

STATES' RIGHTS AGAINST CORPORATE RIGHTS

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Most of the many critics who denounce Citizens United v. FEC and Burwell v. Hobby Lobby Stores, Inc., ground their complaint in consequentialist terms, at least in part. They see these decisions as entrenching corporate power, by constitutional or quasi-constitutional means, against what ought to be a supervening public will. This Article argues for a different view. Far from entrenching corporate power, the rights cases effectively delegate choices about corporate activities to a politically sensitive, if surprising, instrument: ordinary state legislation. In particular, this Article advances two claims about the nature of states' rights against corporate rights: first, under existing law, the states can subvert the federal rights of their own corporations; second, and more speculatively, the states can also frustrate the federal rights of foreign corporations that do local business. The analysis suggests that reformers would do well to look to the state capitols rather than the halls of Washington. It also yields implications for the theory of interstate corporate regulation more generally.

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I. INTRODUCTION

The Supreme Court's decisions in *Citizens United v. FEC*¹ and *Burwell v. Hobby Lobby Stores, Inc.*² sparked a wide-ranging debate about the place of business corporations in the American economy and political scene. Dozens of articles attacking the decisions have populated the law reviews, to say nothing of the leading newspapers' editorial pages.³ Even politicians have put the question of corporate rights center stage—President Obama's critique of *Citizens United*, in his 2010 State of the Union address, being only the most famous instance.⁴ In the academic as well as public presses, most

¹ *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010).

² *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751 (2014).

³ For a catalog of some critical responses, see Kent Greenfield, *In Defense of Corporate Persons*, 30 CONST. COMMENT. 309, 309–12 (2015).

⁴ President Barack Obama, State of the Union Address (Jan. 27, 2010), in 156 CONG. REC. H418 (daily ed. Jan. 27, 2010) (“With all due deference to the separation of powers, last week, the Supreme Court

critics' judgment is based at least in part on the decisions' supposed ill consequences. At bottom lies a perception that the cases entrench corporate power in domains where a sensible public judgment might opt to curtail it.

Enough ink has been spilled on the merits of *Citizens United* and *Hobby Lobby*. Rather than revisit those decisions or the theoretical foundations of corporate rights more generally,⁵ this Article takes aim at common assumptions about the cases' functional significance. The central contention of this Article is that consequentialist critics of federal corporate rights are wrong, ironically enough, to concentrate their attention on federal law.⁶ The practical meaning of the corporate-rights cases is less a function of the Constitution than of garden-variety state laws.⁷ More

reversed a century of law that I believe will open the floodgates for special interests—including foreign corporations—to spend without limit in our elections.”).

⁵ For my defense of the decisions—and of the bulk of the Court's historic corporate-rights cases, see Vincent S.J. Buccola, *Corporate Rights and Organizational Neutrality*, 101 IOWA L. REV. 499 (2016).

⁶ Notable exceptions are Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639 (2016) (arguing that *Citizens United* and *Hobby Lobby* put pressure on state corporate law to ameliorate conflicts of interest within the firm); Greenfield, *supra* note 3, at 327–32 (arguing that attention to governance rules would ameliorate concerns over corporate political influence); Joseph K. Leahy, *Corporate Political Contributions as Bad Faith*, 86 U. COLO. L. REV. 477 (2015) (arguing that managers' direction of corporate political contributions might constitute bad faith under state law); Joseph K. Leahy, *Are Corporate Super PAC Contributions Waste or Self-Dealing? A Closer Look*, 79 MO. L. REV. 283 (2014) (arguing that corporate political contributions might constitute waste or self-dealing under state law); James Kwak, *Corporate Law Constraints on Political Spending*, 18 N.C. BANK. INST. J. 251 (2013) (arguing that courts should entertain derivative suits to restrain managerial political speech at odds with shareholder interest); Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Speech: Who Decides?*, 124 HARV. L. REV. 83 (2010) (arguing for political-speech specific voting rules to ensure expenditures are made to further shareholder interests).

⁷ *Hobby Lobby* turned on the application of a statute—the Religious Freedom and Restoration Act—rather than the Constitution. *Burwell v.*

specifically, this Article advances two claims about the law of states' rights against corporate rights—one claim weaker but more conclusive, one stronger but less certain. The weak claim says that the states can already enact ordinary legislation that would practically undermine their domestic corporations' federal rights. The strong claim says that the states can also undermine the rights of foreign corporations—that is, corporations incorporated in other states—that do business within their borders.

On its face, the notion of state preeminence in this domain might seem vulnerable to an elementary syllogism. *Citizens United* and *Hobby Lobby* concern the application of federal rights. Federal law trumps inconsistent state enactments. Therefore, an attempt by the states to countermand the Court looks doomed. Nevertheless, this Article will argue that the states in fact have much to say about federal corporate rights' practical import, if not their formal existence. Implicit in the argument is a more general reminder of the states' central role not only in regulating shareholder-manager relations, but also in defining the nature of the corporate form itself.

The weak claim begins with an observation about the formal structure of the Court's corporate-rights decisions. To understand these cases, one needs to distinguish between the related but distinctive concepts of corporate rights and corporate powers.⁸ When the Justices decide that a corporation, *C*, may resist a regulation on the ground of some federal right, they in effect decide two things in addition to the strength of the right itself: first, that the corporation is,

Hobby Lobby Stores, Inc., 134 S. Ct. 2751, 2759 (2014). But in holding that for-profit corporations are capable of religious exercise, the Court implicitly concluded also that they may assert the right to free exercise under the First Amendment.

⁸ Joe Leahy independently suggested a distinction along these lines in remarks made at the National Business Law Scholars Conference in 2015. See Joseph K. Leahy, *The Ultra Vires Solution to Citizens United*, presentation slides available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2802147 [https://perma.cc/W7BR-2TZW].

as a general matter, a kind of entity capable of bearing the right; and, second, that *C* in particular has been constituted with the power to do whatever it is the right immunizes. The first holding, about corporate rights, has by its nature a broad application because it concerns the fit between the right and the corporate form generally. The second holding, about *C*'s powers, is necessarily limited in application because it depends on localized facts about *C*. Yet both are necessary to *C*'s assertion that it may act in its preferred manner notwithstanding contrary law. Put generally, a corporation can thwart regulation if and only if it has both the power to act contrary to the regulation and the right to do so.

The states cannot overrule the Court's understanding of corporate rights. That much is clear. What they can do, however, is disempower the corporations they create from doing the kinds of things that implicate disfavored federal rights. An axiom of corporate law holds that the corporation's powers derive from its articles of incorporation—in most cases a matter of state law.⁹ The states thus can effectively cabin the consequences of federal rights precisely because declining to grant a power to do some act is importantly different from invading a person's right to do an act it is empowered to do.

To make the intuition concrete, consider a trivial yet telling example. Under Delaware law, no domestic corporation organized after April 18, 1945 has the power to issue "honorary degrees" unless the Secretary of Education specially endorses its articles of incorporation.¹⁰ It is at least arguable—and for present purposes we may assume—that

⁹ See Pollman, *supra* note 6, at 644–54 (describing the emergence of corporate law as a matter primarily of state concern). Some federally chartered corporations are disproportionately significant to the national economy. But they are relatively few in number outside the banking industry. See Paul E. Lund, *Federally Chartered Corporations and Federal Jurisdiction*, 36 FLA. ST. U. L. REV. 317, 320–25 (2009).

¹⁰ DEL. CODE ANN. tit. 8, § 125 (West 2011).

the mark of approval implied in conferring an honorary certificate is speech protected by the First Amendment. If, for example, a scion of the du Pont family wished to confer a (richly deserved) honor on Wilmington native Judge Reinhold, it is doubtful the state could stop her. But not so where E.I. DuPont de Nemours & Company, Inc. seeks to do likewise. The corporation may do only what its creator—Delaware, in this case—vests it with power to do. It violates no constitutional rule to create “bodies politic,” as corporations were once known,¹¹ incapable of granting honorary degrees. Thus, although the First Amendment protects speech the corporation is empowered to make, it has nothing to say about speech that is *ultra vires*.

If the rights-powers distinction strikes the modern ear as too clever by half, it is for two reasons. First, lawyers are accustomed to thinking about the rights of natural persons. Most rights cases—certainly most constitutional rights cases—concern an individual’s authority to block government regulation. The government seeks to prevent a person from doing something she wishes to do, and she resists. There is no question of her *power* to act contrary to the regulation. Unlike natural persons, however, corporations are products of law. Positive law defines the corporation by establishing its capacities to be and to do. Second, corporations today are in fact typically endowed with very broad powers. In exchange for a small fee and some rudimentary documentation, all fifty states will create a corporation competent to pursue “all lawful acts and activities.”¹² It was not always so. During the republic’s first century, charters were hard to come by, and they tended to

¹¹ 1 WILLIAM BLACKSTONE, COMMENTARIES *467; 1 STEWART KYD, A TREATISE ON THE LAW OF CORPORATIONS 12 (1793).

¹² See, e.g., DEL. CODE ANN. tit. 8, § 102(a)(3) (West 2011). The precise formulation varies. See, e.g., MODEL BUS. CORP. ACT § 3.01 (AM. BAR ASS’N 2010) (ascribing to the corporation the purpose of conducting “any lawful business”); MODEL BUS. CORP. ACT § 3.02 (AM. BAR ASS’N 2010) (granting the corporation “the same powers as an individual to do all things necessary and convenient” to its purpose).

circumscribe quite narrowly both the means and ends of corporate activity. Those days have passed, but as long as the states' prerogative remains, the distinction between corporate rights and powers will be vital.

The strong claim takes as given a corporation whose articles empower it to do acts protected by a federal right. If such a corporation does business wholly within its state of incorporation, this is the end of the story. But the question remains what, if anything, other states in which the corporation seeks to operate may do to restrain its exercise of disfavored powers. It is clear these "host" states lack the authority to abrogate charters or the Constitution.¹³ But host states might nevertheless adopt two kinds of strategies by which they could practically restrain the exercise of disfavored corporate rights. Neither strategy targets the formal existence of powers. Instead, they would seek to influence corporate decision-making. Both approaches would provoke criticism, and the courts have doctrines at their disposal that could, if extended plausibly, nullify both. But for reasons of political economy to be discussed, host states are in a much stronger position than many would suppose.

The first strategy challenges the internal-affairs doctrine. Ordinarily, the mode of corporate decision-making is supposed to be the chartering state's province.¹⁴ Indeed, the federal structure generated by the internal-affairs doctrine has been called, plausibly, "the genius of American corporate law."¹⁵ But fundamentally it is a choice-of-law rule and, many think, only a customary one.¹⁶ Some states already

¹³ This Article uses the phrase "chartering state" to describe a firm's state of incorporation, and "host state" to describe a state seeking to regulate a corporation chartered elsewhere.

¹⁴ RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. a (AM. LAW INST. 1971)

¹⁵ ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 1–13 (1993).

¹⁶ See *infra* Section IV.A.

reject it in part.¹⁷ They may wish to weaken it further. An aggressive intervention of this sort could make foreign corporations' exercise of a federal right practically, although not formally, impossible. For example, a legislature wishing to undermine *Citizens United* might declare the directors of any corporation doing business domestically liable to the corporation's shareholders for making political contributions absent their unanimous approval. Less extreme laws are of course possible.

The second strategy conditions the state's recognition of foreign corporations on their abstaining from exercising a right. Similar laws have deep roots in American law. Until late in the nineteenth century, it was commonly understood that the states could refuse to recognize the existence of foreign corporations for reasons good, bad, or nonexistent,¹⁸ and it followed that they could condition recognition on any basis they wished.¹⁹ The states' authority today is no longer plenary, as it once was. Although courts have never abrogated the non-recognition power in general terms, they have chipped away at some of its applications.²⁰ As one commentator puts it, "modern juridical thinking has cut deeply into the acceptability of the principle of conditional entry."²¹ A state can still decline to recognize foreign corporations, but not for reasons that are themselves unconstitutional. In addition, some strands of constitutional doctrine can be read to prohibit a state's undermining of foreign corporations' rights. But the cases invalidating conditional-recognition laws have typically concerned state policies discriminating against out-of-state business. If a state disempowered its own domestic corporations with

¹⁷ See *infra* notes 102–06 and accompanying text.

¹⁸ *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519 (1839); see *infra* notes 139–45 and accompanying text.

¹⁹ See, e.g., *Paul v. Virginia*, 75 U.S. (7 Wall.) 168 (1869); *infra* Section IV.B.

²⁰ See *infra* Section IV.B.

²¹ William Laurens Walker, *Foreign Corporation Laws: A Current Account*, 47 N.C. L. REV. 733, 733 (1969).

respect to a particular activity, the state may well be within the Constitution's bounds to demand that foreign corporations play on a level field.

Although this Article focuses on the states' authority to curtail federally recognized rights, the analysis has broader implications for the law of corporate regulation. The central theoretical dilemma concerns not the nature of political rights in particular, but, more generally, the allocation of regulatory authority in a federal system. In this vein there are two fundamental questions. First—in which domains should state policy supplant the results of voluntary association under competitive conditions? And second—*which* state or states ought to supply the terms on which firms will compete? Thus, many of this Article's findings can be generalized to other, perennially vexing issues of corporate law in a national economy, including, for example, the extent of limited liability, the definition of agency, and the nature and direction of fiduciary duties.

What follows is organized in three parts. Part II discusses the theory and history of state authority over domestic corporations' powers, arguing that an absolute authority to undermine the significance of federal rights persists to today. Parts III and IV turn to the states' putative authority to regulate *foreign* corporations' use of chartered powers. Part III considers the political economy arguments for and against such authority. Part IV describes and evaluates the relevant legal doctrines. It argues that, notwithstanding apparent doctrinal ambiguity, the courts have in general condemned only those host-state interventions that reflect a discriminatory policy. This finding reflects the political economy story tolerably well, and suggests that economically important states could influence the significance of federal corporate rights more profoundly than has been supposed.

II. THE STATES AND DOMESTIC CORPORATION POWERS

This Part argues that the states can, if they wish, decline to give their own corporations the power to act in ways modern constitutional law seems to protect. The claim is grounded in a theory of the corporation that dates to, and before, the nation's founding. The facts are well known to corporate scholars, but their significance in the constitutional context seems to have gone largely unrecognized. In the early-American imagination, the states were understood to have broad authority to regulate the capacities of the corporations they created, and they routinely used the authority. By the early twentieth century, the states more or less ceased to restrict corporate powers, as such, but they did so as a matter of political expediency rather than legal compulsion. No doctrine in the development of modern corporate law suggests that the states surrendered their constitutional authority over domestic corporations' powers.

A. The Traditional Legal Theory of Corporate Powers

To a nineteenth-century American lawyer, the proposition that a corporation has any inherent powers to act, irrespective of the terms of its charter, would have been astounding. The nature of the relationship between a state and the corporations it constituted was well settled, and it was the relationship between creator and created.²² Individuals, including those associated in partnership, were entitled to do whatever acts government did not or, in virtue of its limited sphere, could not prohibit. A corporation, by contrast, could invoke rights against government

²² In *Trs. of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819), the Supreme Court famously held that the contracts clause prohibits states from altering a charter's terms once granted. The decision's practical effect was, however, short-lived. The states began reserving the option to revise terms.

intervention only insofar as its charter licensed the activity at issue.

Early decisions of the Supreme Court consistently announced this common understanding. In an 1804 insurance dispute, for example, Chief Justice Marshall explained that the corporation derives its powers, its very nature, so to speak, from positive legislation:

[T]his body . . . in its corporate capacity, is the mere creature of the act to which it owes its existence, . . . [and] it may correctly be said to be precisely what the incorporating act has made it, to derive all its powers from that act, and to be capable of exerting its faculties only in the manner which that act authorizes.²³

Fifteen years later, in the *Dartmouth College Case*, Marshall reprised the theme. “Being a mere creature of law,” he wrote, the corporation “possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence.”²⁴ This understanding was not peculiar to the Marshall Court. Marshall’s successor, Chief Justice Taney, repeatedly set out the same view. “[C]orporations created by statute must depend,” he explained, “both for their powers, and the mode of exercising them, upon the true construction of the [charter] statute itself.”²⁵ In his view, it “will not be denied” that “a corporation is strictly limited to the exercise of those powers which are specifically conferred on it.”²⁶

With this last remark Taney perhaps spoke hyperbolically. The law of corporate powers was somewhat more complicated. Not all powers had to be “specifically

²³ *Head & Armory v. Providence Ins. Co.*, 2 U.S. (2 Cranch) 127, 167 (1804).

²⁴ *Trs. of Dartmouth College*, 17 U.S. (4 Wheat.) at 636.

²⁵ *Bank of the United States v. Dandridge*, 25 U.S. (12 Wheat.) 64, 68 (1827).

²⁶ *Charles Rivers Bridge v. Warren Bridge*, 36 U.S. (11 Pet.) 420, 546 (1837).

conferred” by charter. Some were implied. Chancellor Kent identified six such “ordinary” powers: perpetual succession, amotion, the power to sue and be sued, the power to hold property, the power to act under a common seal, and the power to make bylaws for internal governance.²⁷ These ordinary powers were to be inferred from silence; they were not, however, beyond the chartering state’s authority to curtail. In fact, as a matter of practice, the ordinary powers were “taken, in many instances, with much modification and restriction.”²⁸ For example, although corporations were presumed to exist perpetually, most were in fact chartered for a limited term of years.²⁹ In addition, although corporations were presumed to be able to hold property of all kinds, they were frequently deprived of their “common-law right, of purchasing or receiving lands or other property.”³⁰

Apart from the ordinary or “incidental” attributes of incorporation, all powers had to be spelled out in the charter. A leading nineteenth-century treatise on corporate law explained the general rule of charter construction in terms similar to those governing Congress’s grants of power under the Constitution. According to Angell and Ames, “a corporation has no other powers than such as are specifically granted; or, such as are necessary for the purpose of carrying into effect the powers expressly granted.”³¹ Grants of power

²⁷ 2 JAMES KENT, COMMENTARIES ON AMERICAN LAW *277–78 (1889 rev’d ed.). These were sometimes referred to as the corporation’s “incidental” powers. See, e.g., JOSEPH K. ANGELL & SAMUEL AMES, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS AGGREGATE § 110, at 84 (7th ed. 1861).

²⁸ 2 KENT, *supra* note 27, at *278; see ANGELL & AMES, *supra* note 27, §§ 110–11, at 83–84.

²⁹ *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 554–64 (1933) (Brandeis, J., dissenting in part) (noting that until the late-nineteenth century, most corporations were chartered to last twenty, thirty, or fifty years); 2 KENT, *supra* note 27, at *267–68 (“[M]ost of the private corporations recently created by statute are limited in duration to a few years.”).

³⁰ ANGELL & AMES, *supra* note 27, § 151, at 114.

³¹ ANGELL & AMES, *supra* note 27, § 111, at 85; see also 2 KENT, *supra* note 27, at *298–99.

were often construed narrowly.³² Chancellor Kent reasoned that corporations, “mere creatures of law, established for special purposes,” who derive “all their powers from the acts creating them,” should have to justify the business they sought to do in terms of the charter “and be confined in their operations to the mode, and manner, and subject matter prescribed.”³³ Angell and Ames likewise explained the governing norm in terms of the corporation’s ontological foundations. The corporation, “having been created for a *specific* purpose, not only can make no contract forbidden by its charter, which is, as it were the law of its nature, but in general can make no contract which is not necessary, either directly or incidentally, to enable it to answer that purpose.”³⁴ Each corporation’s charter was like a custom-built moat. Inside it, entrepreneurial activity in the corporate name could flourish; outside it, there simply was no corporation.

Two remedial schemes policed the moat. One was the information in the nature of *quo warranto*, by which an attorney general could oust a corporation from business exceeding its charter or cause the forfeit of its franchise altogether. The other, more important, remedy lay in the doctrine of *ultra vires*, which holds void, and hence unenforceable, a corporation’s colorable agreement to do acts beyond its chartered powers.³⁵ “In its proper sense,” one

³² See, e.g., *Charles Rivers Bridge v. Warren Bridge*, 36 U.S. (11 Pet.) 420 (1837); *Beatty v. Lessee of Knowler*, 20 U.S. (4 Pet.) 152, 168 (1830) (“That a corporation is strictly limited to the exercise of those powers which are specifically conferred on it, will not be denied. The exercise of the corporate franchise, being restrictive of individual rights, cannot be extended beyond the letter and spirit of the act of incorporation.”).

³³ 2 KENT, *supra* note 27, at *299.

³⁴ ANGELL & AMES, *supra* note 27, § 256, at 228.

³⁵ Pollman, *supra* note 6, at 648–49; Leo E. Strine, Jr. & Nicholas Walter, *Originalist or Original: The Difficulties of Reconciling Citizens United with Corporate Law History*, 91 NOTRE DAME L. REV. 877, 880–81 (2016). See generally Kent Greenfield, *Ultra Vires Lives! A Stakeholder*

treatise explains, the *ultra vires* act “denotes some act or transaction on the part of a corporation which, although not unlawful or contrary to public policy if done or executed by an individual, is yet beyond the legitimate powers of the corporation as they are defined” by the law creating it.³⁶ *Ultra vires* harnesses market forces in an ingenious way to constrain corporate managers where active state monitoring might be exceedingly expensive. But the doctrine also follows deductively from the theory of the corporation. The corporation *is* just what the state has made—no more or less. By its nature, therefore, it can do only those things the state has allowed. Whatever else management might pretend to do in the corporation’s name cannot, in fact, be a corporate act, but only the act of individuals masquerading as a collectivity.³⁷

Ultra vires decisions fill the nineteenth-century corporate law treatises. The 1891 case of *Central Transportation Co. v. Pullman’s Palace Car Co.* is but one example of the many decisions reflecting the charter’s supremacy.³⁸ In 1862, Pennsylvania had created the Central Transportation Company, providing in its charter that its objective was “the transportation of passengers in railroad cars constructed and to be owned by the said company” under certain patents.³⁹ Eight years later, the commonwealth empowered Central also “to enter into contracts with corporations of [Pennsylvania] or any other state for the leasing or hiring and transfer to them, or any of them,” of its “railway cars and other personal property.”⁴⁰ At stake in the case was the

Analysis of Corporate Illegality (with Notes on How Corporate Law Could Reinforce International Law Norms), 87 VA. L. REV. 1279 (2001).

³⁶ 2 ARTHUR W. MACHEN, JR., A TREATISE ON THE MODERN LAW OF CORPORATIONS WITH REFERENCE TO FORMATION AND OPERATION UNDER GENERAL LAWS § 1012 (1909).

³⁷ See generally Albert J. Harno, *Privileges and Powers of a Corporation and the Doctrine of Ultra Vires*, 35 YALE L.J. 13 (1925).

³⁸ 139 U.S. 24 (1891).

³⁹ *Id.* at 50.

⁴⁰ *Id.*

validity of a contract under which Central would lease all of its business to Pullman for 99 years. The Court held the deal invalid. In the Justices' eyes, the "lease" was a ruse by which Central sought to alienate its franchises entirely, an end its charter did not contemplate.⁴¹ If Central had been a partnership, there is no doubt it would have had a liberty of contract to dispose of its property as it saw fit—and likewise if Central's actual charter had been understood to allow the sale of its business. But it was not a partnership, and the charter was not so understood. The Court saw only a straightforward application of an unchallenged premise: "The powers of corporations organized under legislative statutes are such, and such only, as those statutes confer."⁴²

B. The Modern Politics of Corporate Powers

The judicial doctrine of plenary state authority over domestic corporations' powers was not just a speculative deduction. The states actively and regularly restricted corporate prerogatives through the republic's first century.⁴³ Until the middle of the nineteenth century, general incorporation statutes were rare. The creation of each new corporation entailed a unique legislative act, and legislatures took the opportunity to circumscribe the means as well as the ends of corporate activities.⁴⁴ This habit of restricting corporate powers was likely a function of the widespread use of franchises. To induce investment in naturally monopolistic enterprises, legislatures regularly granted monopoly privileges. A legislature hoping to develop the infrastructure of trade might, for example, create a corporation with exclusive authority to build a toll road between points A and

⁴¹ *Id.* at 53.

⁴² *Id.* at 43 (quoting *Thomas v. R.R. Co.*, 101 U.S. 71, 82 (1879)).

⁴³ See Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 258 (1976).

⁴⁴ Naomi R. Lamoreaux, *Partnerships, Corporations, and the Theory of the Firm*, 88 AM. ECON. REV. 66, 66 (1998).

B. To ensure the monopoly did not exceed the bounds in which it could be justified, the corporation's sphere of activity had to be limited. But whatever legislators' true motivations might have been, the charters they issued in fact tended to be exceptionally narrow by modern standards. The turnpike corporation's charter would often do more than restrict the firm's activities to those necessary to road building; it might, for example, specify the highway's precise route.⁴⁵

In time, the importance of state preeminence over the powers of domestic corporations waned. The states never lost their plenary authority, whether through constitutional change or federal statute; they simply ceased to exercise it.⁴⁶

⁴⁵ Ronald E. Seavoy, *The Public Service Origins of the American Business Corporation*, 52 BUS. HIST. REV. 30, 46 (1978).

⁴⁶ The broad outline of this history was a focal point of Justice Stevens' dissent in *Citizens United*. See *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310, 426–28 (2010) (Stevens, J., concurring in part and dissenting in part). Critics of the decision likewise cite the history as evidence of the decision's supposed non-originalism. See, e.g., Leo E. Strine, Jr., *Corporate Power Ratchet: The Courts' Role in Eroding "We the People's" Ability to Constrain Our Corporate Creations*, 51 HARV. C.R.-C.L. L. REV. (forthcoming 2016) (manuscript at 26) (on file with author) ("The Court's analysis in *Citizens United* is at odds with traditional corporate legal theory on a variety of dimensions."); Strine & Walter, *supra* note 35, at 882 ("Because *Citizens United* takes a view at odds both with the historical understanding of business corporations' legal subordination to the decisions made by elected legislators and the lengthy history of federal and state legislation restricting the involvement of for-profit corporations in the political process, it can be fairly be described as more 'original' than originalist."); John C. Coates IV, *Corporate Speech & the First Amendment: History, Data, and Implications*, 30 CONST. COMMENT. 223, 225 (2015) (arguing that historical regulation of speech activities by the states should "lead committed originalists to reject First Amendment rights for corporate speech"); Joseph F. Morrissey, *A Contractarian Critique of Citizens United*, 15 U. PA. J. CONST. L. 765, 780–84 (2013); cf. Geoffrey R. Stone, *Citizens United and Conservative Judicial Activism*, 2012 U. ILL. L. REV. 485, 497. This line of criticism confuses sovereigns. *Citizens United* concerned the validity of a federal regulation's application to a Virginia non-stock corporation constituted by the Commonwealth to be capable of doing any lawful act with powers equal to those of an individual. See VA. CODE ANN. §§ 13.1–825, 826 (2011). The founding-era practice of a

The historical reasons for this important change are contested, but the change itself is not. What is certain is that liberal access to the corporate form, which is so familiar today, is the product of state legislative choice in a period of rapid industrial expansion, not of judicial reconsideration of the theory of the firm.

Two related developments are of particular importance for our purposes. The first was the growth of general incorporation statutes. As the industrial age dawned, entrepreneurs' ability to aggregate capital became increasingly important. Legislatures found themselves doing little more than considering charter applications. Not that most legislators found this a burden: the issuance of corporate charters had become a primary locus of regulatory rent-seeking. Adherents to a Jacksonian populism, already predisposed to distrust concentrated wealth, agitated in particular against the legislatures' practice of picking and choosing the winners of industrial development. Their answer was not, however, the corporation's abolition, but its democratization.⁴⁷ By the 1870s, most states had enacted a general incorporation statute to make the corporate form widely available.⁴⁸

The same forces that pushed to liberalize access to the corporate form simultaneously conspired to broaden the uses to which the form could be put. The connection between liberal access and scope was not strictly necessary. It would have been possible to make incorporation freely available,

sovereign's limiting its own corporations' powers would have been relevant to an originalist investigation of Virginia's authority to restrict corporate political speech. It says nothing about the validity of a federal law abridging the speech of corporations actually constituted with authority to speak.

⁴⁷ See Seligman, *supra* note 43, at 257–58 (describing the minimal preconditions to a charter under the general incorporation acts).

⁴⁸ Lamoreaux, *supra* note 44, at 66; see HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW 1836–1937 (1991). Delaware enacted its first general incorporation statute in 1875. Seligman, *supra* note 43, at 249–50.

but to limit the corporation's ambit to select industries, with significant restrictions on conduct. Indeed, many states experimented with regimes of this sort, at least for a time.⁴⁹ But in a general sense, the liberal impulse toward general incorporation was inherently at odds with a world in which legislatures set tight bounds on corporate activity. The corporation, as a means of aggregating capital cheaply, was becoming increasingly central to the economy.⁵⁰ Perpetual existence was established as a norm, and limitations on capital stock were abolished. The corporation came to have, as near as possible, all of the powers of an unincorporated association of entrepreneurs—a partnership. The trend toward broader corporate powers found its logical conclusion in 1888, when New Jersey allowed corporations chartered there to own stock freely, thereby allowing entrepreneurs to replicate the trust in substance if not form.⁵¹ Josiah Marvel, the Wilmington attorney who drafted Delaware's ambitious 1899 general corporation act, summarized the law's distinctive features in a single sentence. The act, he wrote in an advertisement to potential promoters, "furnishes at least expense, ample right to stockholders, and reduces restrictions upon corporate action to a minimum."⁵²

⁴⁹ *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 554–55 (1933) (Brandeis, J., dissenting in part) ("At first, corporations could be formed under the general laws only for a limited number of purposes—usually those which required a relatively large fixed capital, like transportation, banking, and insurance, and mechanical, mining, and manufacturing enterprises.").

⁵⁰ See Henry N. Butler, *Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges*, 14 J. LEGAL STUD. 129, 138–61 (1985) (arguing that developments in the technologies of communication and transportation, which increased the amount of interstate commerce in absolute terms and as a share of total trade, pushed state legislatures toward general incorporation statutes granting broad corporate privileges).

⁵¹ Charles M. Yablon, *The Historical Race: Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910*, 32 J. CORP. L. 323, 335–45 (2007); Seligman, *supra* note 43, at 265–70.

⁵² Seligman, *supra* note 43, at 271. Nascent competition among the states, so evident in Marvel's advertisements, ensured that no state could long resist liberalizing its corporation laws. Not all were pleased with the

By 1912, forty-two states permitted the organization of corporations for “any lawful purpose.”⁵³ The modern regime was in place. Today, in exchange for a small fee, all fifty states will create a corporation empowered to pursue more or less all lawful purposes and do more or less all lawful acts.⁵⁴

For present purposes, one need not decide whether the modern legislation marks a salutary development. What is important to see in this familiar story is the fundamentally political rather than constitutional nature of the change. Without this understanding, one cannot properly understand the scope of the holding in a case like *Hobby Lobby*, and in particular the way in which such a case preserves state authority. In *Hobby Lobby*, the Court considered whether three firms—Hobby Lobby Stores, Mardel, and Conestoga Wood—could be excused on religious grounds from complying with an otherwise valid regulation promulgated by the Department of Health and Human Services. As one might expect, the greater share of the opinions dealt with a difficult question of federal right—whether corporations can

dynamic. *See, e.g., Lee*, 288 U.S. at 555–60 (Brandeis, J., dissenting) (describing and lamenting the competitive pressures that caused many legislatures to liberalize their corporation laws).

⁵³ Seligman, *supra* note 43, at 269. Among other things, liberalization of corporate powers and purposes spelled the effective end of *ultra vires*. For an argument that the doctrine could be revitalized, if in a reduced form, see Greenfield, *supra* note 35.

⁵⁴ *E.g.*, DEL. CODE ANN. tit. 8, § 121(a) (West 2011) (“In addition to the powers enumerated in § 122 of this title, every corporation, its officers, directors and stockholders shall possess and may exercise all the powers and privileges granted by this chapter or by any other law or by its certificate of incorporation, together with any powers incidental thereto, so far as such powers and privileges are necessary or convenient to the conduct, promotion or attainment of the business or purposes set forth in its certificate of incorporation.”); *id.* § 102(a)(3) (permitting a corporation to state “that the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware, and by such statement all lawful acts and activities shall be within the purposes of the corporation, except for express limitations, if any.”).

bear a right of religious free exercise under the Religious Freedom Restoration Act (“RFRA”). The Court answered yes.⁵⁵ But, consistent with the history sketched above, the Justices also saw that federal law alone could not dispose of the case. The question of whether the companies had the power to exercise whatever religious rights the RFRA might protect was critical to the judgment in the case, if not the decision’s precedential significance. The Justices answered that the companies had the power to exercise these religious rights:

[T]he objectives that may properly be pursued by the companies in these cases are governed by the laws of the States in which they were incorporated— Pennsylvania and Oklahoma—and the laws of those States permit for-profit corporations to pursue “any lawful purpose” or “act,” including the pursuit of profit in conformity with the owners’ religious principles.⁵⁶

Had state law not invested the companies with such broad powers, the very question of the RFRA’s application to corporations, generally, would have been mere digression.

⁵⁵ *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2768–69 (2014).

⁵⁶ *Id.* at 2771–72 (2014) (citing 15 PA. CONS. STAT. § 1301 (2001) (“Corporations may be incorporated under this subpart for any lawful purpose or purposes”)); see OKLA. STAT. tit. 18, §§ 1002, 1005 (West 2012) (“[E]very corporation, whether profit or not for profit” may “be incorporated or organized . . . to conduct or promote any lawful business or purposes”). Among other things, this passage suggests that *Hobby Lobby* was not about unconstitutional conditions. Cf. Kent Greenfield, *Hobby Lobby Symposium: Hobby Lobby, “Unconstitutional Conditions,” and Corporate Law Mistakes*, SCOTUSBLOG (Oct. 4, 2016, 10:00 AM), <http://www.scotusblog.com/2014/06/hobby-lobby-symposium-hobby-lobby-unconstitutional-conditions-and-corporate-law-mistakes> [<https://perma.cc/3LTE-FAXP>]. If it were, then the powers with which Pennsylvania and Oklahoma actually chose to vest the respondents would have been irrelevant. Indeed, *Hobby Lobby* is not about state corporate law at all (apart from the quoted sentence). It is about the existence of a federal right on which corporations may stand *if they are so constituted*.

C. Does the Doctrine of Incorporation Limit State Authority?

The skeptic can be forgiven for raising an eyebrow at all of this history. Much in the constitutional landscape has changed since the states began freely chartering corporations with the power to do all lawful acts. Most important, for our purposes, has been the judicial discovery of the doctrine of selective incorporation. Over the course of eighty-five years, beginning in 1925, the Supreme Court has held that most of the restrictions on federal authority found in the Bill of Rights apply with equal force against the states.⁵⁷ It is all well and good, one might think, to say states had free rein before the Bill of Rights constrained them. But does it follow that the states' prerogative would survive judicial scrutiny today?

This is a serious objection. Indeed, two modern cases, both invalidating state restrictions on corporate political spending, seem to imply that not all is as this Article has claimed. The first case, *First National Bank of Boston v. Bellotti*,⁵⁸ concerned a 1975 Massachusetts law prohibiting business corporations from making contributions or expenditures “for the purpose of . . . influencing or affecting the vote on any question submitted to the voters, other than one materially affecting any of the property, business or assets of the corporation.”⁵⁹ A referendum slated for the following year would have amended the Commonwealth's constitution to authorize a graduated income tax, and the legislature worried that corporate advertising might defeat it.⁶⁰ Five corporations—two nationally chartered banks and

⁵⁷ See *Gitlow v. New York*, 268 U.S. 652 (1925) (holding that the states may not infringe the freedom of speech). For the Court's latest thoughts on incorporation, see *McDonald v. City of Chicago*, 561 U.S. 742 (2010).

⁵⁸ 435 U.S. 765 (1978).

⁵⁹ *Id.* at 767–68 (citing Mass. Gen. Laws ch. 55, § 8 (West 1977)).

⁶⁰ The statute specified that “[n]o question submitted to the voters solely concerning the taxation of the income, property or transactions of

three domestic business corporations—challenged the law, and the Supreme Court ultimately held it invalid.

The Montana statute at issue in the second case, *American Tradition Partnership v. Bullock*, had a broader compass and served evidently different purposes.⁶¹ The law generally prohibited corporations from making contributions or expenditures “in connection with” candidates, political committees supporting a candidate, or political parties.⁶² It made an exception, however, for expenditures made from a segregated fund consisting solely of voluntary contributions.⁶³ In this sense, the Montana law, unlike the Massachusetts statute at issue in *Bellotti*, seems to have been calibrated to ameliorate agency problems within the firm, rather than to silence corporate interests as such. Nevertheless, the Justices, in a one-page opinion per curiam, held the law to be an unconstitutional abridgement of the corporations’ first amendment rights.⁶⁴ Two sentences sufficed to explain the majority’s judgment: “The question presented in this case is whether the holding of *Citizens United* applies to the Montana state law. There can be no serious doubt that it does.”⁶⁵

Superficially, at least, *Bellotti* and *American Tradition Partnership* seem to imply that the states, whatever their historical authority over domestic corporations, may no longer create entities incapable of exercising federal rights. After all, if the states could make their corporations incapable of speech, then the cases should have come out differently—at least with respect to domestic corporations.

individuals shall be deemed materially to affect the property, business or assets of the corporation.” *Id.* Justice Powell’s opinion noted the obvious: the law was “tailor-made” to influence the outcome of one particular referendum. *Id.* at 793.

⁶¹ 132 S. Ct. 2490, 2491 (2012).

⁶² *Id.* (citing MONT. CODE ANN. § 13-35-227(1) (2011)).

⁶³ MONT. CODE ANN. § 13-35-227(4) (2011).

⁶⁴ *Bullock*, 132 S. Ct. at 2491.

⁶⁵ *Id.*

Yet such a broad reading of the decisions would be misplaced. At least two alternative interpretations are plausible and do not depend on an inference that the Court up-ended two centuries of settled doctrine without a word of explanation. On one reading, the decisions represent the Justices' considered view of state authority over domestic corporations, but only with regard to speech. The evidence for this view derives not from the logic of rights and powers, as a general matter, but from the Court's longstanding partiality toward speech as the first right among equals and, more specifically, from the muddled concept of listeners' rights.⁶⁶ If it is the hypothetical audience whose interest counts most, then no great leap is needed to declare that the state-corporation relationship is beside the point when speech is at stake. *Bellotti* itself suggests a rationale along these lines, framing the decisive issue as a question about the marketplace of ideas rather than a coherent theory of the firm:

The court below framed the principal question in this case as whether and to what extent corporations have First Amendment rights. We believe that the court posed the wrong question. The Constitution often protects interests broader than those of the party seeking their vindication. The First Amendment, in particular, serves significant societal interests. The proper question therefore is not whether corporations "have" First Amendment rights and, if so, whether they are coextensive with those of natural persons. Instead, the question must be whether [the Massachusetts law] abridges expression that the First Amendment was meant to protect.⁶⁷

Despite its plausibility, however, a speech-specific interpretation of *Bellotti* and *American Tradition*

⁶⁶ See, e.g., *Red Lion Broad. Co. v. FCC*, 395 U.S. 367, 390–91 (1969) (identifying the rights of listeners and viewers as paramount concern in license adjudication).

⁶⁷ 435 U.S. 765, 775–76 (1978).

Partnership is unsatisfying because it lacks a limiting formal principle. Many legal rules benefit persons other than those whom they nominally protect. Basic property rights illustrate the idea. Rights to exclude, to alienate, and to improve nominally belong only to the owner of an asset. But property rights to the asset redound to the benefit of the “audience” too, in the sense that they induce owners to invest in capital in ways consumers are apt to approve. In some sense, it is fair to say that property rights exist not for the good of the nominal beneficiary, but for the “public interest.” This principle likewise applies to many other rights. No plausible formal criterion distinguishes speech rights.

On another reading, the judgments came out as they did because the Justices did not consider the history and logic of the corporate charters presented above. Silence is powerful evidence on this score. Neither Massachusetts nor Montana argued from its traditional authority to limit the activities of their own corporations.⁶⁸ Neither *Bellotti* nor *American Tradition Partnership* explains why state authority in this domain, once thought to be absolute, no longer holds sway.⁶⁹ Indeed, neither decision so much as mentions the distinctive questions at stake when a state restricts its own corporations’ activities. To call the omission surprising would understate the magnitude of departure from past practice. If

⁶⁸ See, e.g., *Bullock*, 132 S. Ct. at 2491 (“Montana’s arguments in support of the judgment below either were already rejected in *Citizens United*, or fail to meaningfully distinguish that case.”).

⁶⁹ Jill Fisch has defended the majority’s decision on the ground that the Massachusetts statute “was a campaign finance law, not a part of the state corporation law.” Jill E. Fisch, *Frankenstein’s Monster Hits the Campaign Trail: An Approach to Regulation of Corporate Political Expenditures*, 32 WM. & MARY L. REV. 587, 598 (1991). As such, the statute purported to regulate all corporations doing business in the Commonwealth, not merely those corporations Massachusetts itself had constituted. Two of the respondents in *Bellotti* were in fact federally chartered banks. *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819) explains why Massachusetts would lack authority to disable them. On at least one view of severability, Fisch offers a clever and plausible rationalization. The Court did not itself reason along these lines, however.

Bellotti and *American Tradition Partnership* were but two of many decisions ignoring the states' historical chartering authority, one might suppose the longstanding law of corporate powers had been abrogated *sub silentio*, replaced by some as-yet unarticulated theory of the corporation. But there is no such trend. As previously mentioned, the Court in *Hobby Lobby*, decided two years after *American Tradition Partnership*, once again appeared to return to the traditional conception of corporate power.

Can anything be said in defense of *Bellotti* and *American Tradition Partnership*? None of the Justices' opinions offers a reason to disregard the states' traditional authority over domestic corporations. That said, a potential justification is found in the unconstitutional conditions doctrine. In its familiar form, this doctrine holds that "government may not grant a benefit on the condition that the beneficiary surrender a constitutional right, even if the government may withhold that benefit altogether."⁷⁰ The state need not license you to drive, but it cannot condition your license on your agreeing to quarter troops in the home. Likewise, the argument would go, permission to act through the corporate form is a privilege the states can withhold altogether; but it must not be defined so as to prevent would-be incorporators from jointly accomplishing constitutionally protected acts. The nineteenth-century cases affording states *carte blanche* are explicable, on this view, because the Bill of Rights was not then understood to apply to the states at all. Any conditions were not *unconstitutional* conditions. Now that most of the Rights bind the states, they are bound not to trample them.

⁷⁰ Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 HARV. L. REV. 1413, 1415 (1989); see also, e.g., Robert L. Hale, *Unconstitutional Conditions and Constitutional Rights*, 35 COLUM. L. REV. 321, 321 (1935) (unconstitutional conditions describes "the theory that a condition attached by a state to a privilege is unconstitutional if it requires the relinquishment of a constitutional right").

Whatever the logic's intuitive appeal, however, the unconstitutional conditions doctrine, at least in its current form, should not be understood to curtail state authority over corporate powers. As a basic doctrinal matter, the *sine qua non* of an unconstitutional condition is a proposed swap. In return for a valuable consideration from the state, you agree to give up a valuable right you would otherwise enjoy against the state. No such bargain is implicated when a state constitutes corporations unable to, say, make political contributions. The state offers a privilege it needn't offer—the opportunity to act through the corporate form. In return it asks prospective promoters for a modest filing fee, not to relinquish a constitutionally enshrined right. The promoters are able to make political contributions in their own names, whether or not they accept the state's "deal." The deal at stake with incorporation is not a trade; it is a kind of implicit subsidy of cooperative, especially capital-intensive, industry. It thus does not fit comfortably within the framework of unconstitutional conditions.

Even if the courts were otherwise inclined to extend the unconstitutional conditions doctrine, a practical problem would counsel them against it. The courts would need to prescribe local aggregation rules—rules to decide whether and how a corporation has invoked its rights. To be concrete, suppose *Bellotti* and *American Tradition Partnership* are right: the states cannot prohibit even their own corporations from making certain kinds of political expenditures. Who, then, is to decide whether a corporation wishes to make an expenditure? And on what basis? These questions do not arise when an individual wants to speak; her say-so is conclusive. But a collective entity's decision—its will, so to speak—reveals itself only by reference to a voting rule or some other method of individual-preference aggregation.⁷¹

⁷¹ See Bebachuk & Jackson, *supra* note 6, at 107–09. That the rule selected to aggregate preferences can decide the aggregation's outcome has been clear since Arrow published his impossibility theorem. See Kenneth J. Arrow, *A Difficulty in the Concept of Social Welfare*, 58 J. POL. ECON. 328 (1950).

These rules are the heart of all corporation codes. Indeed, corporate law is little more than a set of aggregation rules tailored, for better or worse, to discrete issues frequently arising in the life of a business firm. Many corporate acts are accomplished without shareholder say; some are conditioned on a majority of votes (with varying denominators); others on supermajorities. Broadly speaking, the aggregation rules are calibrated to the risks of free-riding, hold-up, or other exploitation associated with the context. In this sense, the architecture of “corporate democracy,” which *Bellotti* and *Citizens United* themselves endorse,⁷² is not dissimilar to that of American democracy. Plainly, aggregation rules requiring a high threshold of consent generate relatively little of the activity at issue, and more activity is generated where the aggregation rule requires little support.

The *status quo* default rule in most states permits firm management to direct political expenditures without special shareholder authorization.⁷³ But the *status quo* is not obligatory. The Court itself has emphasized state law’s important role in resolving conflicts over speech and religion that might arise within the firm.⁷⁴ Indeed, since *Citizens United*, at least one state has made corporate speech more

⁷² See *Citizens United v. Fed. Election Comm’n*, 558 U.S. 310, 361–62 (2010) (“the procedures of corporate democracy” will protect shareholders); *Bellotti*, 435 U.S. at 794.

⁷³ James Kwak, *supra* note 6, at 253 (“[D]ecisions to support particular political organizations and causes are generally made by company executives, occasionally with oversight by the board of directors, but without meaningful input from shareholders.”).

⁷⁴ Such is the central argument of Pollman, *supra* note 6; see also *Citizens United*, 558 U.S. at 362 (gesturing toward “the procedures of corporate democracy”); *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2768 (2014) (explaining that “[s]tate corporate law provides a ready means for resolving any conflicts by, for example, dictating how a corporation can establish its governing structure”).

difficult to produce.⁷⁵ At the limit, the states could make the exercise of federal rights a practical impossibility.⁷⁶

Some commentators critical of *Citizens United* are resigned to concede that a state could not condition its corporations' political-speech expenditures on unanimous shareholder approval.⁷⁷ But their reasoning is unclear. Unanimous consent is an uncommon default rule in today's corporation codes, for obvious reasons. But it is plainly a *plausible* rule because it forms the basis of ordinary contract and property law. Indeed, *Bellotti* itself suggested that state law could be used to make corporate political speech unlikely by requiring directors to account for waste.⁷⁸ If there is a coherent ground under the First Amendment to preclude a state from disabling its corporations from making a given expenditure while allowing the state to impose monetary liability on directors for the very same expenditure, it is not obvious. Surely the Justices would prefer to hew to traditional theories of the state-corporation relationship and in so doing avoid the need to draw arbitrary lines about just what kind of aggregation rules are permissible in the context of political expenditures.

⁷⁵ See Bebhuk & Jackson, *supra* note 6, at 101 n.54 (observing that law now requires approval of a majority of board members).

⁷⁶ This possibility was first suggested in Victor Brudney, *Business Corporations and Stockholders' Rights Under the First Amendment*, 91 YALE L.J. 235 (1981).

⁷⁷ Kwak, *supra* note 6, at 292 (doubting the constitutionality of a voting rule "that makes it extremely difficult for a corporation to engage in political speech"); Bebhuk & Jackson, Jr., *supra* note 6, at 107–10 (expressing skepticism about the constitutionality of rules appearing to make corporate speech difficult). *But see* Brudney, *supra* note 76, at 241–43 (arguing the constitutionality of law withdrawing authority over political expenditures from board).

⁷⁸ See 435 U.S. 765, 795 (1978). Whether this obiter comment can be reconciled in any meaningful sense with the holding is uncertain.

III. THE POLITICAL ECONOMY OF CORPORATE POWERS

If the argument in Part II is correct, the states can curtail the powers of corporations they charter as they see fit, including powers to do acts immunized by federal rights. This creates a puzzle. The recent corporate-rights cases have met stout public disapproval—*Citizens United* in particular—yet no state has moved to disempower its corporations. Why not? One possibility is that the average legislator thinks cases such as *Citizens United* and *Hobby Lobby* were sensibly decided. This might be true—it is unlikely—but in any event it is uninteresting. Another possibility is that legislators do not know their own legislative authority. If so, maybe they will soon discover it. A more intriguing explanation hinges on political economy. On reasonable assumptions about legislative behavior, states will vest their domestic corporations with powers in excess of those that the median legislator thinks sensible for the economy as a whole. Because entrepreneurs value, and so will be willing to pay for, freedom from government intervention, there is a market for corporate powers. Because each state expects its corporations to use their rights in part to resist regulation in *other jurisdictions*, legislatures will tend to underweight the social costs associated with corporate powers. This is the problem of territorial externalization.

This Part explores the political economy of corporate powers. Section III.A examines the standard assumption that managers are willing to pay for, and so will make marginal decisions about reincorporation on the basis of, broad corporate powers. Sections III.B and III.C consider the political economy of rules under which corporate powers are determined by chartering and host states, respectively. Part III.D argues for the desirability of overlapping authority. Where a particular corporate power carries with it the prospect of significant territorial externalities, a sensible legal regime would allocate to host states the authority to

countermand the power, one way or another, subject to the restriction that they not discriminate in favor of local firms.

A. The Corporate Powers Market: Will Entrepreneurs Pay to Retain Corporate Powers?

Most discussions of the political economy of corporate chartering start with the assumption that entrepreneurs want a firm capable of doing more rather than less.⁷⁹ The broader a corporation's powers, the more options its managers have. The power to exercise a constitutional right is just a species of the more general phenomenon. More specifically, the power to exercise a corporate right can be understood as an option to ignore otherwise binding regulation. If a manager is satisfied with a particular regulation, she need not object. She objects only to onerous regulation. Consequently, one might think corporations will prefer the power to exercise more rather than fewer rights. But although this assumption might be right at first approximation, it is worth pausing to consider its realism in the rights context. Not all optionality has positive value. Those who associate with or through the corporate form often do so precisely because the corporation's options are limited. Take, for example, run-of-the-mill contract law. In a static world, a corporate manager would prefer to be able to welch on existing deals at her option. But in the real, dynamic world, where investors make decisions according to their expectations of future performance, a corporate

⁷⁹ See generally, e.g., William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) (proposing a "race for the bottom" in corporate law driven by legislative acquiescence in managerial preferences); Donald E. Schwartz, *Federal Chartering of Corporations: An Introduction*, 61 GEO. L.J. 71 (1972) (arguing that federal chartering is advisable because state legislatures have incentive to cater to managers' preferences for wide latitude); see also *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 554–64 (1933) (Brandeis, J., dissenting in part) (describing historical development of corporate powers as function of managerial preferences and resulting economic pressure on state legislatures).

manager usually prefers to be bound.⁸⁰ Hence, corporations possess the power *to be sued*.

Against this background, consider the right to spend corporate funds on political speech that was at stake in *Citizens United*. The corporate law of most states allows managers to spend firm money on political ends as they see fit, subject only to ordinary fiduciary obligations.⁸¹ The question is: can one expect corporations to pay to retain the power to exercise the right? Much of the naïve criticism of *Citizens United* assumes, at least implicitly, that the answer is yes. *Citizens United* allows corporations to trade money for political considerations in a relatively direct fashion. Traditional lobbying entails significant deadweight losses, and presumably corporations would be ready to pay for the ability to buy favorable policy more cheaply.

But firms might want *not* to have political-speech rights for two kinds of reasons. One relates to conflicts of interest within the firm, and indeed this rationale is oft cited as a justification for prohibitions on corporate political speech.⁸² Some constituents of the corporation may worry about managers' tendency to spend treasury funds on candidates they prefer personally, irrespective of the expected rewards to the corporation. Because managers will always be able to articulate a business purpose sufficient to withstand the challenge of a derivative suit, the corporate power becomes, in a real sense, a managerial power to spend "other people's money."⁸³ A related problem arises when the corporation's

⁸⁰ Whether this is so for any given firm depends quite obviously on context. Consider the trend toward mandatory arbitration in any number of domains.

⁸¹ See Bebchuk & Jackson, *supra* note 6, at 87.

⁸² See Robert H. Sitkoff, *Corporate Political Speech, Political Extortion, and the Competition for Corporate Charters*, 69 U. CHI. L. REV. 1103, 1113–23 (2002) (cataloging related objections along this line).

⁸³ Adam Winkler, *Other People's Money: Corporations, Agency Costs, and Campaign Finance Law*, 92 GEO. L.J. 871 (2004) (arguing that the first campaign-finance laws were, as an historical matter, enacted to ameliorate manager-shareholder conflicts of interest); see also Brudney,

constituents disagree about the political message the firm should send. This is not, narrowly speaking, an agency problem, because the supposed “principals” lack a unified interest. Rather, it reflects the reality that corporate constituents are not merely constituents, but real people with political views as well as interests in other investments that may conflict with the firm’s financial interests. In either case, the prospect that managers might choose to spend corporate funds on disfavored candidates is a cost prospective shareholders (and other constituents) realistically face, and they can be expected to charge for it in the price of the capital or other inputs they provide. If they charge more than the benefits a manager perceives, then presumably the manager will not value, or will even disvalue, the corporate right. Prohibition of political expenditures by charter or bylaw would seem the appropriate remedy.⁸⁴ To be sure, many commentators doubt the efficacy of market constraints on managerial action. That old debate is not worth joining here. What is important to see is simply that, in some real-world situations, some corporations will act as though an ostensibly valuable power has zero or negative value.

Alternatively, firms might disvalue the power to engage in political speech because of the threat of exploitation by politicians.⁸⁵ To the extent the power to spend in furtherance of a candidate’s election is valuable to a corporation, it is because the candidate herself perceives the spending as useful—to herself. Put differently, according to the self-interested model of corporate behavior, the power to make

supra note 76, at 237–38 (arguing that agency conflict was among the motivations for early restrictions on political-speech expenditures).

⁸⁴ See Fisch, *supra* note 69, at 641–42.

⁸⁵ Sitkoff, *supra* note 82, at 1131–33; HENRY N. BUTLER & LARRY E. RIBSTEIN, *THE CORPORATION AND THE CONSTITUTION* 76 (1995) (“All corporations might come out ahead if none participated in political activity. Yet individual firms cannot afford to refuse to participate in the game, because they may lose more wealth transfers to participating firms than they would save in rent-seeking costs.”).

direct expenditures is valuable precisely because direct expenditures represent a cheap method of funneling money to political candidates. But if this is so, then it cannot be long before candidates perceive the strength of their own bargaining position. Politicians are not mere passive objects of corporate rent-seeking. They may actively seek payment by explicit or implicit threat (promise) of regulatory retaliation (subsidy).⁸⁶ Absent the power to spend corporate funds on political speech, politicians' threats lose credibility on the margin. Thus, managers might in fact lobby *not* to be permitted to make political expenditures—at least if competitors are similarly disabled. But most of the salient constitutional rights do not seem to present an analogous dynamic. Few seem to generate collective-action problems among corporate actors.

This analysis suggests a fault line. Corporations might not value the power to exercise corporate rights that generate high agency costs relative to the efficiency gains they make possible. Whether political-speech rights are of this type is an open question. Undoubtedly some of the *quid pro quo* associated with political expenditures might redound to managers in their personal capacity—a kind of disguised salary. But so, too, with the corporate power to donate funds to charity. Political speech does not obviously generate special agency problems not found elsewhere,⁸⁷ and, on the other hand, firms may gain much by privileged access to policymakers. Whatever one thinks about political-speech rights, though, most constitutional rights would seem to generate relatively small agency costs. Think of the religious-exercise rights at issue in *Hobby Lobby*. Almost by

⁸⁶ Sitkoff, *supra* note 82, at 1126–27. This insight is often identified with Fred McChesney's work. *E.g.*, FRED S. MCCHESENEY, MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION (1997).

⁸⁷ *Cf.* Sitkoff, *supra* note 82, at 1105 (“There is nothing special about the agency problem associated with managerial control over corporate political speech that distinguishes it from any other area of managerial discretion.”).

definition, religious practices that affect business policy are open and notorious. Monitoring costs are accordingly small, and there are significant opportunities to generate surplus—even if only because of idiosyncratic religious scruples. Ultimately, the question whether any given constitutional right is valuable to corporations must be judged on its own merits. But the standard assumption that all such rights are valuable is probably a fair one at first approximation.

B. Chartering-State Incentives to Grant Socially Costly Powers

If managers are willing to pay for the power to exercise federal rights, then the standard criticisms of the corporate-charter market apply. It is old hat to observe that there is a market for corporate powers. Entrepreneurs value the opportunity to conduct business through the corporate form with minimum restrictions. State legislatures value the franchise taxes their corporations pay as well as the legal and administrative services domicile brings into the jurisdiction.⁸⁸ The more freedom a legislature is willing to grant its corporations, the more revenue it can expect to generate. Indeed, commentators of varying stripes—both those who celebrate and those who decry the state-centered framework of American corporate law—have long invoked this very dynamic to explain the rise of enabling statutes in the late nineteenth century. Because entrepreneurs' choice of a state of incorporation need not affect their business operations more than trivially, the story goes, states such as New Jersey and Delaware were able to enrich their treasuries by providing relatively robust corporate powers.

⁸⁸ For the classic elaboration of the relationship between franchise tax revenues and other state interests that could motivate corporate law legislation, see generally Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987).

Other states tried vainly to keep hold of whatever franchise tax base they could.⁸⁹

The standard account is plausible enough as history, but it presents a puzzle in the context of corporate rights. In particular, the standard account suggests an equilibrium in which state corporate law supplies a roughly optimal package of corporate attributes. As we have observed, the negative-value corporate right is doubtless a special case. The baseline scenario is one in which entrepreneurs will be willing to pay for the power to exercise a given corporate right. But there is another side to the equation. Entrepreneurs will be willing to pay only so much as the right is worth to them. Likewise, it is clear enough that legislatures want tax revenue. But here, too, there is another side. Rights are apt to entail costs to the state, in the form of reduced regulatory efficacy. The easiest way to see this is to think of a putative corporate right not to pay income tax. Each dollar the firm avoids paying imposes a correlative cost on the rest of society. Other kinds of rights impose costs in a less obvious fashion by distorting otherwise binding legal relations thought to promote the general welfare, but notionally they work the same way. Legislators committed to their state's welfare will therefore be willing to "sell" the power to exercise a corporate right only for a price outweighing the magnitude of the regulatory cost. The result seems to be that corporations will tend to be empowered to exercise socially valuable rights, but not socially costly ones.

To see this concretely, consider a simplistic numerical example in which a single, wealth-maximizing corporation, *C*, bargains on Coasean terms for law with a single state, *S*, whose legislators seek to maximize the local welfare. Suppose *C* values at 20 the power to exercise the religious rights identified in *Hobby Lobby*. In other words, *C* will pay up to 20 for the option to ignore certain regulations on religious grounds. In addition, suppose *S*'s legislators

⁸⁹ *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 554–64 (1933) (Brandeis, J., dissenting in part).

estimate the cost of granting the power at 15. *C*'s invocation of a free-exercise right will frustrate regulation to some degree, legislators might think, but alternative legal responses could ameliorate any corresponding disruption of the economy. On these assumptions, *S*'s decision to grant the power results in a surplus of 5. Both *C* and *S* are better off in a world where *C* can make free-exercise claims. This is the uninteresting case where legislators think *Hobby Lobby* a sensible decision. Now suppose, instead, the legislators think the costs associated with a corporate free-exercise right are 100. Perhaps the right is thought to create an end-run around important laws without any close, religiously unobjectionable substitute. To grant the right would cost *S* more, in lost regulatory efficacy, than it would yield *C*. The result is a regime in which *C* lacks power to exercise religious rights.

To be sure, these examples are unrealistic along every dimension. Firms differ. Legislative preferences differ. There is no explicit bargaining process, and even if there were it would be plagued by holdup and free-rider problems. Nevertheless, the bargain paradigm can usefully develop intuitions about the way equilibria in real, diffuse markets can be expected to develop. The bargain paradigm suggests an equilibrium in which states would decline to grant corporations the power to exercise inefficient rights. If this were so, then one could expect state legislatures to bar their corporations from exercising the rights identified in *Citizens United* and *Hobby Lobby* if indeed legislators thought the rights net harmful.

But the situation is not this simple, and the reason lies in the prospect of territorial externalization.⁹⁰ A corporation's powers are determined by the state that creates it. To this same state the corporation pays its franchise tax. But the corporation might do most of its business and—critically, for present purposes—exercise most of its rights elsewhere.

⁹⁰ For a systematic examination of this notion, see Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1485–95 (1992).

There is thus an opportunity for entrepreneurs and any one state jointly to push costs onto other states.⁹¹ Return to the religious-rights example. *C* values a free-exercise right at 20, and *S*'s legislators think the right would entail costs of 100. But now assume *C* operates nationwide. Only one-fiftieth of its operations are located in *S*. The 100 in regulatory costs are divided across the country. In expectation, *S* will bear only 2 of the 100. From the perspective of the country as a whole, the right is socially costly. From the perspective of *S* and *C* only, however, the right is socially valuable.

The dynamic recalls the rhetoric of the “race to the bottom” in corporate law. In its classic formulation, the race turns on the divergent interests of shareholders and managers.⁹² States seeking franchise tax revenues will cater to managerial interests at the expense of investor interests because managers and not investors decide where to incorporate.⁹³ The standard rejoinder argues that proponents of the “race to the bottom” err by focusing on a single market—the market for incorporation. Managers operate as well in product and capital markets such that the increased capital costs associated with inefficient rules will discipline managers’ desire for pro-management rules.⁹⁴ Managers should tend to seek efficient rather than pro-management rules.⁹⁵ Whatever one thinks of the empirical validity of the “race to the top” in the context of rules governing investor-manager relations, there is no corresponding “upward” pressure in the context of corporate rights. The drive toward

⁹¹ See *id.* at 1494.

⁹² See Cary, *supra* note 79, at 663.

⁹³ *Id.*

⁹⁴ Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEG. STUD. 251 (1977).

⁹⁵ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) (on bonding); Winter, *supra* note 94; Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669 (1984); Romano, *supra* note 15 (on race to the top).

efficient rules follows from the discipline of markets other than the corporate-charter market. That is, the “race to the top” depends on voluntary transactions—capital investments and consumer purchases—mediated by a price mechanism. In robust markets, inefficient rules mean smaller surpluses. No analog exists in the market for corporate rights. Managers and investors of every stripe have in common an interest in securing corporate powers that do not entail especially high agency costs. Thus, any state that unilaterally disables its own domestic corporations puts itself at a competitive disadvantage in the market for state charters.⁹⁶

C. Host-State Incentives to Curtail Socially Beneficial Powers

If the incentive to grant socially costly corporate powers turns on territorial externalization, a sensible legal system might allow states to protect their own territory by, one way or another, “disabling” foreign corporations that do business locally. Indeed, an alternative corner solution would give each state the authority to decide the scope of foreign corporations’ powers on a territorial basis. On this model, if a corporation does business in State *H* sufficient to ground legislative jurisdiction, then *H* would have free rein to set the terms of the corporation’s powers. In effect, *H* would enjoy a veto over local corporate activity, to be exercised if the local costs of the activity’s externalities exceed its local benefits.

This approach has clear appeal. Because franchise taxes are paid to the chartering state, *H* unlike *S* lacks a mechanism to support a direct *quid pro quo* exchange. In any event, *H* cannot collude to externalize the costs of corporate

⁹⁶ Sitkoff, *supra* note 82, at 1125–26, 1139 n.146; *see, e.g.*, Bebchuk, *supra* note 90, at 1486; Stanley A. Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 435–36 (1968) (arguing that the ubiquity of permissive corporation statutes is attributable to the outside option supplied by Delaware).

power outside its territory because it cannot dictate terms in *other* host states. *H* therefore lacks an incentive to grant socially excessive powers to foreign corporations.

But host states have their own perverse incentives. They might tend to restrict the powers of foreign corporations too narrowly. Straightforward protectionism is the most obvious culprit. If a domestic corporation can do things foreign corporations cannot, the domestic corporation has a competitive advantage. To be sure, there are costs associated with excluding foreign corporations or otherwise putting them at a competitive disadvantage. The local activity of foreign corporations increases demand for host-state labor and services and, by encouraging competition, reduces price levels. These effects, in turn, generate income tax and sales tax revenues for the host state's treasury. But these are standard arguments for free trade. Protectionist policy thrives nonetheless, often because of concentrated interests that can effectively organize a lobby.⁹⁷

Host states might discriminate against foreign corporations for another reason. On the margin, rules favoring domestic corporations will induce foreign corporations to migrate to the host state. A host state might not be able to oust foreign firms from the jurisdiction entirely, but by defining foreign corporations' powers narrowly it could destroy the benefits they derive from incorporating elsewhere. Whether or not the market for corporate charters yields net benefits for the national economy as a whole, some economically powerful states, such as California, could rationally prefer to undermine it.

D. A Non-Discrimination Norm

Neither corner solution to the problem of allocating corporate powers is obviously dominant. The chartering state has reason to furnish what might be socially costly powers.

⁹⁷ MANCUR OLSON, JR., *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1965).

Host states, for reasons familiar to students of public choice, might tend to restrict socially beneficial powers. Although the analysis here is too cursory to generate conclusive prescriptions, it suggests that a more refined allocation of regulatory authority could be optimal. A plausible candidate is a rule permitting host states to circumscribe at least some foreign corporation powers, but only on equal terms with domestic corporations.

Two intuitions are important here. First, with respect to corporate attributes that are unlikely to generate significant territorial externalities, the chartering state is in good position to dictate terms. If a chartering state is likely to internalize most of the costs and benefits of a rule, there is no reason to risk undermining the charter market by allowing host states to dictate inconsistent terms. This is an important general consideration, but it has limited application in the context of constitutional rights. At their core, these rights signify the ability to resist territory-specific regulation. Second, to the extent host states are able to cabin corporate powers, the authority should be limited by a non-discrimination principle. Protectionist impulses are not the only problem associated with host states' setting the parameters of corporate activity, but they are the most important and are relatively easy to detect.

IV. THE STATES AND FOREIGN CORPORATION POWERS

This Part argues that a plausible reading of current doctrine is consistent with the political economy analysis offered in Part III. Chartering and host states have overlapping authority to curtail the exercise of corporate rights. In particular, each has an effective veto over their exercise, subject to the proviso that a host state may not exercise its veto in a discriminatory fashion. This is not to say host states have formal authority to revoke powers granted in a corporation's charter. Corporate powers are granted by the chartering state, and corporate rights are secured by the Constitution.

But host states have other means of achieving their ends. Broadly speaking, there are two practical approaches a host state could adopt to restrain foreign corporations from doing acts protected by federal right. It must be said that neither approach is obviously constitutional. At the same time, however, both have pedigree and are at least plausible under existing law. Part IV.A outlines an approach whereby the host state seeks to regulate corporate decision processes ordinarily subject to the internal-affairs doctrine. Part IV.B considers a strategy whereby the host state seeks to induce compliance with its preferred policy by threatening non-recognition.

A. Regulation of Foreign Corporations' Decision Rules

Under one approach, a host state would assert direct authority, in a limited sphere, over the decision rules that generate corporate activity. By imposing rules that make the assertion of a right unlikely, the host state would indirectly reduce the use of federal rights by foreign corporations. The effect of this approach would not be to deprive the corporation of its powers or rights as a formal matter, but to make the exercise of the right highly unlikely. Laws reflecting this approach could take many forms. By way of example, a state law, applicable to all corporations doing business there, might make directors liable to the corporation for asserting its religious free-exercise rights absent supermajority approval by shareholders and employees. The states are generally supposed to have authority to define the rights and obligations of persons sufficiently "present" in their territory. The question is whether any doctrine specific to the context of federal corporate rights is inconsistent with the general rule.

The most significant objection to this approach is found in the internal-affairs doctrine, a longstanding choice-of-law rule that assigns to the chartering state the authority to

regulate rights and obligations “inside” the corporation.⁹⁸ The doctrine’s subjects include, for example, the role of shareholders in directing management and the liability of directors and officers to the corporation.⁹⁹ Rules governing corporate decision-making and establishing liabilities among persons associated in the corporation are thus quintessential examples of rules usually assigned to the state of incorporation.

The internal-affairs doctrine has much to commend it. It is the foundation of jurisdictional competition, which at least arguably redounds to the public good.¹⁰⁰ It provides a stable, predictable rule in a domain that might otherwise be marked by multiple, inconsistent regimes and cycling.¹⁰¹ Whatever

⁹⁸ See, e.g., RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. a (AM. LAW INST. 1971) (defining internal affairs as “the relations inter se of the corporation, its shareholders, directors, officers or agents”). For examination of the doctrine’s historical roots, see generally Vincent S.J. Buccola, *Corporate Law’s Domain* (unpublished manuscript) (on file with author); Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33 (2006).

⁹⁹ RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 304 (shareholder participation), § 309 (director and officer liability) (AM. LAW INST. 1971).

¹⁰⁰ See, e.g., ROMANO, *supra* note 15, at 1–13 (explaining that jurisdictional competition arises from the lack of necessary connection between a firm’s physical presence and its chartering state); David A. Skeel, Jr., *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 TEX. L. REV. 471, 521 (1994) (describing the internal affairs doctrine as a “crucial” component of state competition); Easterbrook & Fischel, *supra* note 95, at 697 (noting that competition can flourish only if entrepreneurs can choose which state provides rules for internal governance).

¹⁰¹ See, e.g., Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161, 175–76 (1985) (arguing that *some* uniform choice-of-law rule is needed to prevent incoherence, as when two states require mutually exclusive voting rules). Strictly speaking, incoherence is not a problem. The validity of any single transaction can usually be determined conclusively by the first court to render a judgment on the matter. That said, the law sensibly tends to prefer stable rules, even arbitrary ones, over the prospect of cycling. See generally Saul Levmore, *Public Choice and Law’s Either/Or Inclination*, 79 U. CHI. L. REV. 1663 (2012).

its merits, the doctrine is widely accepted. Yet notwithstanding their general acquiescence to the internal-affairs doctrine, the states have never embraced it fully and universally. Since the late-nineteenth century, when New York sought to stymie the New Jersey incorporation mill, some states have declined to respect the doctrine's full application.¹⁰² The most prominent examples today are California and New York. With their so-called "outreach" statutes, these states seek to regulate some or all of the internal affairs of foreign corporations having especially close local ties.¹⁰³ California's outreach statute applies to foreign corporations having at least half of their operations in-state and at least half of whose shares are owned by Californians.¹⁰⁴ For these corporations, according to the statute, California corporate law displaces the law of the chartering state with respect to a wide range of "internal" issues, including director elections, directors' standard of care, director liability and indemnification, shareholder inspection rights, and other things that run the whole gamut of corporate law.¹⁰⁵ New York's outreach statute is less dramatic in scope, but applies at a less exacting threshold.¹⁰⁶

Whatever functional merits one might perceive in the internal-affairs rule, the relevant doctrinal question for present purposes concerns only its legal source. If the internal-affairs doctrine is constitutional in nature, then outreach statutes are invalid and host states cannot, by prescribing aggregation rules, discourage foreign

¹⁰² See Tung, *supra* note 98 at 92–96.

¹⁰³ CAL. CORP. CODE § 2115 (West 2014); N.Y. BUS. CORP. LAW §§ 1317–20 (McKinney 2003). Exceptions to the states' general acquiescence in the internal affairs doctrine were noted at least 60 years ago. Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137 (1955).

¹⁰⁴ CAL. CORP. CODE § 2115(a) (West 2014).

¹⁰⁵ *Id.* § 2115(b).

¹⁰⁶ N.Y. BUS. CORP. LAW §§ 1317, 1320 (McKinney 2003) (applying select provisions of New York law to foreign corporations, not traded on a national securities exchange, that derive more than half their income from operations in New York).

corporations' exercise of federal rights. If, on the other hand, the doctrine is merely a default rule applied by judges as a matter of comity, then states are free to abrogate what they dislike in it, as California and New York do, and impose their own law on foreign corporations within their legislative jurisdiction.

Unfortunately, the internal-affairs doctrine's legal source is uncertain.¹⁰⁷ Respectable judges and scholars line up on both sides of the matter. California courts seem to think that the doctrine lacks constitutional pedigree, that it is a matter of common judicial practice only.¹⁰⁸ Indeed, a version of this view is needed to justify the "outreach" statutes, and most scholars who have opined on the doctrine's source agree with the California courts.¹⁰⁹ As a matter of historical fact, the internal-affairs doctrine took hold in the postbellum courts without reference to the Constitution.¹¹⁰ If history is to be

¹⁰⁷ See ERIN A. O'HARA & LARRY E. RIBSTEIN, *THE LAW MARKET* 124 (2009) ("The Supreme Court has not spoken definitively on whether the courts in the United States are constitutionally compelled to apply the IAD."); Jack B. Jacobs, *The Reach of State Corporate Law Beyond State Borders: Reflections Upon Federalism*, 84 N.Y.U. L. REV. 1149, 1165–66 (2009) ("The question [of the internal affairs doctrine's constitutional status] is debatable, and legal commentators have lined up on both sides of the debate.").

¹⁰⁸ *Wilson v. Louisiana-Pac. Res., Inc.*, 187 Cal. Rptr. 852, 857–58 (Cal. Ct. App. 1982); *W. Air Lines, Inc. v. Sobieski*, 12 Cal. Rptr. 719, 728 (Cal. Dist. Ct. App. 1961). *But see* *State Farm Mut. Auto. Ins. Co. v. Superior Court*, 8 Cal. Rptr. 3d 56, 63, 67–69 & n.3 (Ct. App. 2003) (applying the internal affairs doctrine).

¹⁰⁹ O'HARA & RIBSTEIN, *supra* note 107, at 126 ("[T]he U.S. Constitution probably does not forbid a state from regulating the internal governance of a firm that is incorporated elsewhere . . ."); Norwood P. Beveridge, Jr., *The Internal Affairs Doctrine: The Proper Law of a Corporation*, 44 BUS. LAW. 693, 702–15 (1989); Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CAL. L. REV. 29 (1987); P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 33–46 (arguing that forum state may apply its own corporate law, at least if foreign corporation's contacts predominate); Latty, *supra* note 103.

¹¹⁰ See Buccola, *supra* note 98 (describing the doctrine's emergence beginning in the 1860s); Tung, *supra* note 98, at 74 ("Th[e] reluctance to

squared with a constitutional conception of internal affairs, a “look-through” theory of some type is needed. Nevertheless, some observers ground the internal-affairs doctrine in constitutional text, specifically the commerce and the full faith and credit clauses.¹¹¹ Delaware courts have made clear their view that the Constitution prescribes the doctrine, but are less clear about why.¹¹² As recently as 2005, the Delaware Supreme Court declared that the internal-affairs doctrine was mandated *both* by the negative commerce clause *and* by the Fourteenth Amendment’s due process clause.¹¹³ The Court of Chancery found another source of authority in the full faith and credit clause.¹¹⁴

The Supreme Court’s decisions in cases involving internal affairs leave room for interpretation. Some cases seem to

regulate foreign corporations’ internal affairs was more or less a calculated response to economic conditions—especially the changing industrial organization brought about by technological innovation—and not as a result of constitutional mandate.”).

¹¹¹ See Harold W. Horowitz, *The Commerce Clause as a Limitation on State Choice-of-Law Doctrine*, 84 HARV. L. REV. 806 (1971) (dormant commerce clause); Willis L.M. Reese & Edmund M. Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 1118 (1958) (full faith and credit clause).

¹¹² *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1116 (Del. 2005) (“Accordingly, we hold Delaware’s well-established choice of law rules and the federal constitution mandated that Examen’s internal affairs, and in particular, VantagePoint’s voting rights, be adjudicated exclusively in accordance with the law of its state of incorporation, in this case, the law of Delaware.”); *Draper v. Paul N. Gardner Defined Plan Trust*, 625 A.2d 859, 867, 869 (Del. 1993) (observing that internal affairs doctrine has constitutional underpinnings); *McDermott Inc. v. Lewis*, 531 A.2d 206, 217 (Del. 1987) (“[W]e conclude that application of the internal affairs doctrine is mandated by constitutional principles, except in ‘the rarest situations.’”); see also *Jacobs*, *supra* note 107, at 1161–64 (describing the conflict between Delaware and California courts).

¹¹³ See *Examen, Inc.*, 871 A.2d at 1113.

¹¹⁴ See *Rosenmiller v. Bordes*, 607 A.2d 465, 468 (Del. Ch. 1991) (explaining that the internal-affairs doctrine “implicates federal due process, commerce clause and full faith and credit clause considerations”).

suggest the internal-affairs doctrine is constitutionally demanded. Others seem to endorse legislative schemes inconsistent with its premise.¹¹⁵ Some older precedents tend to support a “constitutional” theory under the full faith and credit clause. A telling example is *Broderick v. Rosner*, which considered whether a state court could apply its own law to resolve the obligations of local stockholders in a foreign bank.¹¹⁶ New York’s banking law provided that stockholders could be assessed to pay the bank’s debts ratably, up to the par value of their stock.¹¹⁷ Broderick, New York’s Superintendent of Banks, brought an assessment action under this law in New Jersey against stockholders of a New York bank. The defendants sought refuge in New Jersey law, which prohibited the state’s courts from entering judgment against stockholders for corporate debts.¹¹⁸ On appeal, the Supreme Court held that New York law should prevail.¹¹⁹ The Court explained, “[t]he nature of the cause of action br[ought] it within the scope of the full faith and credit clause.”¹²⁰ As the Justices saw it, the subject matter of the complaint was so “peculiarly within the regulatory power of . . . the State of incorporation” that “no other State properly can be said to have any public policy thereon.”¹²¹ *Broderick* seems like an endorsement of the view that a chartering state’s law trumps all inconsistent law with respect to internal disputes, or at least stockholder

¹¹⁵ See, e.g., *Pinney v. Nelson*, 183 U.S. 144 (1901) (holding that California law concerning stockholder liability could be applied in case of Colorado mining corporation doing business in California); *Thomas v. Matthiessen*, 232 U.S. 221 (1914) (same result for Arizona corporation doing substantially all of its business in California).

¹¹⁶ 294 U.S. 629 (1935).

¹¹⁷ *Id.* at 637.

¹¹⁸ *Id.* at 638.

¹¹⁹ *Id.* at 642–44.

¹²⁰ *Id.* at 643.

¹²¹ *Id.* (quoting *Converse v. Hamilton*, 224 U.S. 243, 260 (1912)).

assessment cases.¹²² If the Court's choice-of-law jurisprudence today otherwise resembled that of the 1930s, *Broderick* and other cases like it might be conclusive.¹²³ But it does not. The Court's use of the full faith and credit clause to constrain choice of law has declined markedly since then. According to one analysis, the Court has invalidated the application of a forum state's law only once since the 1970s.¹²⁴ The modern trend is to allow a state court to apply domestic law so long as the forum state has at least a plausible connection to the dispute.

The other potential constitutional basis for the internal-affairs doctrine is the negative commerce clause.¹²⁵ Although the commerce clause is phrased as a grant of legislative authority to Congress,¹²⁶ the Court has long understood it to bar state laws that discriminate against, or otherwise bear sufficiently baleful consequences on, out-of-state businesses.¹²⁷ A statute abrogating part of the internal-affairs doctrine would not be discriminatory; on the contrary, its aim would be to impose uniform decision rules on all corporations, wherever incorporated, doing business in the host state. The relevant question for our purposes is whether such a law would discourage interstate commerce to a degree local interests cannot justify. It could do so, one might think, by subjecting corporate activity to multiple, inconsistent

¹²² See also *Supreme Council of Royal Arcanum v. Green*, 237 U.S. 531, 546 (1915); *Modern Woodmen of Am. v. Mixer*, 267 U.S. 544, 551 (1925).

¹²³ Compare *Reese & Kaufman*, *supra* note 111 (arguing that full faith and credit clause should be read to mandate internal affairs doctrine), with *O'HARA & RIBSTEIN*, *supra* note 107, at 126 (concluding that best interpretation of modern choice-of-law doctrine suggests internal affairs doctrine is not constitutional).

¹²⁴ *O'HARA & RIBSTEIN*, *supra* note 107, at 125.

¹²⁵ For more on this possibility, see *Horowitz*, *supra* note 111.

¹²⁶ U.S. CONST. art. I, § 8, cl. 3.

¹²⁷ See Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091 (1986).

mandates.¹²⁸ If any state in which a corporation does minimal business, or in which some of its shareholders reside, may regulate their joint relations, the result is a possible mess, the threat of which might discourage interstate commerce.

The Supreme Court has never directly articulated the view that the commerce clause mandates the internal-affairs doctrine. As others have noted, though, the idea finds some support in the juxtaposition of two cases, decided five years apart, on the constitutionality of anti-takeover statutes.¹²⁹ *Edgar v. MITE Corp.* concerned the enforceability of an Illinois outreach statute.¹³⁰ The statute sought to regulate tender offers for the stock of any corporation, whether or not domestically chartered, with certain connections to the state. Before launching a tender offer for the stock of a covered corporation, a would-be acquirer was obliged to register its offer with the Secretary of State. The Secretary, in turn, was empowered to block the offer if, among other reasons, he determined the terms “inequitable.”¹³¹ MITE, a Delaware corporation with its principal place of business in Connecticut, initiated a tender offer for the stock of an Illinois company.¹³² MITE complied with the Williams Act, but not the Illinois law, and sought an injunction against its enforcement. The Supreme Court sided with MITE, invalidating the Illinois law on commerce clause grounds. As a majority of the Justices saw things, Illinois was seeking to

¹²⁸ Cf. *Cooley v. Bd. of Wardens*, 53 (12 How.) U.S. 299, 319 (1851).

¹²⁹ For more thorough analyses of the constitutional significance of this pair of cases, see Arthur R. Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes After CTS Corp.*, 29 WM. & MARY L. REV. 699, 743–74 (1988); Paul N. Cox, *The Constitutional “Dynamics” of the Internal Affairs Rule—A Comment on CTS Corporation*, 13 J. CORP. L. 317, 337–62 (1988); Donald H. Regan, *Siamese Essays: (I) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (II) Extraterritorial State Legislation*, 85 MICH. L. REV. 1865, 1865–84 (1987).

¹³⁰ 457 U.S. 624 (1982).

¹³¹ *Id.* at 627.

¹³² *Id.* at 626–28.

block trades among persons with no connection to the State—a “direct” attempt to regulate interstate commerce.¹³³

Five years later, in *CTS Corp. v. Dynamics Corp. of America*, the Court again considered the enforceability of a state law seeking to deter hostile takeovers.¹³⁴ The Indiana statute at issue in *CTS Corp.* differed from the Illinois statute in two important respects. First, Indiana accomplished its end by denying voting rights to shares acquired without the target’s permission, not, like Illinois, by claiming the license to block transactions in securities directly. Second, the Indiana law applied only to domestic corporations.¹³⁵ This time the Court upheld the statute against a commerce clause challenge.¹³⁶ A consequentialist will struggle to see why. For covered corporations, the two statutes produced more or less the same effect. Both reduced the viability of hostile tender offers, and both imposed most of the costs on out-of-state stockholders. Something other than the function was at play.

Edgar and *CTS Corp.* can be reconciled in two ways, only one of which depends on a constitutional view of the internal-affairs doctrine. The first possibility is that the internal-affairs doctrine was decisive. Illinois sought to deter transactions in the stock of foreign as well as domestic corporations (not okay); Indiana sought to deter transactions in the stock of domestic corporations only (okay). Some of the rather meandering discussion in *CTS Corp.* supports this view—namely, that the negative commerce clause implies the internal-affairs doctrine because its absence would threaten incompatible dictates. But “[s]o long as each State regulates voting rights only in the corporations it has created, each corporation will be subject to the law of only one State.”¹³⁷ Alternatively, the cases can be understood

¹³³ *Id.* at 643–44.

¹³⁴ 481 U.S. 69 (1987).

¹³⁵ *Id.* at 73–74.

¹³⁶ *Id.* at 94.

¹³⁷ *Id.* at 89.

simply to reaffirm a persistent disjunction in commerce clause cases between “direct” and “indirect” regulation of trade.¹³⁸ Illinois sought to stop a person in one state from buying securities from persons in other states (not okay); Indiana sought to create conditions under which securities transactions would be unattractive (okay). This rationale too finds support in *CTS Corp.* The bottom line is that the constitutional status of the internal-affairs doctrine is arguable.

B. Conditional Recognition of Foreign Corporations

Under another approach, a host state would seek to restrict foreign corporations’ exercise of rights by conditioning recognition of the corporation on its not invoking its rights. The consequence of this strategy, if effective, would be to deprive foreign firms that exercise disfavored rights of their corporate character with respect to acts done and property held in the host state. It is well established that there are some grounds on which a state can refuse to “admit” foreign corporations or “eject” those it previously admitted. For example, every state requires that foreign corporations register their business and nominate a local representative on whom service of process may be effected. The relevant question, which this section pursues, is whether a state can decline to recognize foreign corporations on the ground that they choose to exercise a federally established right. Again here, existing law yields no straightforward answer. The courts could plausibly extend available constitutional doctrines to neuter this sort of strategy. On the other hand, legislators in an economically powerful state, such as California, could enact a robust non-recognition law without blushing—at least if the state were also to disempower its own corporations on equal terms along the lines articulated in Part II.

¹³⁸ So concluded the Seventh Circuit. See *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496, 506 (7th Cir. 1989).

The states' authority not to recognize foreign-chartered corporations was first established in 1839, in *Bank of Augusta v. Earle*.¹³⁹ The case presented a deceptively simple dispute over the enforceability of a contract made in Alabama between Earle, an Alabama citizen, and the bank, chartered by Georgia. Earle contended the deal was unenforceable by virtue of these facts alone. On his theory, Georgia corporations, being a product of that state's sovereignty, could act validly in Georgia only.¹⁴⁰ The bank, for its part, argued that it was constitutionally entitled to make contracts anywhere in the Union.¹⁴¹ Georgia had empowered the bank to buy bills of exchange domestically and abroad.¹⁴² According to the bank, because the bank's members were citizens of one of the several states, the bank was entitled, derivatively, to the privileges and immunities of Alabama citizens.¹⁴³

The Court sided with the bank. The Court's reasoning did not, however, turn on a supposed constitutional privilege to conduct business in Alabama. On the contrary, the Court disclaimed the view that Alabama was obliged to recognize the contract. Alabama could, if it wished, decline to give effect to the local acts of corporations chartered elsewhere. As the Court saw it, "[e]very power . . . which a corporation exercises in another state, depends for its validity upon the laws of the sovereignty in which it is exercised; and a corporation can make no valid contract without their sanction, express or implied."¹⁴⁴ The bank prevailed only because Alabama had not in fact announced a rule of non-

¹³⁹ 38 U.S. (13 Pet.) 519 (1839).

¹⁴⁰ *Id.* at 588.

¹⁴¹ *Id.* at 586.

¹⁴² *Id.* at 588.

¹⁴³ *Id.* at 586; see U.S. CONST. art. IV, § 2, cl. 1; *Bank of U.S. v. Deveaux*, 9 U.S. 61, 83 (5 Cranch.) (1809) (holding, for purposes of the diversity jurisdiction, that a corporation has the citizenship of its members).

¹⁴⁴ *Bank of Augusta*, 38 U.S. at 589.

recognition. As a matter of comity, the acts of a corporation chartered in one state were to be deemed valid in another state absent the latter state's contrary legislation. *Bank of Augusta* thus established two principles of enduring significance: first, as a matter of constitutional authority, a state can decline to recognize, as corporate in nature, the local acts of foreign corporations; second, as a matter of interpretation, courts will presume a state's recognition.¹⁴⁵

An important corollary to the states' non-recognition power was soon to emerge. If a state can refuse altogether to recognize foreign corporations, then, by the theory that the greater power implies the lesser, it follows that a state can also qualify recognition of foreign corporations on specified conditions. So, in any event, the Court held in a series of cases beginning in 1855. *Lafayette Insurance Co. v. French* concerned the enforceability of a judgment of the Ohio courts, against an Indiana corporation, on a contract made in Ohio.¹⁴⁶ Ohio law allowed foreign insurers to do business in the state, but it conditioned their privilege on their agreeing to receive service of process on any agent who might be found in the jurisdiction.¹⁴⁷ Consistent with the statute, French effected service on a Lafayette agent, in Ohio, and won a judgment. He then sought to enforce the judgment in Indiana, where Lafayette's assets could be found. The question thus arose whether Ohio's rule on service of process was sufficient to ground its courts' jurisdiction and thereby oblige Indiana to give the judgment full faith and credit. The Supreme Court ruled that the Ohio courts' jurisdiction was proper, on the theory that Lafayette had impliedly consented

¹⁴⁵ See *Pensacola Tel. Co. v. W. Union Tel. Co.*, 96 U.S. 1, 13 (1877) (asserting that comity is to be presumed absent explicit state action to the contrary); ANGELL & AMES, *supra* note 27, § 161 at 125 ("Every power which a corporation exercises in another State, depends for its validity upon the laws of the sovereignty in which it is exercised."); *id.* § 374, at 377 ("The legislature undoubtedly has power to prohibit foreign corporations from contracting in the State; but, until it does so, contracts so made will be enforced.").

¹⁴⁶ *Lafayette Ins. Co. v. French*, 59 U.S. (18 How.) 404, 406 (1855).

¹⁴⁷ *Id.*

to service on its agents.¹⁴⁸ The company's consent was to be found in its very decision to do business in Ohio. Ohio had announced a rule concerning service of process on foreign corporations. Lafayette chose to enter Ohio. Therefore, Lafayette must have agreed to Ohio's terms. The deduction was sound, but only if Ohio had authority to exclude Lafayette *absent* its consent to the state's terms. This is precisely what *Lafayette Insurance* signified. Recalling *Bank of Augusta*, Justice Curtis's opinion for the Court began with the premise that "[a] corporation created by Indiana can transact business in Ohio only with the consent, express or implied, of the latter State."¹⁴⁹ To this consent Ohio could attach:

such conditions as Ohio may think fit to impose; and these conditions must be deemed valid and effectual by other States, and by this court, provided they are not repugnant to the constitution or laws of the United States, or inconsistent with those rules of public law which secure the jurisdiction and authority of each State from encroachment by all others, or that principle of natural justice which forbids condemnation without opportunity for defence.¹⁵⁰

The proviso would in later years prove important, and it remains important today. But in the decades following *Lafayette Insurance*, the Court upheld any number of state laws conditioning recognition of foreign corporations. The states were held competent to require foreign corporations to, for example, file copies of their charter documents,¹⁵¹ appoint local agents to receive service of process, post special bonds,¹⁵² and pay special taxes.¹⁵³ The states were held

¹⁴⁸ *Id.* at 404.

¹⁴⁹ *Id.* at 407 (citing *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519 (1839)).

¹⁵⁰ *Id.*

¹⁵¹ *Interstate Amusement Co. v. Albert*, 239 U.S. 560 (1916).

¹⁵² *Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 181 (1869).

competent to exclude foreign corporations for failing to comply with these obligations, for removing suits to federal court,¹⁵⁴ and for violating state antitrust laws, whether locally or abroad.¹⁵⁵ In short, until the twentieth century, as one commentator remarked, “it was clearly the doctrine of the Supreme Court that a state might decline to admit a foreign corporation arbitrarily or even from a motive contrary to the general purposes of the Constitution.”¹⁵⁶

Non-recognition did not, and does not, imply the authority to confiscate corporate property, on the one hand, or to bar commerce with foreign citizens, on the other. Non-recognition pierces the corporate fiction, casting the firm’s acts and property as the acts and property of individuals associated in partnership. As one court put it, a law disregarding foreign corporations “convert[s] the foreign corporators, as to the state enacting the supposed law, into a partnership of individuals.”¹⁵⁷ The corporate form is valuable, and so therefore is the power to disregard it, but it is worth remembering that a firm can do business abroad whether or not it is recognized as a corporate body.¹⁵⁸

¹⁵³ *Ducat v. Chicago*, 77 U.S. (10 Wall.) 410, 413 (1870).

¹⁵⁴ *Doyle v. Cont’l Ins. Co.*, 94 U.S. 535, 542 (1876); *see also* *Sec. Mut. Life Ins. Co. v. Prewitt*, 202 U.S. 246, 258 (1906) (reaffirming the rule in *Doyle*).

¹⁵⁵ *Hammond Packing Co. v. Arkansas*, 212 U.S. 322, 343 (1909); *Waters-Pierce Oil Co. v. Texas*, 177 U.S. 28 (1900).

¹⁵⁶ GERARD CARL HENDERSON, *THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW: A CONTRIBUTION TO THE HISTORY AND THEORY OF JURISTIC PERSONS IN ANGLO-AMERICAN LAW* 110–11 (1918).

¹⁵⁷ *Erie Ry. Co. v. New Jersey*, 31 N.J.L. 531, 544 (N.J. 1864); *see also* Tung, *supra* note 98, at 99 n.334 (collecting cases in which the judicial decision not to recognize a foreign corporation was understood to imply the *de facto* substitution of a partnership).

¹⁵⁸ *See, e.g., Flexnor v. Farson*, 248 U.S. 289, 292 (1919) (holding that partnership operating in state with law authorizing service of process on agents, as in *Lafayette Insurance*, does not impliedly consent to such service, since “the State had no power to exclude the defendants,” and so the defendants did not impliedly consent to be bound by the prescribed service); *see also* *Lafayette Ins. Co. v. French*, 59 U.S. (18 How.) 404, 408–09 (1855) (noting that implied consent theory applicable to foreign

The states' plenary authority to qualify recognition of foreign corporations was not to last. To some extent the waning of the non-recognition power followed inevitably from the national economy's rapid nationalization. Trade across state lines was becoming cheaper. Increasingly complex production and distribution networks made the corporate form increasingly valuable and led to a proportionate increase in the number and importance of firms engaged in interstate commerce. It was understood that the commerce clause prevented states from excluding corporations engaged in interstate commerce,¹⁵⁹ and the functional significance of this limitation grew proportionally. Nationalization also implied growth in the amount of local trade that bore significant interstate consequences—importantly to be distinguished from “interstate commerce” in the narrow, constitutional sense of the phrase. Here lay an opportunity for states to use their non-recognition power to favor local interests and balkanize trade. Many states adopted differential tax schemes to expropriate surpluses generated by what was ultimately interstate trade. The Court responded by fashioning new exceptions to the states' non-recognition authority.

The Justices have never questioned the general premise that states may exclude foreign corporations. Instead the Court began, over time, to fashion ad hoc exceptions to state authority under the banner of three constitutional headings: the negative commerce clause, the equal protection clause, and the unconstitutional conditions doctrine. This is not the place to canvas these doctrines' full implications. A contextual sketch of each must suffice. What matters for

corporations might not hold as applied to foreign, natural persons, whom a state lacks absolute power to exclude).

¹⁵⁹ See *Pensacola Tel. Co. v. W. Union Tel. Co.*, 96 U.S. 1 (1877) (holding that a Florida law purporting to grant a monopoly on telegraph lines in the state, irrespective of congressional legislation on the subject, was void under the commerce clause); see also HENDERSON, *supra* note 156, at 112–16.

present purposes is whether any of the three would bar a state law that conditions recognition of foreign corporations on their “agreement” not to invoke federal rights. As the Court has applied these doctrines in the non-recognition context, they share a theme—preventing states from adopting protectionist tactics. If this is so, states may well be able to condition recognition of foreign corporations on their non-exercise of certain federal rights. But they almost certainly cannot do so without also disabling their own domestic corporations in similar fashion.

Commerce Clause. In its negative form, the commerce clause invalidates state laws that interfere unreasonably with interstate commerce. As early as the 1870s, this principle began to form a definite limit on the states’ authority to condition recognition of foreign corporations.¹⁶⁰ Two applications emerged.¹⁶¹ First, the states were held incompetent to exclude foreign corporations engaged solely in interstate commerce. The power to exclude, like the power to tax, would involve the power to destroy.¹⁶² If the states could not exclude such corporations absolutely, then nor could they exclude them conditionally. After all, the theory of implied consent articulated in *Lafayette Insurance* was premised on the notion that a state could, if it wished, exclude foreign corporations absolutely. Although this application of the commerce clause was important as far as it went, it had limited breadth. To the extent a corporation engaged in *intrastate* as well as *interstate* commerce, the states remained free to condition recognition.¹⁶³

Second, and more important for our purposes, the states were held incompetent to condition recognition of foreign corporations on account of discriminatory rules that might

¹⁶⁰ *Pensacola Tel. Co.*, 96 U.S. at 1.

¹⁶¹ See HENDERSON, *supra* note 156, at 110–17 (describing the early application of the commerce clause to the question of the states’ non-recognition authority).

¹⁶² *Cf. McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 327 (1819).

¹⁶³ *E.g., Interstate Amusement Co. v. Albert*, 239 U.S. 560, 567–68 (1916).

indirectly burden interstate commerce. Most of the commerce clause cases in this vein concern discriminatory taxation.¹⁶⁴ On the traditional theory, a host state could exact from foreign corporations any price it pleased—any tax—as a condition of the right to do business within the state. The commerce clause's elaboration changed that. The principle underlying the dormant commerce clause implied that a state may not use its taxing power to discriminate against interstate commerce.¹⁶⁵ How this principle would apply in concrete cases was not always clear, and the Court's apportionment jurisprudence remains convoluted to this day.¹⁶⁶ For our purposes, though, the general principle is enough. The courts will look askance at non-recognition rules, a consequence of which is to discourage the flow of goods or persons across state lines. Any time foreign firms are treated more harshly than domestic firms, a discrimination case is plausible. But if domestic and foreign corporations are treated alike, the case is much weaker.

Equal Protection. In 1886, the Court held that corporations are “persons” within the meaning of the Fourteenth Amendment's equal protection clause.¹⁶⁷ Applying as it does only to persons within a state's jurisdiction,¹⁶⁸ the clause has nothing to say about the conditions a state may place on foreign corporations' entry. The equal protection principle does, however, limit states' authority to enforce laws, including by ejection, against

¹⁶⁴ See HENDERSON, *supra* note 156, at 117.

¹⁶⁵ *Id.* at 118.

¹⁶⁶ Regan, *supra* note 127, at 1185 (“The Court has done much in recent years to clarify dormant commerce clause doctrine in the taxation area, but no one would claim it has completed the task of clarification.”).

¹⁶⁷ *Santa Clara Cty. v. S. Pac. R.R.*, 118 U.S. 394, 397 (1886). For discussions of the historical and theoretical underpinnings of this important decision, see generally Ruth H. Bloch & Naomi Lamoreaux, *Corporations and the Fourteenth Amendment* (unpublished manuscript) (on file with author); Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173 (1985).

¹⁶⁸ U.S. CONST. amend. XIV, § 1.

foreign corporations that entered validly.¹⁶⁹ The principle has been an important substitute for the commerce clause in two situations: (i) where a state's non-recognition rule discriminates against out-of-state business, but not strictly against "interstate commerce,"¹⁷⁰ and (ii) where legislation makes the negative commerce irrelevant.¹⁷¹

The equal protection clause—even more clearly than the commerce clause—stands simply for a principle of non-discrimination.¹⁷² As a matter of hornbook law, equal protection analysis first asks whether the state has a legitimate interest in the ends of its regulation, and, second, whether the means are rationally related to it. In particular, a state's imposition of "more onerous taxes or other burdens on foreign corporations than . . . on domestic corporations" is invalid, notwithstanding the general non-recognition authority, unless "the discrimination between foreign and domestic corporations bears a rational relation to a legitimate state purpose."¹⁷³ Protecting local business at the expense of interstate competition is not a "legitimate state purpose."¹⁷⁴ Thus, equal protection effectively mandates like

¹⁶⁹ See *Herndon v. Chi., Rock Island & Pac. Ry. Co.*, 218 U.S. 135, 158 (1914) (holding that railway had become "person within the state" and hence could not be discriminated against without reason).

¹⁷⁰ See, e.g., *Power Mfg. Co. v. Saunders*, 274 U.S. 490, 492–95 (1927) (invalidating Arkansas venue rule providing that suits against a domestic corporation be brought in a county in which the corporation does business, but permitting suit against foreign corporations in any county).

¹⁷¹ See *Metro. Life Ins. Co. v. Ward*, 470 U.S. 869, 874–83 (1985) (invalidating statute which taxed domestic insurers' gross insurance premiums at a lower rate than foreign insurers'). This rule has been most important in the realm of state insurance regulation, which the McCarran-Ferguson Act exempts from negative commerce clause scrutiny. See 15 U.S.C. §§ 1011–15 (2012); *W. & S. Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 654–55 (1981).

¹⁷² Cf. *Ward*, 470 U.S. at 880–82 (noting counsel's complaint that the Court used equal protection merely to instantiate commerce-clause values where the commerce clause would not apply).

¹⁷³ *State Bd. of Equalization*, 451 U.S. at 667–68 (citing *Power Mfg. Co.*, 274 U.S. at 493–94).

¹⁷⁴ *Ward*, 470 U.S. at 876–78.

treatment of foreign and domestic corporations in all but trivial matters. Under this principle, a state likely cannot require foreign corporations to forswear the exercise of federal rights while simultaneously permitting its own corporations to invoke them. But, if a state were willing to treat or disable its own corporations on similar terms, equal protection would not stand in the way.

Unconstitutional Conditions. The biggest threat to the non-recognition strategy is found in the doctrine of “unconstitutional conditions.”¹⁷⁵ This doctrine describes “the theory that a condition attached by a state to a privilege is unconstitutional if it requires the relinquishment of a constitutional right.”¹⁷⁶ To recognize the corporate form is to grant a privilege. States may or may not grant the privilege as they see fit. However, they may not qualify it on an unconstitutional condition. The problem is obvious. Consider the rights of religious free exercise. Corporations empowered by their charters to practice religion have a constitutional right to do so. A state’s law conditioning recognition of foreign corporations on their agreement not to exercise religion thus seems in a straightforward sense to be a law conditioning a privilege on “the relinquishment of a constitutional right.” Some cases seem to support this deduction. States cannot, for example, condition the recognition of a foreign corporation on its waiver of the “constitutional right to resort to the federal courts,”¹⁷⁷

¹⁷⁵ Frost v. R.R. Comm’n, 271 U.S. 583, 593–94 (1926). For a history of the development of unconstitutional conditions theory in relation to the states’ non-recognition power, see HENDERSON, *supra* note 156, at 132–47.

¹⁷⁶ Hale, *supra* note 70, at 321.

¹⁷⁷ Terral v. Burke Constr. Co., 257 U.S. 529, 532–33 (1922) (“[T]he federal Constitution confers upon citizens of one state the right to resort to federal courts in another . . .”). The Justices apparently had in mind a constitutional right not to be blocked from suing in whatever federal courts were presently vested with jurisdiction—a statutory rather than constitutional predicate.

payment of a tax on property held outside the state,¹⁷⁸ or agreement to charge non-discriminatory prices.¹⁷⁹

Yet the doctrine's application is unpredictable notwithstanding the apparently clean categories in which it is typically framed. In the context of the state's non-recognition authority, no safe bet is possible. As the Court itself has admitted, unconstitutional conditions cases in this domain have "produced results that seem inconsistent or illogical."¹⁸⁰ Nor could it be otherwise, for the doctrine contains within its very articulation a contradiction in terms. Consider, for example, the following rule: "A state may not say to a foreign corporation, you may do business within our borders if you permit your property to be taken without due process of law."¹⁸¹ Few would object to what sounds like a reasonable principle. But the rule hides a conceptual problem. As one commentator explained, "To 'permit your property to be taken without due process' is a contradiction in terms. Property taken by permission is not taken without due process."¹⁸²

The doctrine of unconstitutional conditions is really a doctrine of *unreasonable* conditions, with the judiciary cast as the arbiter of reason. The evidence is unmistakable. Take the trivial example of the driver's license. Every state requires would-be drivers to pay a modest fee in addition to passing a battery of tests. How can this arrangement be constitutional? You have a right to the security of your property, and to compensation for its taking. "License for a fee" is an offer to give you a privilege on condition that you surrender a part of your property rights. If the terms in

¹⁷⁸ *Equitable Life Assurance Soc'y of the U.S. v. Pennsylvania*, 238 U.S. 143, 146 (1915) ("[A] state cannot tax property beyond its jurisdiction" and "cannot effect that result indirectly by making the payment a condition of the right to do local business . . .").

¹⁷⁹ *Frost*, 271 U.S. at 593–97.

¹⁸⁰ *W. & S. Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 658 (1981).

¹⁸¹ *Baltic Mining Co. v. Massachusetts*, 231 U.S. 68, 83 (1913).

¹⁸² HENDERSON, *supra* note 156, at 147.

which unconstitutional conditions is usually framed were taken literally, the arrangement could not stand. But of course it can stand. License fees are ubiquitous and constitutional. The illustration is useful only to see that the unconstitutional conditions doctrine is less straightforward than one might suppose.

As the Justices have applied it in the non-recognition cases, unconstitutional conditions furthers the same goals as the commerce and equal protection theories do. That is, the Court invokes unconstitutional conditions mainly to invalidate discriminatory regimes.¹⁸³ So, for example, a state may not condition recognition on a corporation's agreement to "more onerous" taxes than an otherwise comparable domestic corporation must bear.¹⁸⁴ To the extent *domestic* corporations are empowered to do acts the Constitution protects, a state may not entice *foreign* corporations to disclaim them. The level playing field is the key metaphor.¹⁸⁵ In sum, a state that disables its own corporations along a particular dimension has a strong claim to insisting that foreign corporations behave in a like manner—whether or not the conduct at issue implicates constitutional values.

V. CONCLUSION

This Article's title is meant to evoke a unifying theme: the states' ability in practice to abrogate the Supreme Court's corporate-rights decisions. In broad strokes, the suggestion

¹⁸³ For an account casting the relevant case law as concerned primarily with "disguised differential taxation"—that is, discrimination, see Richard A. Epstein, *The Supreme Court, 1987 Term—Foreword: Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 HARV. L. REV. 4, 31–38 (1988).

¹⁸⁴ *State Bd. of Equalization*, 451 U.S. at 667–68.

¹⁸⁵ See Epstein, *supra* note 183, at 31–32 ("The best way to combat this problem [of foreign corporations maneuvering to gain admission] is through a strong, categorical rule granting foreign corporations the same right to do business in another state *on the same terms and conditions* available to its local corporations.").

of thematic unity is justified. Scholarly and popular commentators alike have largely assumed that federal law—and more specifically the Court’s take on it—is the beginning and end of the story when it comes to corporate rights. If it accomplishes nothing else, this Article hopes to put the lie to that notion. State law supplies the terms that give constitutional corporate rights their purchase. Because state law is relatively easy to change, would-be reformers should focus their attention on it rather than far-fetched plans to amend the Constitution. The distinction here outlined between powers and rights is easy to overlook in an era of liberal corporate codes, but it is central to the legal theory of the firm, and we forget it at our peril.

In another sense, though, the title conceals an important disjunction. The states tread on unequal footing with respect to any particular corporation’s scope of action. Nor can it be otherwise in a federal system where the national government charters only very few corporations. The chartering state has a stronger claim than others to restrict a corporation’s powers, precisely because the chartering state reaps benefits from a lax policy. If the chartering state is willing to forgo these benefits, there is a strong presumption that it does so for sound reasons. But host states, too, can claim authority to curtail disfavored corporate acts, and their claim finds substantial support both in political economy and, absent discrimination, in existing doctrine.