



Episode 325-Are Corporations Un-Libertarian?

Guest: Stephan Kinsella

January 23, 2015

WOODS: As I was framing this episode before you came on, I was explaining to people what the controversy is, and the controversy is that you have the corporate form, and you have some libertarians who say that state incorporation is a state benefit, so libertarians can't support it. What's interesting about that, by the way, is a book that you and I both like very much by Robert Hessen called *In Defense of the Corporation* was actually written as a response to Ralph Nader, who was making exactly the arguments that left-libertarians are making now. That doesn't make them wrong; Ralph Nader is not always wrong. But this was thought of from the start, this kind of modern defense of the corporation, as a response to people like Ralph Nader. What exactly is the corporate form, first of all, that's the cause of all this controversy?

KINSELLA: I think Hessen's work is the kind of the seminal work on this issue. Although, to be honest, for libertarians, probably there's about three pages of that book which address the only issue we ought to have. The rest of it addresses concerns that non-libertarians really have; these kind of utilitarian arguments, etc. But of course, the word corporation means "body." And it's a legal form that's fairly recent in its modern form in the modern Western society. It's a way of organizing a firm or a business enterprise. Traditionally in the past you have individuals, which are persons, which we now call natural persons in the law to distinguish them from legal person or civil persons, which are these artificial entities that have legal personality. The United States government is a form of a corporation in a sense. All states are corporations because they have a legal personality. They are said to exist on that plane as an acting entity. In private relationships, individuals would have a business or they would be employed, or have a shop, and they are just an individual. If you owned a shop, you called yourself a sole proprietor. If you partnered up with someone because you needed more than one person, unless they were employees or family members, you might have someone else who contributes capital, and you all work together, and that's called a partnership. So you just partner together. But that's really nothing more than a private contractual arrangement. Under those types of legal arrangements in the past, each partner would contribute a certain amount of capital or have a certain share of ownership of this partnership, which was not a legal entity. It was just the way that these people arranged their affairs. But if there was a debt owed by the partnership, like for a loan or even for some kind of tort, traditionally all of the partners were held to be liable for the entire amount.

There are many reasons for that, one of which was they wanted to hold themselves out that way so that they could have a good reputation, and also, a lot of times these are like family-type businesses where there was honor involved and all this. But sometimes they needed the capital from someone who didn't really want to be too involved in the business. They just wanted to contribute some capital and have an ownership stake in it, but they didn't want to be liable for possible debts of the partnership, and so the practice of limited-liability partnerships arose. A limited-liability partnership is one where there are two different types of partners. There are general partners, which are the traditional type of partners who are each personally liable for all of the debts of the entire partnership, and then there are limited-liability partners, who are only liable up to the amount of money that they invested in the partnership.

So that was the emerging model in early industrialism and capitalism. And then the state stepped in and came up with something similar to that, which they called the corporation. The corporation is similar in many ways to a limited-liability partnership. The state allows you to register a charter with the state and call it a corporation, and the shareholders—the people that invest capital—are not liable for the general liability of the corporation. Only the corporation and its assets are. And as part of that process, the corporation was deemed to have what's called entity status. It has a legal personality. So it is a legal person. So that's how the corporation arose. And the criticism by the libertarians is that they believe that when the state did this, it granted a privilege to the shareholders, it granted them immunity from general liability for debts of the corporation that they otherwise would have had in a free market, and therefore, it's a privilege and ought to be abolished.

WOODS: I have to admit that years ago I fell into that error, too—I believed that incorporation was a state privilege, and it was mainly because I hadn't looked into it all that deeply, and it was, frankly, an easy way for me to seem like I had some common ground with the left. Hey, I'm against corporations, too! I'm kind of embarrassed as I look back on it. And frankly, it was you more than anybody else who jolted me out of that. When we see the government involved in something, we're inclined to think that the government is granting something, but it could be simply codifying a relationship that could emerge inoffensively from a libertarian standpoint.

I want to look at the three areas that Hessen identifies, and that you're talking about here as really constituting the major corporate features. So entity status, as you just mentioned, or so-called corporate personhood—I think that's one of the key ones. Then perpetual life I think is not as big a deal, and then limited liability. I want to get to all of these. When we say entity status, this is the same thing as corporate personhood, is it not?

KINSELLA: Yes.

WOODS: This is a topic that comes up quite a bit on the left, too, because you see people chanting, "Corporations aren't people," and I think they think they're making some kind of profound point here, but I think everybody knows that a corporation is not actually a human

being. It seems to me that entity status is a fairly benign feature of corporations. What is the purpose of entity status? What does it do?

KINSELLA: Okay, that's the right place to hit it. And I agree with you, we should be suspicious of anything the state does, but we should also be suspicious of its claims, right? We're used to the state providing education and roads. They take credit for these things. They co-opt them, right? So it could be something like that's going on here, so we have to be careful not to just assume this. And if you want to find common ground with the left, and we can get to this later, I would agree: we should abolish state incorporation statutes and grants. But I don't think it would lead to what the left-libertarians think it would. You mentioned the three features that Hessen zeroed in on. There's limited liability, there's perpetual duration, and there is the entity status. Now, you say what's the purpose of entity status? I think there's two answers to that. The free-market, or the practical answer, is it's just for administrative convenience. It's actually for the benefit of people that the company might owe money to. A creditor could just sue Chevron Corporation in the courts instead of having to sue 10,000 shareholders or some nebulous group of managers. It's actually an administrative convenience. And there's no reason contractually or practically a court system couldn't allow something like that. But the state's reason for entity status is to pretend like they are granting some special privilege.

So since the state and the Left, the left-libertarians, all agree that the state is granting a privilege to the corporation or to the members of the corporation, so the state grants them entity status, why? So they can say it's a privilege so that they can say, well, we don't have to give you this privilege, so we can condition it, or we can ask for something in return. For example, corporate taxation, double taxation or corporate regulation. You hear this kind of rhetoric all the time. Hey, we're giving you the privilege of entity status and limited liability. So you can't complain if we have corporate taxation or capital gains taxation or regulations on what you do—Sarbanes-Oxley regulations—all these kinds of things. So basically, it's an excuse for the state to regulate companies. If we were able to achieve something like a corporation without the state's assistance just by pure private contract and private law, then the state would have no excuse to tax the corporation. So I think it would be a good thing if we removed entity status, but I don't think it would result in unlimited liability for shareholders.

And by the way, the perpetual duration thing I think is easy to dispose of, as Hessen does. You could easily arrange for some kind of contractual network to live indefinitely, because the members can be switched in and out just like a neighborhood association or a restrictive covenant, or a trust. There's no reason you couldn't just have private arrangements to make some so-called business firm last potentially forever or beyond the lifetime of its original founders.

So to my mind, the only sticking point for libertarians is limited liability, and for that, we have to look at two types of limited liability—that is, two types of debts that the shareholders are protected from. One would be contractual liability, like a debt to a creditor: someone who loans money to the firm or someone to whom the firm owes money like a vendor. And the other

would be someone who doesn't have a contractual relationship with the firm, but was injured by some kind of negligent act by the firm. So for example, a little old lady who is run over by a FedEx truck. That's a tort committed by the driver of the truck. So then the question is, who is she entitled to sue? So this is where we get into this question of limited liability.

WOODS: Right, now with limited liability, up until I read your stuff I was more or less able to handle half the issues.

KINSELLA: Yes.

WOODS: I could handle half. I could handle the part that deals with debts and say, there's no reason that, again, contractually creditors couldn't just say: we understand that in lending you this money we will not be able to go into the college funds of every shareholder to get it if you guys don't pay. We're limited to the assets of the corporation or whatever. They would understand that, and there would be a premium in the interest rate here reflecting the fact that they know that this is a limitation on how much they can grab in a case of default. So everybody could establish that purely voluntarily.

KINSELLA: Yes, and the other way around, too, Tom. If you want to loan money to a corporation, and you insist that some of the shareholders or some of the managers, or some of the major shareholders—you insist that they personally guarantee it, which is done sometimes in very small corporations, then those borrowers, the corporate borrowers, they are taking on more risk, and they may insist on better terms for themselves because of that. So it's a two-way street there.

WOODS: Okay, I hadn't actually thought of it that way.

KINSELLA: So for example, if you wanted to loan money to Exxon, you don't really need the CEO to be personally guaranteeing a loan because they have plenty of assets, but if you insist on that, they will turn you away and go to the next lender, so you would actually lose business. So it's a two-way street.

WOODS: Now, what about the classic case of the delivery driver. He's an employee of the corporation. He's driving around, and he strikes somebody and harms them. That's the issue that we need to tackle.

KINSELLA: Yes, so here's the fundamental issue I think for libertarians on this corporation issues, and in a way, it's like the IP issue. It's one of these issues where there's a lot of things taken for granted or a lot of assumptions, and you just have to step back and think: what is everyone assuming here? And let's think more clearly about this to get to the heart of the issue, and it starts becoming clearer. I was like you on this. I was confused on this privilege issue. You don't want to be in favor of the state granting privileges, but we're in favor of capitalism, and there's got to be something wrong with what the leftists are proposing, and I discovered that basically this has already been addressed by at least three libertarians that I found—Hessen and also Roger Pilon and Rothbard, specifically. I had never noticed it when I read him the first time

because I wasn't thinking about corporate limited liability, but going back and researching this issue, all three have basically the same point, and it really comes down to a question of causation and responsibility. The idea is that what should individuals be responsible for in life or what makes you responsible for someone else—for a negligent act or for a tort, and the general answer is that if you commit it, right? The delivery truck driver at first glance is the person who committed the tort. What the people who want to abolish limited liability want to see happen is they want the shareholders of the corporation to be also liable.

Now, in the law, that's called vicarious or secondary responsibility. That is, there is a doctrine saying that A is responsible directly for his actions like the truck driver, and B is also responsible for some reason. Now, there are several exceptions or cases in the law for which B should be responsible for A's actions. So if B coerced A into doing it, right? Like a mafia boss ordering a hit man or coercing someone to do something, or if B was somehow in cahoots with the driver. There's different exceptions like that. But in general you can't just pick a random B out of the crowd and say, well, B should be responsible for A's liabilities.

What the Left and the libertarians who are on the opposite side of this issue say is, well, the shareholders are owners of the corporation and therefore they should be responsible. So to me this is the crucial issue. That's the mistake they make. There's two mistakes in that formulation. One mistake is that they are assuming that ownership implies responsibility, but that is actually not what ownership is. Ownership is the legal right to control. It's not the obligation to be responsible for. It's the right to control. A clear example of that would be if you own a knife and someone steals your knife, and they stab someone with it, we would say you still own the knife because the thief doesn't gain title to the knife, and your knife is used to kill someone, but you're not responsible for that because you didn't perform it. So ownership by itself does not confer responsibility. It has to be action that causes responsibility. So then the question is, what action did the shareholder perform that caused the harm to the victim of the negligence of the truck driver? That's the real question.

The second mistake they make is they rely upon state classification, like, when they say ownership, they say, well, the shareholders own the corporation. Well, that's kind of a legal classification that the state uses to call these guys owners, but we need to look as libertarians and as Austrians at the reality of the situation. If you remember, ownership is the legal right to control a scarce resource. Possession is the factual ability to control a resource. That's what human action is. Now, as a matter of fact, if you're a shareholder in Google, you're not entitled to go have your child's birthday party in their conference room. You're not entitled to take the corporate jet and go fly with it. You don't have actual day-to-day control of that asset like an owner in the simple sense would. Just because the state labels someone an owner doesn't mean they are an owner in the actual libertarian legal sense. If you get rid of these assumptions, which are kind of statist influenced, which libertarians just rely upon in their arguments, then you have to go back to a causal question, and then the question becomes one of causation and responsibility.

And then we get to the nub of the issue, and this is what Rothbard and Hessen and Pilon point out. What they point out is that traditionally, in the law, the reason that we assume that the owners of a business are responsible for torts committed by the employees is the doctrine of *respondeat superior*, which means the superior is responsible for the actions of his subordinate. This is a relic of feudalistic times when you had an apprentice or you had a master. You had a small shop, a blacksmith, and his apprentice, or a small family-type unit, and basically you do have a closely controlled setting where there's a manager who is really in charge of ordering the subordinates to do things. So the doctrine arose of *respondeat superior* that the master is responsible for the actions of his servants. And that doctrine is reasonable enough. Although, I am not quite sure you could justify even that under libertarian principles.

But let's assume that we could take that for granted that if there's a master controlling the actions of a subordinate, by which I mean giving orders, that we would say the master has some liability for what that servant does, just as President Truman had liability for the bombs dropped over Nagasaki and Hiroshima because he gave an order to someone. Although that's a state setting, but still, you could say he's responsible. He's not off the hook just because someone else did it. You could see relationships in hierarchical structures where masters ought to be responsible for the actions of the servants that they direct. So the question is, what kind of theory of causation could you come up with that would show that shareholders are in that position like the managers of the corporations are? And the problem I have is that you can't, because if you broaden the scope of responsibility and causation so broadly that you say everyone who gives Exxon \$30 for one share of stock is now on the hook for \$50 billion of liability for an oil spill, then all that person did was give money to Exxon and have the right to vote in elections for the board of directors, who don't themselves run the company. They appoint managers who run the company. I could see an argument that the managers are responsible for actions of their subordinates, maybe even an argument that the board of directors is responsible because they appoint the managers, although that's weak, but there is a potential for liability there. That's why there's such a thing as D&O, directors and officers insurance. This is what most corporations get. So even though they are potentially liable, they are not really personally liable because they are insured anyway.

So this whole issue that that Left raises is just a non-issue because even if you said shareholders should be responsible, then corporations would just get shareholder liability insurance, and it still would be a non-issue. They would still go on as before. I don't know if they'd call themselves corporations, but the point is if you were to expand the net of causality and say that just because someone has the right to vote for the board of directors in a corporation, which means the right to influence the outcome of an election, then they are responsible.

Remember, every shareholder doesn't necessarily even—they haven't even given money to the corporation because I can buy a share from an existing shareholder. I can buy a share of Exxon stock from Joe Blow, and I give money to him. I never gave a dime to Exxon. So I'm not contributing money to Exxon. I only have the right to vote. What if I never exercise the right to

vote, or what if I vote, and the vote didn't matter, or what if I vote for a different candidate who lost? These nuances are never gone into primarily because most critics of the corporation I think don't understand how corporations actually work. In fact, you hear all the time people say that limited liability exempts from liability the managers and the employees of the corporation, which is completely false. Limited liability only says the shareholders aren't liable. But in my view and Roger Pilon and Hessen's and Rothbard's view, they wouldn't be liable anyway in a free market, so that law does nothing. In fact, I think it's pretty difficult to sue a manager personally for a tort of a driver that he was responsible for supervising. Although you could argue that he should be liable. So the state system actually exempts from liability people who wouldn't have liability anyway, and it doesn't provide them a remedy or a cause of action against people that arguably should be liable. So the state theory is bad on the causation role in both directions.

WOODS: Well, let's complicate things a bit with the case of a truck driver who is reckless and a drunk, and the manager knows he's reckless and a drunk, but figures he's the cheapest guy to hire. Are you saying that there might be some world in which that manager would be liable to some degree?

KINSELLA: Absolutely. I think this is one of these armchair libertarian issues where the whole field has been so corrupted by state interference that it's hard to see what really ought to develop with a nuanced private law, customary court decision process over time. But my feeling is that probably that manager would be liable. Although, as I said, he would probably be covered by a type of D&O insurance. Now, that insurance would probably have exceptions for willful negligence or gross negligence. But you know, if you make a mistake, then you're covered by the insurance anyway. But this is all really practically irrelevant, because for any corporation that's responsible enough and has the resources to procure insurance for its managers and its officers and its board members, it's going to have insurance for the corporation itself. So the victim is going to go after the assets of the corporation, and then as a backup, they have the assets of the insurance company, which would be the insurance company for the corporation as a whole. And yes, I suppose they would have—they could sue the manager directly and then go after his insurer, but this is all just lagniappe. This is extra security.

WOODS: Let's go back for a minute to the debts question. I want to ask you if this is a legitimate analogy in your mind. Suppose you have some kind of grievance against a local church. You're suing them for damages. What you're able to get from them would be drawn from the assets held by that church. You would not be able to get into the pockets and the savings accounts of the congregation. Is that a good analogy for what's going on with a corporation with limited liability?

KINSELLA: I think it's a very good analogy, because as I was going to say, and I lost my train of thought, if you extend this net of causation so broadly in the corporate context that you could sue the shareholders for the minimal role they have in the actions of the person who

committed the tort—basically, the law considers them passive, and the law, by the way, makes exceptions for what they call something like active shareholders. So if you're a passive shareholder, you're just someone who owns stock in a company. All you do is vote in the occasional election and receive your dividends. You can receive the benefit of limited liability, but if you actually interfere with the actions of the corporation, or you're such a big shareholder that you start telling them what to do, then you start becoming basically one of the management, and then you could be liable. So I think that's a perfectly reasonable exception.

But my point is, if you hold a passive shareholder liable for the actions of the corporation, then you would also have to hold liable every other employee of the corporation, every vendor of the corporation, every customer of the corporation—because every one of them benefits the corporation in some way. If I go to McDonald's and I buy a \$30 meal for my family, I am giving them \$30. What's the difference if I buy a stock—a share of stock for McDonald's for \$30 or if I buy food from them, or if I supply food to them, or if I loan them money as a creditor? And in fact, a lot of lenders like bank lenders, they request, or they require, official, contractual input to board appointments and how the company is run. Believe me, a lot of companies that have large lenders, they listen to what those lenders say. Those lenders are a lot more influential on the policies and the direction the corporation takes than some little shareholder. So the point is, if you have this kind of theory, this broad theory of causation or responsibility, you have one medium-sized corporation—you have 10,000 people that are all liable for its debts, not just the shareholders, but its customers, its vendors, every employee, all the union workers, all the janitors—everyone. And this is clearly absurd.

WOODS: Right.

KINSELLA: And by the same token, that's why your analogy is apt. The parishioners of a church are not really the owners of the assets, I don't think in most cases. Right? It's probably some kind of non-profit trust or something like that.

WOODS: Absolutely. I would think so. I heard that analogy, and I can't now remember where, but it seemed to make sense because I've never heard of anybody complaining that you can't get at the assets of a member of the congregation. But it would seem that if you're making this complaint about corporations, you should make that complaint.

KINSELLA: Yeah, the problem is, if you bring this point up, then the libertarian will say, but the shareholders are owners, so then they will go back to the state classification system, and they will rely upon the state's own classification system. What if the state just used a different word? What if the state said, here's a shareholder who is a person that has the right to receive dividends, that has the right to vote for board of director elections, and that has the right to receive a *pro rata* share of the assets of this in a liquidation event. That's what they are. In other words, they didn't have to call them an owner because they are not really an owner of the assets. They have certain contractually specified rights just as creditors do, just as vendors

do, just as employees do, just as suppliers do, just as anyone that the corporation interacts with does.