

EXPLAINING THE CORPORATION TO STUDENTS AND OTHER NON-SPECIALISTS: A GRAPHIC APPROACH

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I INTRODUCTION

The corporation needs to be explained to a wide range of people both in and well beyond the academic context. Everyone from first year law students, frustrated creditors and fired employees, to would be entrepreneurs and investors struggle to understand basic corporate issues such as why the person they interacted with is not liable for a transaction and how the corporate entity provides new opportunities. It is difficult yet critical to be able explain the corporation simply yet effectively.

Explaining the corporation can become easier when thinking graphically about the problem and using new technologies. Experienced corporate counsel, Rosman, lays down the challenge: '[w]ell-crafted images—charts, diagrams, photographs—can make your briefs [and other presentations] more interesting and persuasive, and law schools would do well to incorporate instruction in visual presentation'.¹ This article proposes a graphic tested in both professional and academic settings as a useful solution to the problem of explaining

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¹ Adam L Rosman, 'Visualizing the Law: Using Charts, Diagrams, and Other Images to Improve Legal Briefs' (2013) 63(1) *Journal of Legal Education* 70.

corporate law, corporate actors and transactions to learners and other non-specialists.

II USE OF THE GRAPHIC IN HIGHER EDUCATION

There are three aspects to the pedagogical use of graphics in education. First, the purpose of using a graphic is to provide a grounding for ethereal socio-legal phenomena, the corporation at law. In educational contexts, the use of graphic representation of ideas is referred to as ‘mind mapping ... a nonlinear visual outline of complex information that can aid creativity, organization, productivity, and memory’.² Essentially, although not a traditional mind map, the graphic here proposed provides a map of sorts for thinking about the legal phenomenon of the corporation. Doing so reduces the cognitive load³ associated with holding ideas in one’s mind while simultaneously extrapolating, explaining and challenging the idea. Here, the learner is both learning and challenging the various doctrines, rules and transactions.⁴ A graphic provides a visual, and hence, a cognitive focal point for attention. This shifting of cognitive load away from short term memory to the task at hand is important; it frees up the mind to pay attention and so assists both the teaching and the learning of how to think about phenomena — i.e. the task of higher education — as opposed to mere surface learning associated with rote memorisation strategies.⁵ Graphics are particularly useful in this context. As Davies explains, ‘[i]f students can represent or manipulate a complex set of relationships in a diagram, they are more likely to understand those relationships, remember them, and be able to analyse their component parts. This, in turn, promotes ‘deep’ and not ‘surface’ approaches to learning.’⁶

Secondly, as educators have come to understand the different modalities of learning, it is clear that using a graphic approach helps visually orientated

² Diane Murley, ‘Technology for Everyone...Mind Mapping Complex Information’ (2007) 99(2) *Law Library Journal* 175, 175.

³ Martin Davies, ‘Concept mapping, mind mapping and argument mapping: what are the differences and do they matter?’ (2011) 62(3) *Higher Education* 279.

⁴ Tony Buzan and Barry Buzan, *The Mind Map Book: How to use radiant thinking to maximize your brain’s untapped potential* (Reprint 1996 ed, 1993), cited in Murley, above n 2.

⁵ Janet Gail Donald, ‘The development of thinking processes in postsecondary education: Application of a working model’ (1992) 24(4) *Higher Education* 413.

⁶ Davies, above n 3.

learners.⁷ In law as in other disciplines, learners come from various orientations and being able to communicate the idea of the corporation across the orientations enhances the learning experience. The challenge for educators dealing with corporate law has been to develop graphic that is effective, versatile and comprehensive. The proposed model addresses these issues and solves for the basic corporate law doctrines, corporate theory and transactions.

The third and final pedagogical aspect of the use of the graphic is consistent use. This point can hardly be overstated. Students need to learn to consider the implications, various iterations and alternatives consistently in every instance in which a corporate actor is involved. Students are confused or misled when incomplete or partial corporations are presented, and variations in the diagram are introduced. Just as we teach students to use language technically, with precision and consistently not varying except to show different legal issues, so too the graphic must be used without variation except to show different circumstances. As each corporation is the same in terms of legal structure, there is no cause to draw it otherwise than presented. While it can be slightly cumbersome at first to draw the whole graphic, once the discipline is entrenched in both teacher and learner, it becomes second nature and helps learners (and other non-specialists) to ensure they are remembering to consider all the rights and duties easily, by default.⁸ They are not at risk of overlooking or omitting some consideration of rights or duties in error.

III THE BASIC CHALLENGES OF CORPORATE LAW

It is widely acknowledged that the law of corporations is one of the more difficult areas of law. The reasons for this difficulty are fourfold. These are first, there are contradictory theories underlying the corporation as well as the mix of laws that inform it including the laws of property, agency, contract and trust. This underlying theoretical issue means that people whose task it is to explain the corporation, whether instructors, counsel or others, struggle to find a single, coherent model to use as a framework. The second issue relates to the distinction and relationship between the legal person and the human person.

⁷ MH Sam Jacobson, 'Learning Styles and Lawyering: Using Learning Theory to Organize Thinking and Writing' (2004) 2 *Journal of the Association of Legal Writing Directors* 27, 34-37.

⁸ Michael Wogan and Rolland H Waters, 'The role of repetition in learning' (1959) 72 *American Journal of Psychology* 612.

Non-specialists struggle to identify and understand the concept and nature of legal personhood and its implications for their situation. The third difficulty comes from the distinction between the legal person and its assets. Again, as with the second difficulty, non-specialists struggle to understand the distinction between the property of and contracting with the legal person and the property and contracts of the human actors. Finally, confusion often arises from the facts which, for example, may include individuals holding multiple roles or multiple corporations interacting with each other.

Stripping back this complexity is critical to communicating the corporation to learners and other non-specialists. There are two steps to the simplification task: identifying the core doctrines which need to be communicated and settling on a single, workable theory of the corporation which facilitates explanation.

A core challenge for a party explaining the corporation is identifying the basic doctrines. These doctrines need to be clear before one can successfully explain how they apply to the issue, person or case at hand. There are two foundational doctrines that need to be explained: first, the corporation as a separate entity or legal person. The separate entity doctrine is the overarching doctrine from which logic allows it to exist in perpetuity independently of its membership. Further, as a legal person, the corporation has the rights and duties of human persons, including the right to be a litigant. Finally, the separate entity doctrine facilitates limited liability in which neither directors nor shareholders are liable for the debts of the corporation.

The second foundational doctrine allows the apparent disconnect between decision-making and accountability. Decision-making in the corporate form is divided between the two corporate organs — the member-shareholders and director-officers. The latter, who are identifiable humans, appear to bear no consequence for their actions. Rather, it is the corporation which bears liability. The basic issue is that corporations, as non-human persons, require human agents for all their actions. Hence, these people are acting as agents for the legal person and bear only the liabilities appropriately visited upon agents.

IV THEORIES OF THE CORPORATION

The variety of theories of the corporation and their inconsistency makes both teaching and understanding corporate law problematic. Despite this diversity, two particular theories are most helpful — the contractual theory and the organisational theory. In both the legal and business academy, a common view is that the corporation as no more than a nexus of contracts⁹ --a view championed by law and economics scholars.¹⁰ Yet problematically for those trying to explain the corporation, the contract analysis fails as a legal analysis at a number of critical points. For example, it is a contract that can be amended without the consent of the parties; it is not limited to parties who made,¹¹ courts lack jurisdiction to amend it if it does not accord with the intentions of those currently bound by it; members face significant hurdles if they wish to enforce it against the company;¹² the rights attach to shares not the contracting parties, and contractors are limited in damages remedies 'whilst still a member and without seeking rescission of the contract whereby the shares were obtained.'¹³ The use of the term 'contract' in this instance is perhaps best understood as a metaphor.¹⁴ Yet, corporations are highly dependent on contracting and their ability to contract needs to be explained easily and clearly to parties.

Other theories of the corporation such as concession theory with its focus on origins,¹⁵ social purpose theories¹⁶ or organisationally focused theories have different focal points. For non-specialists, the organisational focus is helpful. It identifies the different parts or corporate organs and explains their different roles governance and the needs for agency.¹⁷ Fortunately, it is also easy to represent graphically, as this paper will demonstrate.

⁹ Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) *Journal of Financial Economics*.

¹⁰ Frank Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991).

¹¹ *Shalfoon v Cheddar Valley Co-operative Dairy Co Ltd* [1924] NZLR 561, 580.

¹² *Bailey v NSW Medical Defence Union Ltd* (1995) 13 ACLC 1698, 1717.

¹³ *Houldsworth v City of Glasgow Bank* (1880) 5 AC 317.

¹⁴ Thomas W Joo, 'Contract, Property, and the Role of Metaphor in Corporations Law' (2002) 35 *UC Davis Law Rev* 779.

¹⁵ *Trustees of Dartmouth College v. Woodward* 17 U.S. 518, 636–37 (1819); Stefan J. Padfield, 'Rehabilitating Concession Theory' (2014) 66 *Oklahoma Law Review* 327.

¹⁶ Frederick Hallis, *Corporate Personality: A Study in Jurisprudence* (Oxford University Press, 1930).

¹⁷ Melvin A Eisenberg, *The Structure of the Corporation: A Legal Analysis* (Little, Brown & Co, 1976) and more recently Stephen Bottomley, *Constitutional Corporation: Rethinking Corporate Governance* (Ashgate Publishing, 2007).

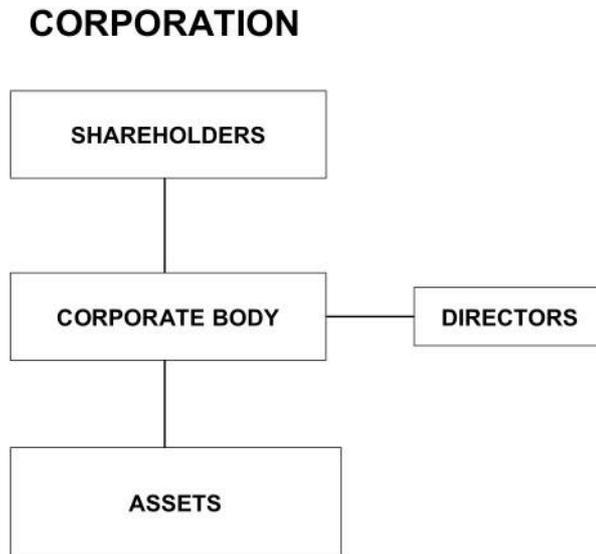


Image 1: Corporate organs

This graphic reifies legal phenomena and provides a location or focal point for the explanation and discussion. Using it consistently has proved helpful to communicating the ideas, rights and responsibilities to learners and other non-specialists.

V DISTINGUISHING LEGAL AND HUMAN PERSONS

The distinction between the legal person and the human person is problematic for most non-specialists, and particularly so in the small corporations where the directors may also be shareholder, manager and employee. In commerce, the two are often so closely identified that non-specialists, including corporate insiders fail to differentiate between them. This can happen easily as often the sole human person is agent for the legal person and acts in all matters. The legal person, having no physical representation, is forgotten or downplayed. Yet, making the distinction clear is fundamental to any understanding of the interaction between the corporation and human persons.

This ‘two person’ approach—human person and legal person—is provides the foundation for understanding the corporation. One successful strategy for explaining is to work from the known to the unknown. Accordingly, an

explanation which begins from the known human person and moves to the unknown corporate person works well using both language and a graphic comparison. The linguistic comparison setting out the parts and graphic representation of legal and human persons is set out first in the table below.

People at Law: 2 types

1. NATURAL PERSON

- Rights and duties
- Birth by biological reproduction

PARTS

- Head
- Torso
- Arms and legs
- Name

2. LEGAL PERSON

- Rights and duties
- Birth given by state

PARTS

- Members
- Corporate body
- Directors
- Assets
- Name

Table 1: Comparing Persons

Taking the comparison a step further provides a workable graphic. The graphical depiction must represent the two but distinguish them adequately. The proposed graphic representation clears up confusion and sets out the basis for the legal issue which is being explained. Drawing the graphic below, setting the persons side-by-side and accompanying it by a simple narration, works best. ‘The human person is represented with one ball and four sticks.’ And, ‘The legal person is represented by four boxes and three sticks.’ Although seemingly juvenile, this clear description accompanying the graphic greatly facilitates grasping the bodies and the distinction. Getting a successful understanding of the distinction between the legal and human person depends on the successful rendering or depiction of the two. Today’s tablet technology allows it to be done very simply.

People at Law

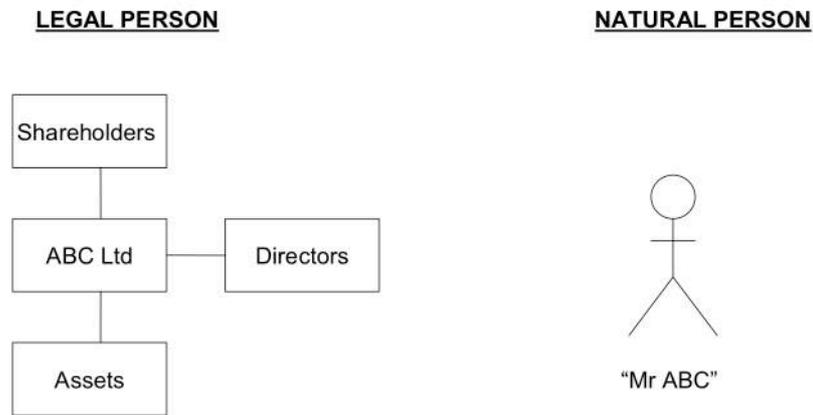


Image 2: Two types of people at law

Explaining the two types of people in graphic terms helps reify the both the legal person and distinguish it from the human person. It serves the purpose well when it is emphasised that just as one does not draw a human with the circle or stick missing, every corporation needs to be drawn with four boxes and three lines. Why?

Each of the lines and each of the boxes represent distinct rights and duties. For example, the line between the directors and the box containing the corporate name ABC Ltd are directors' duties, including fiduciary duties. Or, as another example, the line between the corporate box and the assets box represents property rights and contracts.

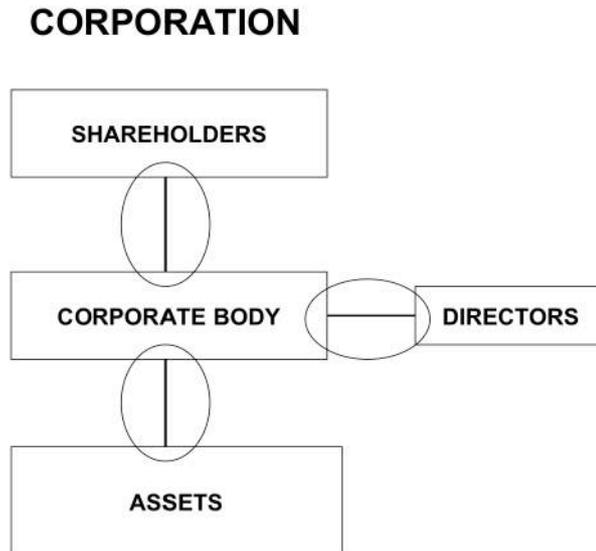


Image 3: Legal person

Further, as noted, each of the boxes represents a different category of participant or actor. Each category has its own rules about joining or exiting, and has distinct rights, duties and procedures. So for example, understanding that a shareholder does not have the decision-making rights that a director has, or that neither a director nor a shareholder is the ‘owner’ of corporate property, can be easily illustrated using the graphic. Having this clear is a first significant step.

The next set of challenges is identifying and explaining the relationship between the legal and human persons. For the non-specialist, it can be quite difficult to understand how legal persons and natural persons interact. Therefore, identifying the different roles or locations where human persons interact with legal persons is helpful. For example, a human person can occupy the role of shareholder, or director or be an employee of the corporation. Each of these relations can be represented by a wavy line.

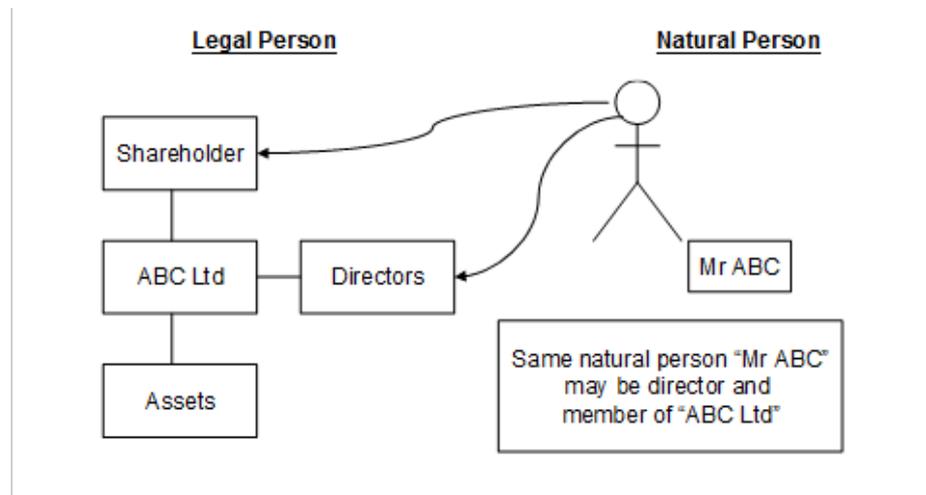


Image 4: Legal person and human person relations

Such roles may be alternatives, or concurrent — a situation many non-specialists initially find particularly confusing. Helping non-specialists conceptualise multiple legal roles can be done rather easily by using a familiar example. It is helpful to point out that a person may be an employee, an account holder at a bank and a person with property rights all simultaneously without any of the roles interfering with or offending the other. Thus, the graphic can help the non-specialist readily grasp the various roles — director, shareholder, employee or other contractor — including simultaneous roles.

A common further confusion arises when human persons name the corporation after themselves. In order to understand the confusion, all one needs to remember one's initial consternation at the first encounter with the case establishing independent corporate identity in commonwealth countries, the case of *Salomon v Salomon & Co Ltd*.¹⁸ Understanding that Mr Salomon was not suing himself but the company is a basic challenge for the beginning law student. In the diagram above, Mr ABC has incorporated a company named ABC Ltd and is a director, shareholder and employee of the company — a situation familiar to most corporate law students.¹⁹

By identifying and illustrating graphically the contractual relationships between the corporation and the human person and explaining those

¹⁸ [1896] UKHL 1.

¹⁹ *Lee v Lee's Air Farming Ltd* [1960] UKPC 33.

relationships the specialist takes the non-specialist a step further in clarifying the mystery of the doctrine of separate legal entity.

VI DISTINGUISHING THE LEGAL PERSON AND ITS ASSETS

Distinguishing between the legal person and its assets is often a challenge for the non-specialist. Non-specialists, when asked what a corporation looks like will often refer to a building, such as a bank building. They confuse the physical assets with the legal corporation. In addition, terms such as ‘corporate car’ or ‘corporate retreat’ are ubiquitous reinforcing such confusion. Having the issue identified and clarified helps people to focus on the legal issues related to the organisation when so required. Or alternatively, to understand and focus on assets and associated business issues when that is appropriate.

The basic conceptual issue is the existence of the corporation’s own, independent legal capacity to enter into contracts and to hold property—an extension of the consequence of separate legal entity. Once this concept is made clear, these corporate rights can be readily distinguished from human rights to property and contracts. Graphically representing the assets in the lower box as distinct from the legal person of the corporation makes this legal and conceptual distinction clear. In addition, it identifies these assets and related liabilities as distinct from those held by human persons. Accordingly, using a separate box to indicate assets — at law, merely collections of contractual and property rights — helps the discussion to focus on the particular doctrine or rule or legal issue under discussion.

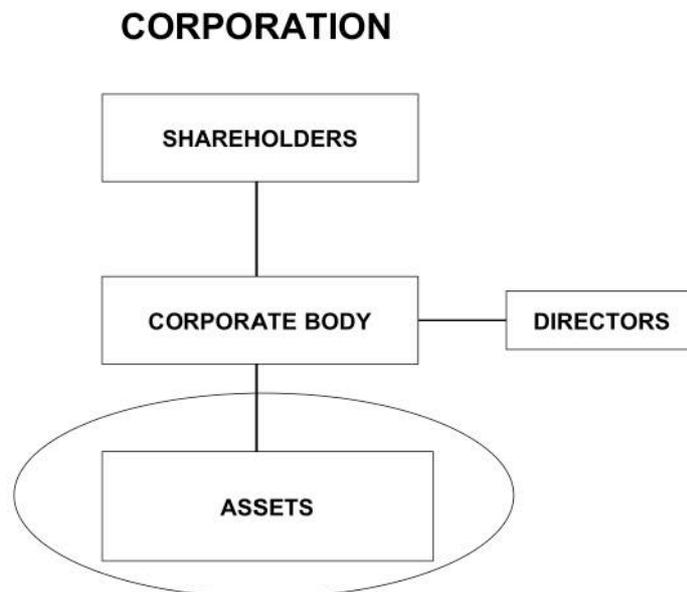


Image 5: Corporate assets

In Image 5 the bottom box of the graphic illustrates the difference between, the corporation, its assets and personal assets. The conceptual failure seems common not only among beginning scholars but even among sophisticated business people — if one is to put any weight on the defences raised by white collar criminal defendants who claim not to be able to distinguish between their own personal assets and those of the corporation.²⁰

VII INTEGRATING THE LEGAL AND THE HUMAN PERSON

The graphic provides a cognitive platform for explaining how the integrating of the human person into the legal person, and provides a focal point for discussion of the substantive legal issues involving corporate law.

²⁰ Rodney Adler, a former HIH Insurance executive convicted of insider trading, is a good example, *R v Rodney Stephen Adler* (2005) 53 ACSR 471. Apparently, Mr Adler continued the practice of insider while incarcerated not fully understanding the nature of the problem: ABC Local Radio, 'Rodney Adler faces charges from jail', *World Today*, 23 June 2005 (Brenan Trembath).

A *Identifying Directors' Rights and Duties and the Agency Issue*

The organ of the board of directors is created by a section of a statute and/or articles of incorporation and is interpreted by case law.

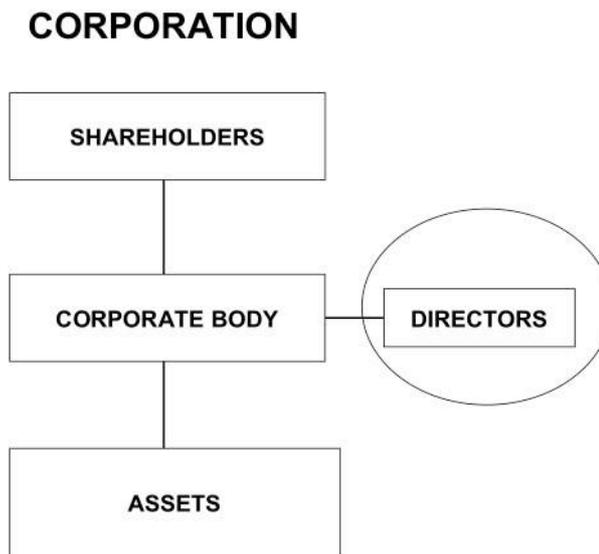


Image 5: Directors

Becoming a director is determined by the substantive rules governing membership on the board. Removal from the board of directors is determined by rules. Explaining the rule frameworks and the associated rights and duties using the graphic, helps learners and other non-specialists distinguish between and stay focused on the relevant legal issues and actors. They are less likely to be confused because it is clear which part of the corporate body is under discussion.

Further, understanding the location of the directors as intimately involved with and directing the operations of the corporation but separate from it allows non-specialists to conceptualise the agency relationship between directors and the corporation more readily. It facilitates explaining to the non-specialist how Smith of Smith & Co Ltd., can sign a contract for the corporation and not be personally liable. Or, for example, it can help show how a director can be a director of a corporation that has a policy which has significant negative environmental ramifications without personally being in support of the policy.

B *Identifying Shareholders' Rights*

In the same way, identifying and distinguishing shareholders is facilitated through use of the graphic. Shareholders may have their own rights vis-à-vis directors. This too can easily be graphically illustrated. For example, whereas the stick which joins the director box to the corporate box depicts directors' duties, the dotted line can represent shareholders' right to elect directors. A simple arc connecting the corporate body box to the shareholder box can be used to illustrate a derivative action.

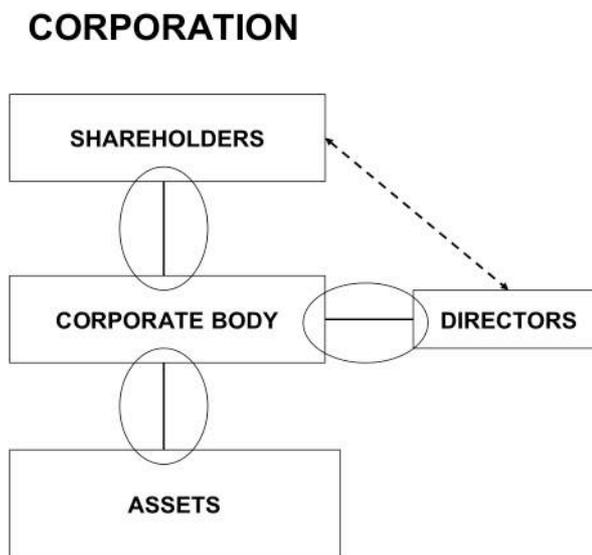


Image 7: Shareholders

Again, the graphic makes it clear that the corporation has its own rights and duties as independent of the members and the board of directors.

C *Corporate Governance*

Governance can readily be illustrated as divided between the member-shareholders and directors. The two separate boxes and the two distinct sticks illustrate the different decision making rights allocated to the two organs. Removal of the directors and replacement by administrators can be illustrated by removing the stick between the director and corporate box, and dissolution by removing the corporate box altogether along with directors and member-shareholder boxes.

VIII TRANSACTIONS

Many of the issues non-specialists encounter come about as a result of corporate transactions. These transactions may be between corporate persons or between corporations and natural persons. The graphic is particularly helpful to illustrate these transactions. Below is a new class of shares from A Ltd issued to purchase assets from B Ltd.

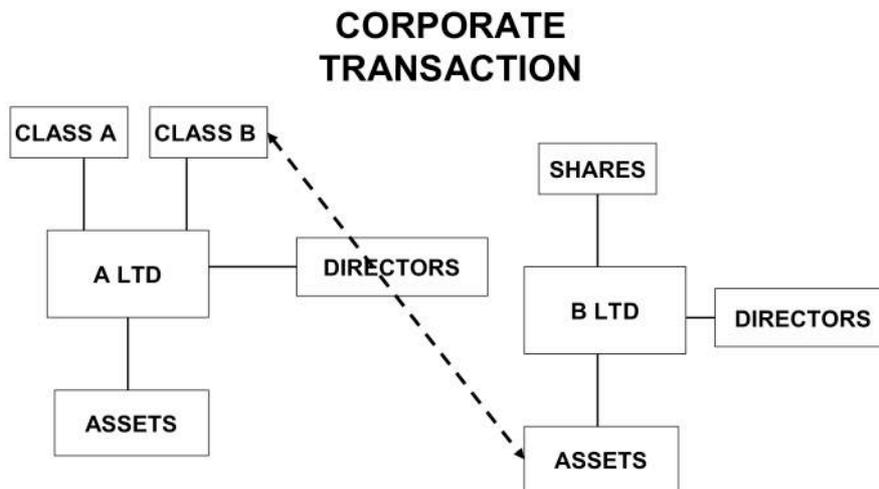
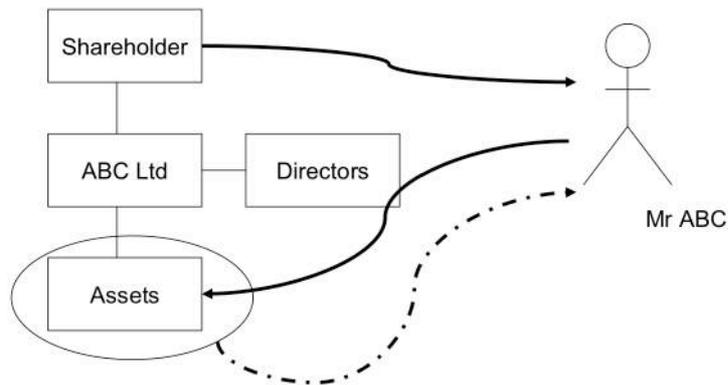


Image 8: Share classes and transaction

The next image shows a transaction in which a sole proprietor sells a business to the corporation for shares and debt which debt is secured. Mr ABC sells his assets to ABC Ltd and takes security over the assets—the security represented by the circle around the assets and the rights as secured creditor being represented by the dashed line.

SALE AND SECURITY



(c) Benedict Sheehy

Image 9: Secured sale of business

IX CONCLUSION

While explaining and understanding corporate law can be a difficult challenge it can also be a rewarding experience for lawyer, client, teacher and student. Using a graphic on a consistently can facilitate the communication of the ideas, doctrines and substantive law as well as help a client understand potential liabilities. Teaching and explaining the corporation as an entity, with organs, subject to governance, created, controlled and wound up by laws has the potential to be an enjoyable challenge for all involved and it is hoped that the graphic presented in this article can be useful in that endeavour.