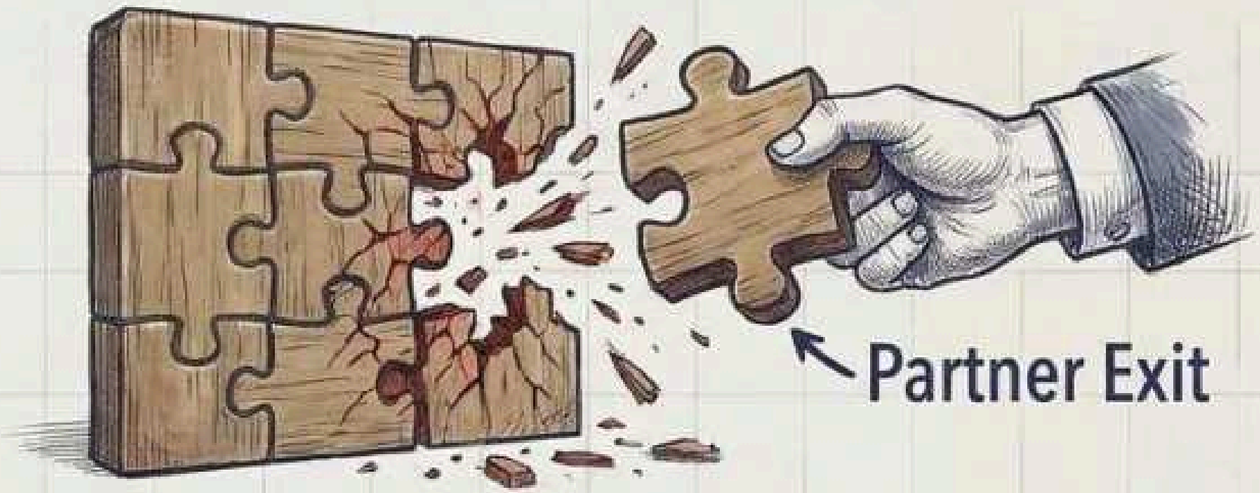
Formula: Creditor(Corporate) ↛ Assets(Personal)

Boundary Limit:
Max Loss = Share Value (e.g., $10M)

Corporate creditors can claim company assets, but not personal assets.
Together, shielding and limited liability draw a strict, absolute boundary.

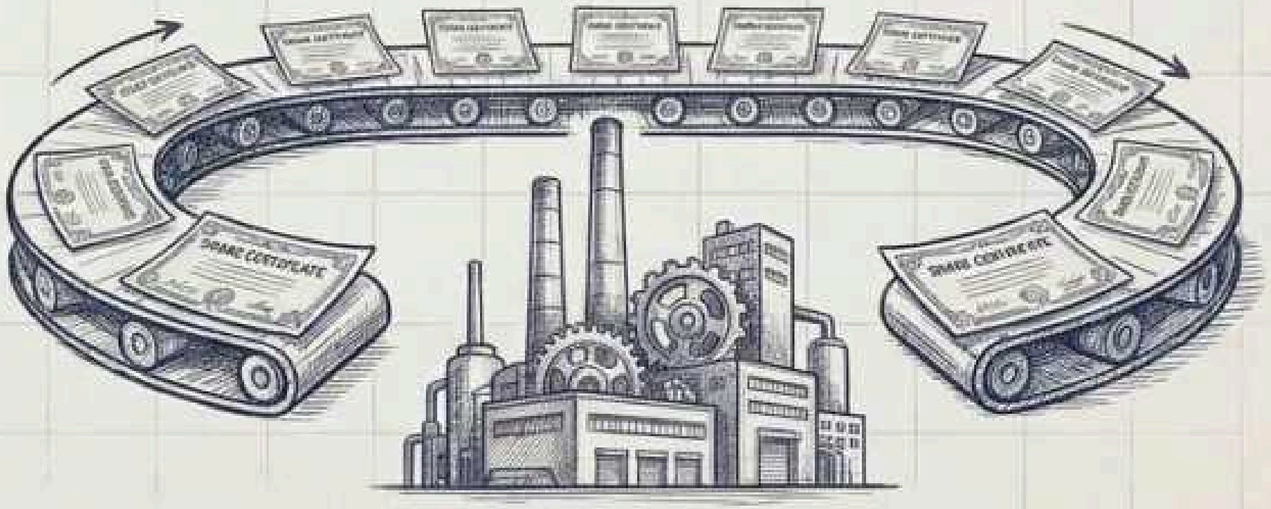
Transferable Shares: Friction-Free Exit

Partnership Friction



Partner exit = Dissolution or Reorganization.

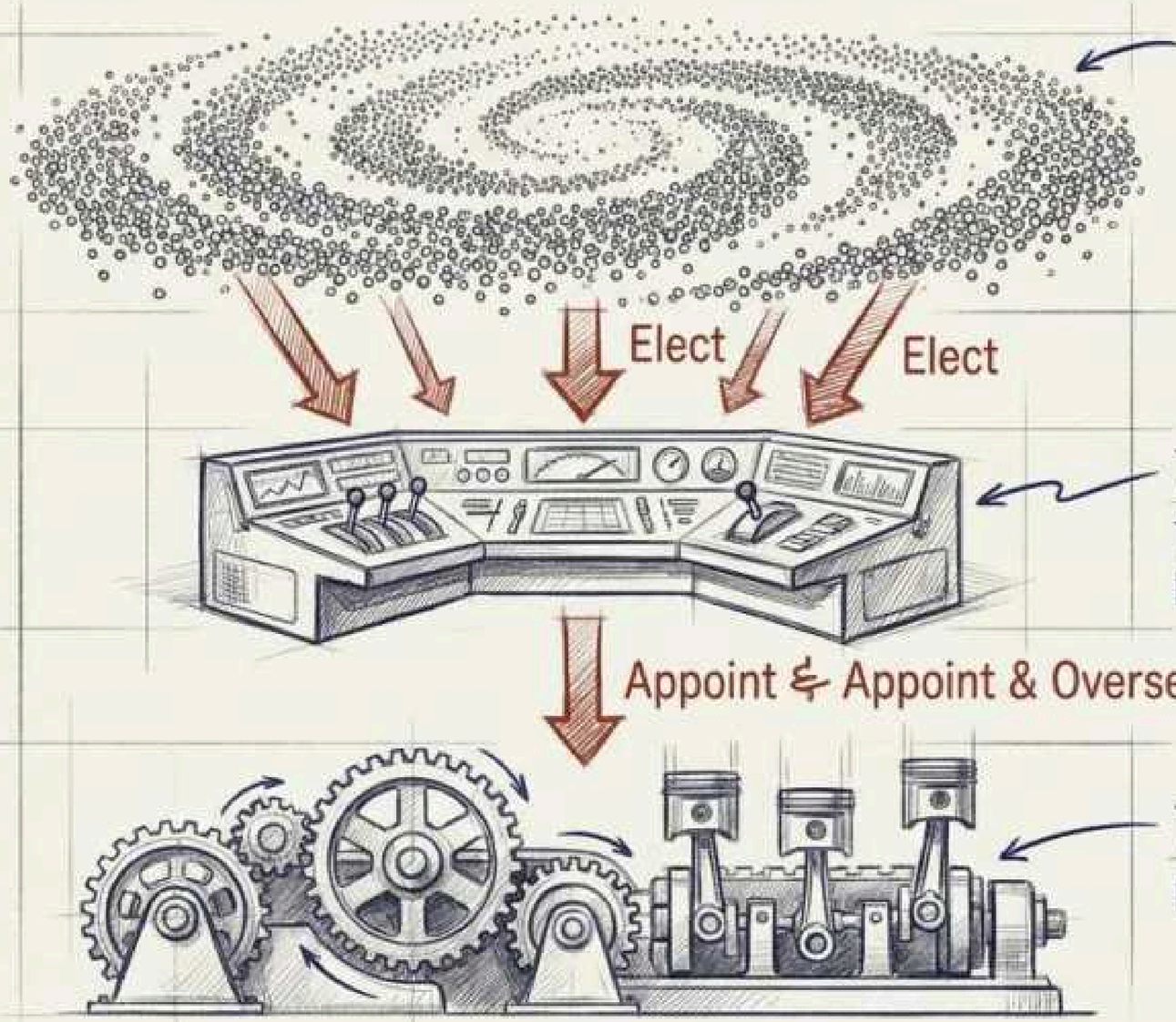
Corporate Liquidity



Owner exit = Seamless sale. Millions of shares change hands daily while the business operates unaffected.

Result: Liquidity ↑ = Investor willingness to pay ↑

Delegated Management: Centralized Control



Hundreds of thousands of Shareholders

Everyday decisions are impossible for mass ownership.

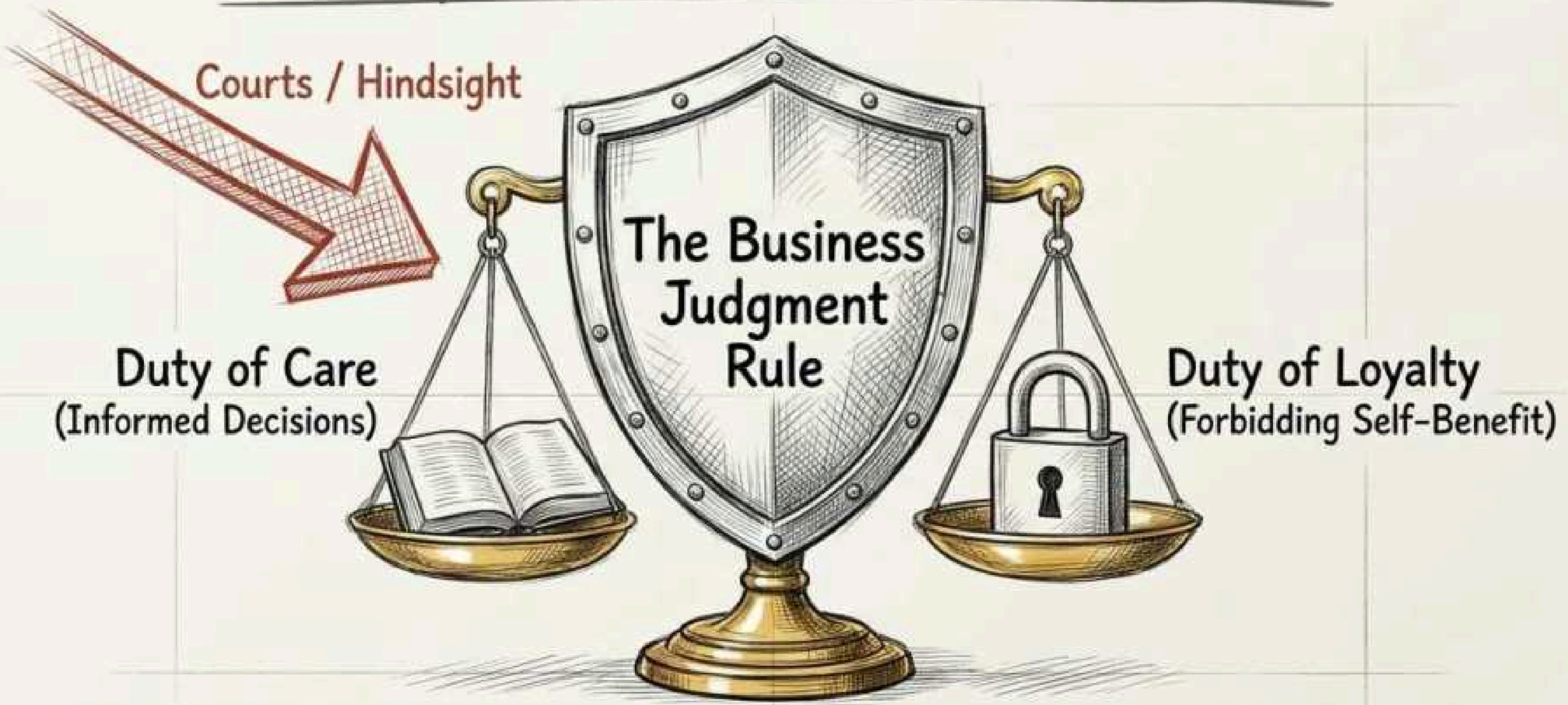
The Board of Directors

The central decision-making body with legal duties.

The Managers

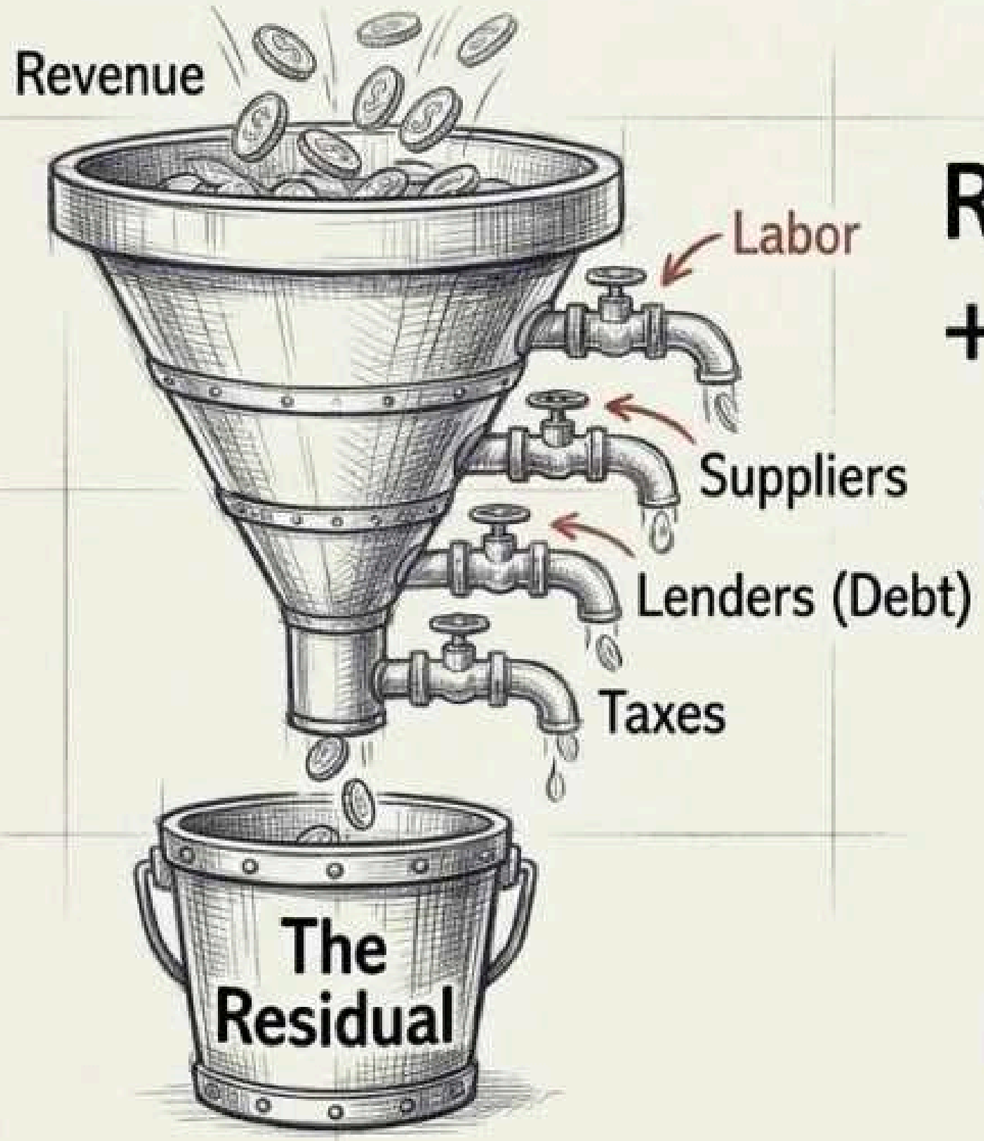
Run the everyday operations.

Fiduciary Duties & The Protective Shield



- Duty of Loyalty: Forbids using position for personal benefit (e.g., inflated property sales).
- Duty of Care: Requires informed decision-making.
- The Shield: Courts are reluctant to second-guess honest business judgments. ✓

Investor Ownership: The Residual Equation



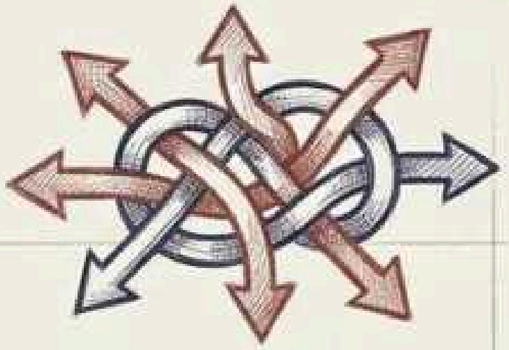
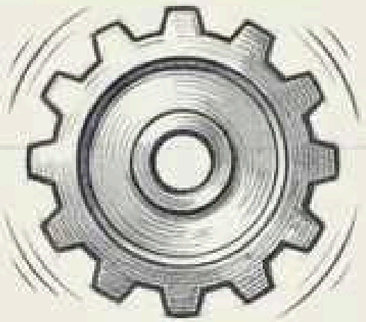
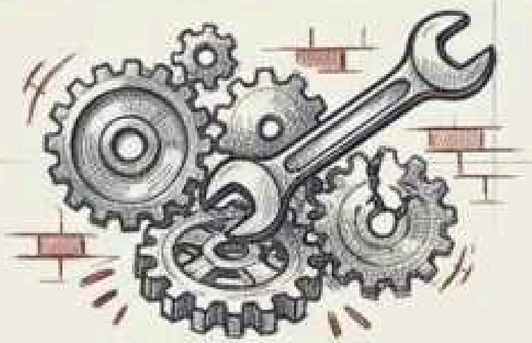
Revenue – (Labor + Supply + Debt + Tax) = Residual

The Rule: Equity capital suppliers hold the right to govern the firm and receive this residual.

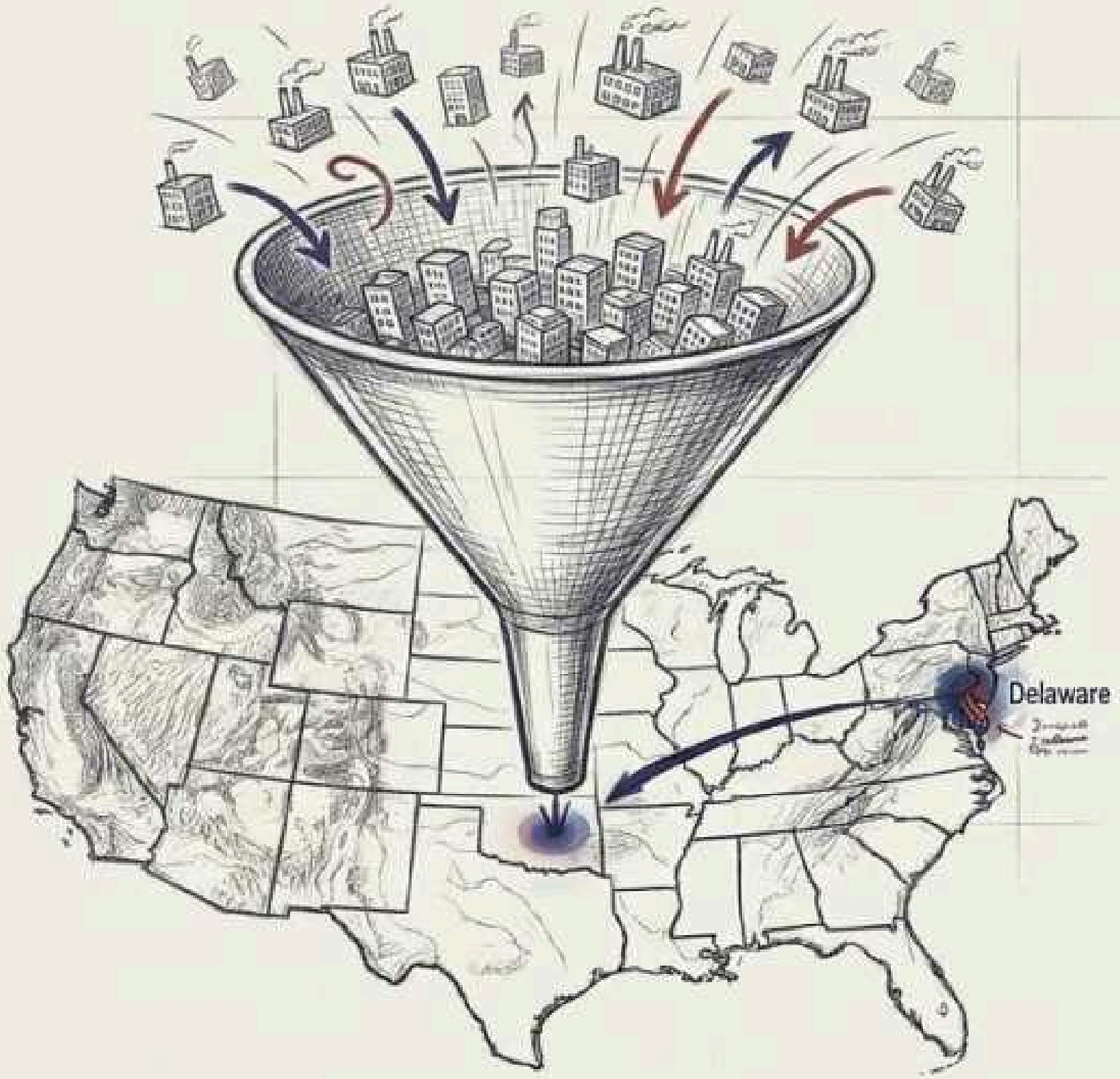
Note: Other forms exist (customer co-ops, mutual insurers), but investor ownership dominates large-scale business.

Why Investors? A Diagnostic of Ownership Costs

*Theory (Hansmann): Ownership falls to the group with the lowest ownership costs.

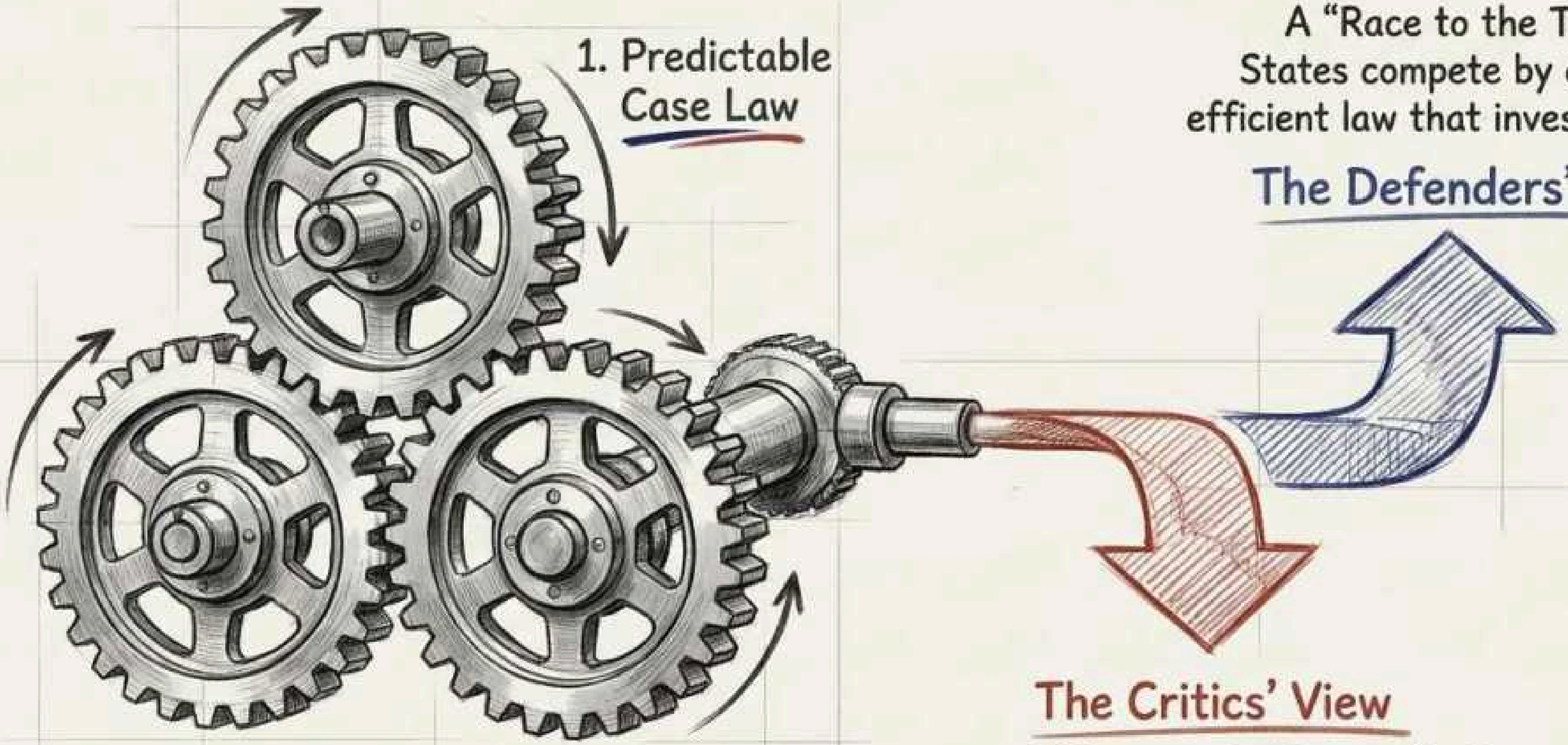
	Investors	Workers / Customers
Goal Alignment	 ↑ Share Value (Simple common interest)	 Divided interests (jobs/products)
Governance Friction	 Low Friction → Easier collective decisions	 High Friction → Harder to govern

The Environment: The Delaware Anomaly



- Corporate law is state law; incorporation is independent of operational geography.
- The Statistics: Delaware (pop. ~1 million) hosts:
  - > 50% of all publicly traded US companies.
  - > 66% of the Fortune 500.
- The Output: Generates significant state revenue from incorporation fees and franchise taxes.

The Engine of Delaware's Dominance



A "Race to the Top" - States compete by offering efficient law that investors value.

The Defenders' View

The Critics' View

A "Race to the Bottom" - States compete by favoring managers.

The European Evolution: Mobility Unlocked

Pre-1999 → 1999 Catalyst → Post-1999



Pre-1999

Old Rule: Bound to the law of the "Real Headquarters" location.

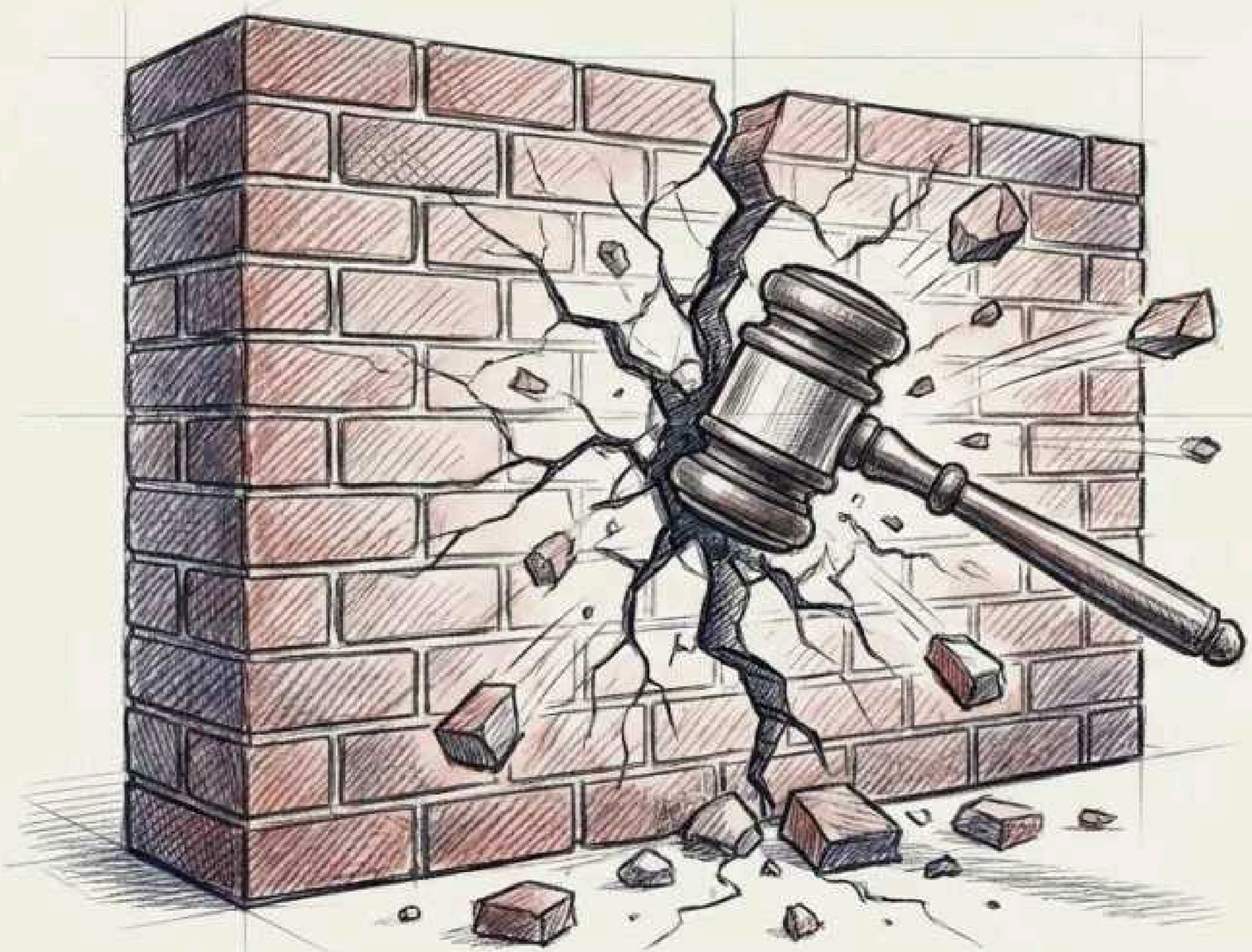
1999 Catalyst

Centros Case (ECJ): Right of establishment.

Post-1999

The Result: Entrepreneurs freely incorporate in one state (e.g., English private limited company for low capital rules) and operate in another.

Vulnerabilities: Piercing the Corporate Veil



The Exception: Courts hold shareholders personally liable when limited liability is abused.

The Triggers (Extremely Rare):

- → Company is a mere sham or façade.
- → Owners intimately mixed personal and company funds.
- → Entity used specifically to commit fraud or evade an existing legal obligation.

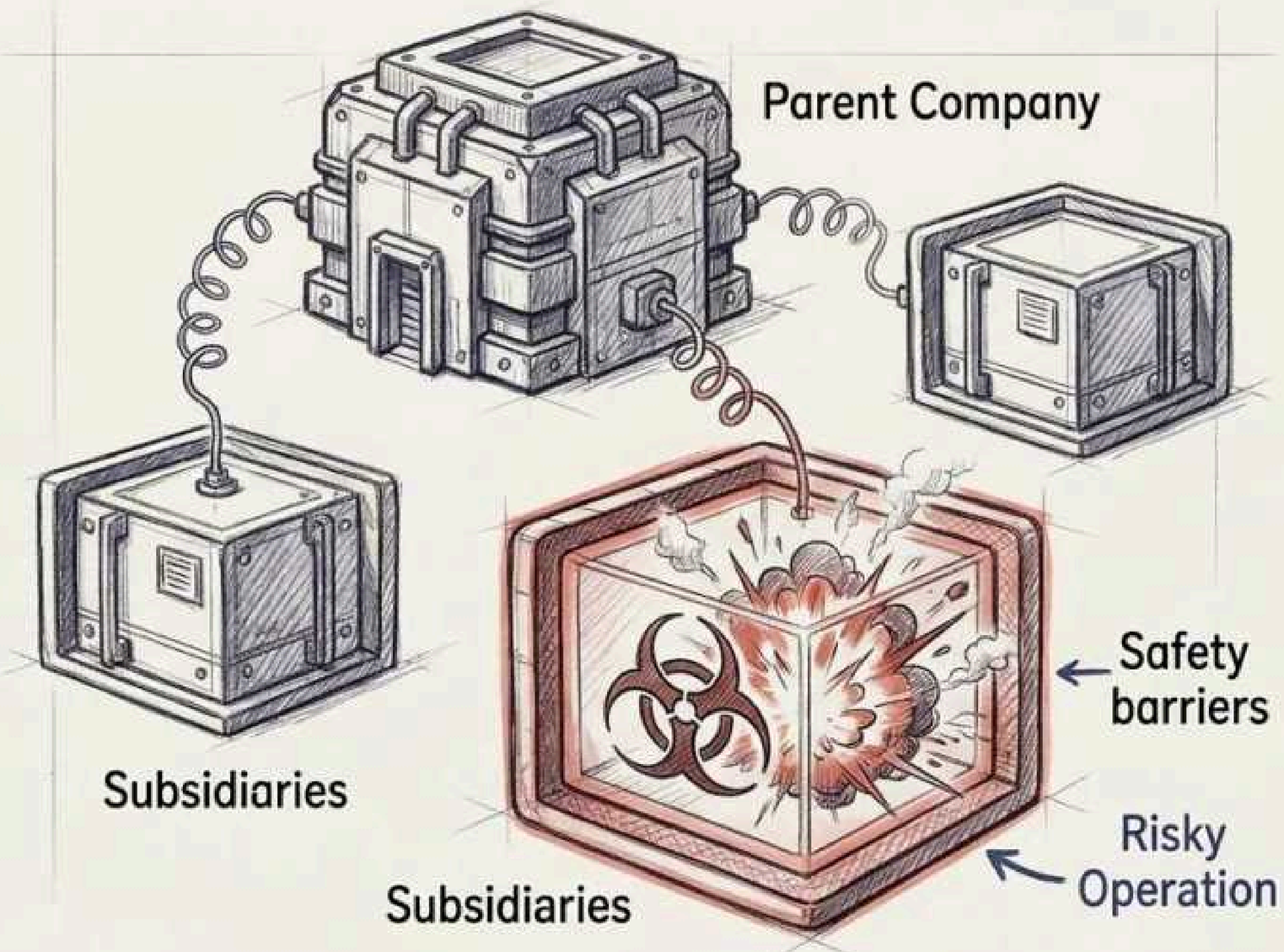
*Precedent: *Prest v Petrodel* (UK Supreme Court, 2013) confirms this doctrine is exceptionally narrow.*

Corporate Groups: Stacking the Shields

Scale: Large firms consist of hundreds of subsidiaries, each a separate legal person.

→ The Strategy: Isolate risky operations in thinly capitalized subsidiaries. If disaster strikes, victims can only claim that specific subsidiary's assets.

→ The Response: Lawmakers create special statutory rules for environmental, tax, and banking damage to counter this.



Corporate Rights: Constructing Personhood

Timeline

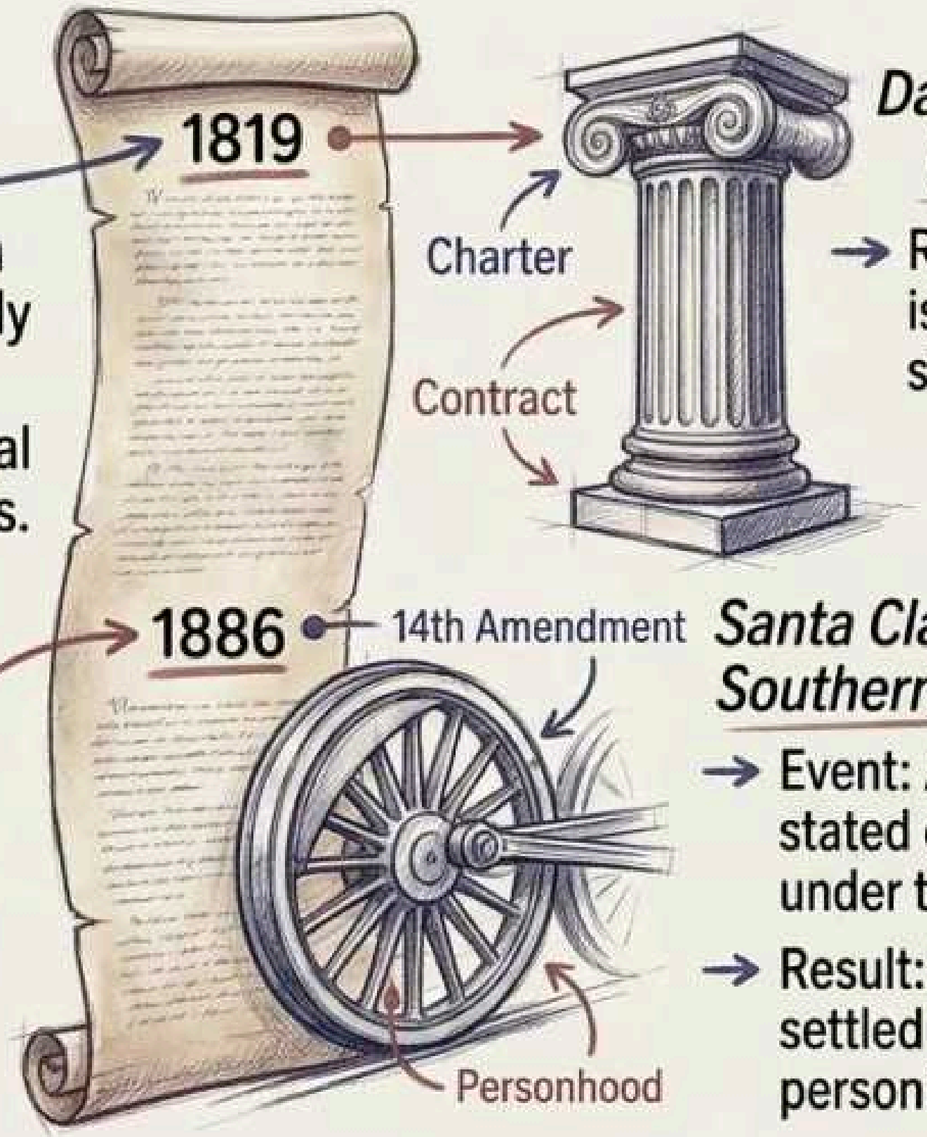
→ Ruling: A corporate charter is a contract the state cannot simply rewrite.

→ Result: Establishes fundamental property & contract protections.

Lestination

→ Event: A note by the court corporations were persons.

→ Result: Treated by later courts as settled law, granting constitutional personhood.



Dartmouth College Case (US Supreme Court)

→ Ruling: A corporate charter is a contract the state cannot simply rewrite.

Santa Clara County v. Southern Pacific Railroad

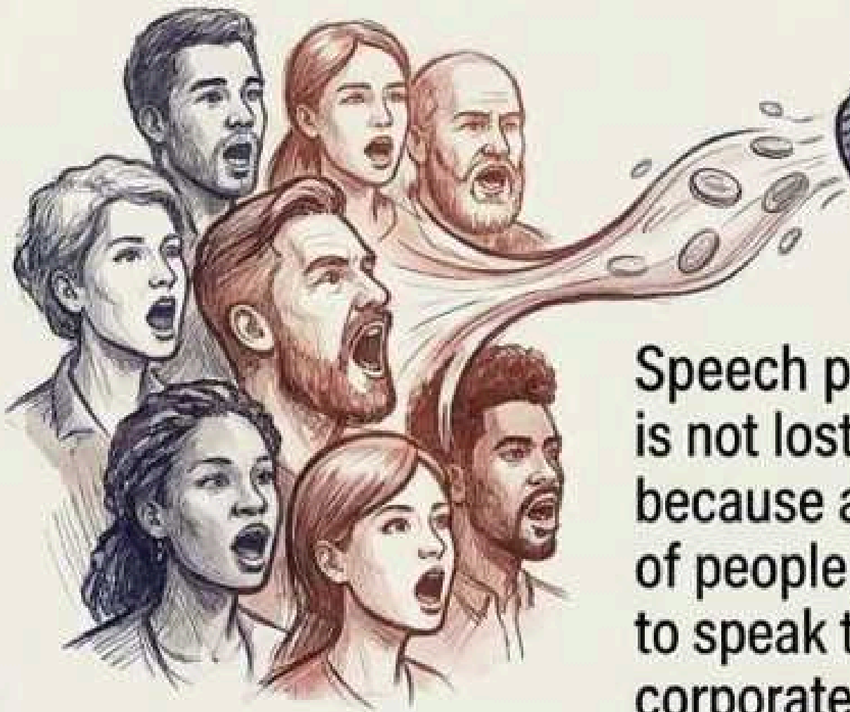
→ Event: A note by the court reporter stated corporations were persons under the Fourteenth Amendment.

→ Result: Treated by later courts as settled law, granting constitutional personhood.

Corporate Rights: The Free Speech Frontier

2010 – *Citizens United v. FEC* (US Supreme Court): Government may not ban independent political spending by corporations (Free Speech).

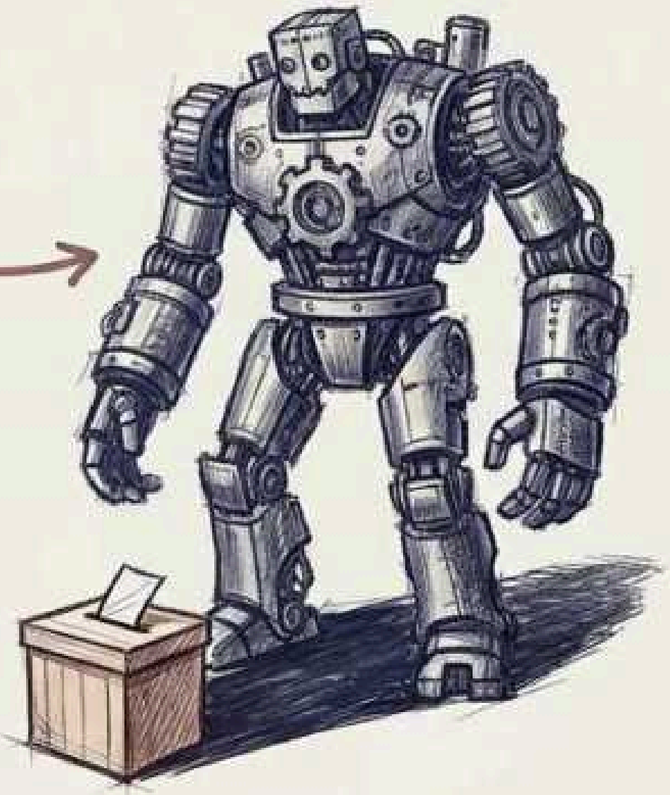
The Supporters



Speech protection is not lost simply because a group of people chooses to speak through a corporate form.

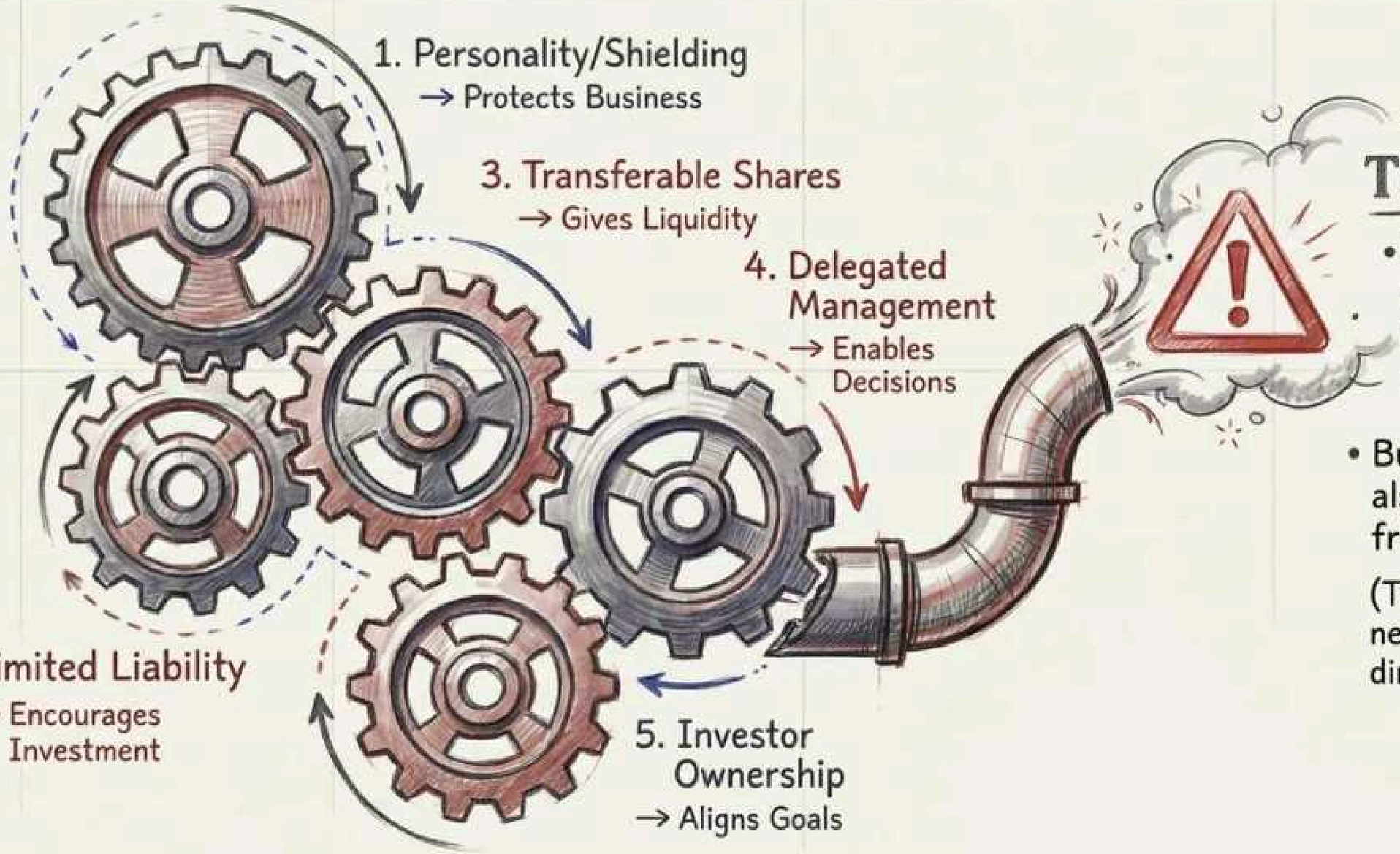


The Critics



Corporations are creatures of the state. Their vast, unnatural resources have the power to distort democracy.

Synthesis: The Corporate Machine



The Output:

- Every feature solves a fundamental problem of early commerce.
- But... every feature also generates a new friction point.

(The biggest of these new problems leads directly to Lecture 3).

Closing Diagnostic & The Gap Ahead



Closing Exercise: Analyze a large company you know:

1. Where is it incorporated?
2. Who sits on its board?
3. How many subsidiaries exist in its annual report?
4. Which of the 5 core features can you see at work?

Preview – Lecture 3:
We examine the gap between those who *own* a corporation and those who *control* it.