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## **Berle's Conception of Shareholder Primacy: A Forgotten Perspective for Reconsideration During the Rise of Finance**

Fenner L. Stewart Jr.

**Editors:**

Peer Zumbansen (Osgoode Hall Law School, Toronto, Director,  
Comparative Research in Law and Political Economy)

John W. Cioffi (University of California at Riverside)

Lisa Philipps (Osgoode Hall Law School, Associate Dean Research)

Nassim Nasser (Osgoode Hall Law School, Toronto,  
Production Editor)



Comparative Research in  
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# Berle's Conception of Shareholder Primacy: A Forgotten Perspective For Reconsideration During the Rise of Finance

*Fenner Stewart, Jr.*<sup>†</sup>

It is not surprising that a one-dimensional model of the past, such as the “shareholder as owner,” is inadequate today and can result in a disjunction between law and reality.<sup>1</sup>

## INTRODUCTION

The 1970s marked an American revolution in corporate governance as managers shifted their focus toward greater market accountability. By the late 1980s, the resulting efficiency gains placed the firm in a competitive position to dominate within an increasingly global marketplace. The firm no longer looked like the tired and bloated conglomerate of the 1960s; it had shed its skin and transformed itself into a glistening profit-maker designed to entice the interest of the emerging class of global investors.

Although a collection of academics created the theoretic groundwork that inspired this heroic rebirth of the American firm, Henry Manne deserves much of the credit. Manne's success can be attributed, at least in part, to how he redefined the interests of shareholders by “flipping”<sup>2</sup> Adolf A. Berle's “shareholder primacy” argument.<sup>3</sup> For the Berle of the

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<sup>†</sup> University of British Columbia, LL.M.; University of British Columbia, LL.B.; University of Prince Edward Island, B.A.; Ph.D. Candidate (Osgoode Hall Law School). Visiting Scholar, Columbia Law School. Adjunct Professor, Osgoode Hall Law School. I am grateful to Peer Zumbansen, Jennifer Hill, John Cioffi, Charles O'Kelley, and William Bratton for their comments on this Article.

1. Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 78 (2000).

2. A flip occurs when legal language is used to endorse a particular reform (like Berle advocating shareholder primacy to open the corporation to public-interest concerns) and then that same language is used to endorse the opposed reform (like Manne advocating shareholder primacy to close the corporation to public-interest concerns). For more on how arguments can be flipped, see DUNCAN KENNEDY, *A CRITIQUE OF ADJUDICATION: FIN DE SIÈCLE* (1998); see also Kerry Rittich, *Functionalism and Formalism: Their Latest Incarnations in Contemporary Development and Governance Debates*, 55 U. TORONTO L.J. 853, 857 (2005).

3. For Manne's work on shareholder primacy, see Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965); Henry G. Manne, *Some Theoretical Aspects of Share Voting—An Essay in Honor of Adolf A. Berle*, 64 COLUM. L. REV. 1427 (1964) [hereinafter

1920s and 1930s, shareholders were the middle- and working-class “Everyman.”<sup>4</sup> Berle believed that if shareholder primacy was ensured, it would correct the democratic deficit that existed in the management of the American economy. For Manne of the 1960s, shareholders were much different; they were rational actors whose constructed intentions could be used to ascertain and justify market function.<sup>5</sup> While Berle believed that the democratization of the shareholder class would make the corporation a tool for the wider polity, Manne used shareholder primacy to focus managerial efforts on economic efficiency. When Manne’s thoughts on shareholder primacy were married with those of Ronald Coase’s on transaction cost theory,<sup>6</sup> what emerged was a powerful reconceptualization of the corporation in legal thought.<sup>7</sup> With the success of Manne’s perspective, the shareholder wealth maximization norm was born, firmly defining the interest of shareholders and planting the seeds for the financialization of the firm.<sup>8</sup>

Today, Berle is celebrated as the grandfather of modern shareholder primacy,<sup>9</sup> but this description glosses over his opposition to Manne’s flip

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Manne 1964]; Henry G. Manne, *The “Higher Criticism” of the Modern Corporation*, 62 COLUM. L. REV. 399 (1962) [hereinafter Manne 1962]; Henry G. Manne, *Corporate Responsibility, Business Motivation, and Reality*, 343 ANNALS AM. ACAD. POL. & SOC. SCI. 55 (1962); Henry G. Manne, *Current Views on the “Modern Corporation,”* 38 U. DET. L.J. 559 (1961); Henry G. Manne, *Accounting for Share Issues Under Modern Corporation Laws*, 54 NW. U. L. REV. 285 (1959).

4. “Everyman” is a reference to *The Summoning of Everyman*, usually referred to simply as *Everyman*, written in the late fifteenth century. See ANONYMOUS, *THE SUMMONING OF EVERYMAN* (BiblioBazaar 2009) (15th cent.). The term may not be altogether the best term to use because there was a large population of female investors at the time. See Harwell Wells, *The Birth of Corporate Governance*, 33 SEATTLE U. L. REV. 1247, 1257 n.39 (2010).

5. The aggregate, private, contractual theory of the corporation that Manne endorsed was later employed by Armen A. Alchian, Harold Demsetz, Michael Jensen, and William Meckling in a manner that allowed theorists to use the sum of the constructed motives of economic actors to explain why organizations (like corporations) and institutions (like the market) functioned as they did. See Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); see also Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 2 J. FIN. ECON. 305, 308–10, 319 (1976).

6. R. H. Coase, *The Theory of the Firm*, 4 ECONOMICA 386 (1937).

7. See Oliver E. Williamson, *The Economics of Governance*, 95 AM. ECON. REV. 1, 2–5 (2005). See generally Alchian & Demsetz, *supra* note 5; Jensen & Meckling, *supra* note 5.

8. Financialization of the corporation occurred when the understanding of the corporation successfully endeavored to narrow the understanding of all social relationships within the corporation so that their value can be translated into an exchangeable instrument, which makes it possible for the financial industry to assess value to them and trade them. See generally Simon Deakin, *The Rise of Finance: What Is It, What Is Driving It, What Might Stop It?*, 30 COMP. LAB. L. & POL’Y J. 67 (2008); Lawrence E. Mitchell, *The Morals of the Marketplace: A Cautionary Essay for Our Time*, 20 STAN. L. & POL’Y REV. 171 (2009); Peer Zumbansen, *The Evolution of the Corporation: Organization, Finance, Knowledge and Corporate Social Responsibility*, CLPE Research Paper No. 6/2009, available at <http://ssrn.com/abstract=1346971>.

9. See William W. Bratton & Michael L. Wachter, *Shareholder Primacy’s Corporatist Origins: Adolf Berle and The Modern Corporation*, 34 J. CORP. L. 99, 101 (2008).

of his argument.<sup>10</sup> Berle's objection is not always appreciated in commentaries of his shareholder primacy argument. For this reason, this Article offers a nuanced understanding of Berle's argument, providing a clear observation point for examining the shift from his shareholder primacy argument to the one of today. This shift is a transition from promoting shareholder primacy in order to protect minority constituents to promoting shareholder primacy in order to protect majority rights and the right of exit for any disgruntled minority.<sup>11</sup> It is also the shift from promoting shareholder primacy in order to tie corporate managers to public interest to promoting shareholder primacy in order to endorse minimizing transaction costs—even when efficacy gains unfortunately result in costs being externalized upon people who did not *ex ante* negotiate contract safeguards to protect themselves against such risk.<sup>12</sup> From this point of observation, the shareholder primacy argument offers another perspective upon investor empowerment during the current "rise of finance."<sup>13</sup>

Part II briefly reviews the history of Berle as a young man. It then introduces Berle's theory of the corporation and how this theory plays out in his early endorsement of shareholder primacy from 1923 to 1926. Part III explores the development and content of *The Modern Corporation and Private Property*, with particular emphasis on the relationship between the book and the Berle–Dodd debate. Part IV provides a fresh analysis of the debate. Part V contextualizes Berle's thoughts on shareholder primacy within the rise of finance as an organizing force not only for the firm, but also for the rest of society. Finally, Part VI offers a concluding thought.

## II. BACKGROUND TO THE DEBATE: 1923–1926

### A. Berle as a Young Man

Adolf Augustus Berle Jr. showed his intellectual capacity from an early age. He was homeschooled<sup>14</sup> by his father, who taught him "how to learn what he needed to know before others [could detect] his ignorance."<sup>15</sup> This teaching probably served him well, as he entered Harvard

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10. Adolf A. Berle, *Modern Functions of the Corporate System*, 62 COLUM. L. REV. 433, 435 (1962). And for what inspired Berle to reply to Manne, see Manne 1962, *supra* note 3, at 400–06.

11. William W. Bratton, *Welfare, Dialectic, and Mediation in Corporate Law*, 2 BERKELEY BUS. L. J. 59, 74–76 (2005).

12. Williamson, *supra* note 7, 11–13.

13. Deakin, *supra* note 8.

14. JORDAN A. SCHWARZ, LIBERAL: ADOLF A. BERLE AND THE VISION OF AN AMERICAN ERA 7–9 (1987).

15. *Id.* at 23.

at the age of 14.<sup>16</sup> By the age of 21, he had received three Harvard degrees and was the youngest student ever to graduate from Harvard Law School.<sup>17</sup> After a year at Louis Brandeis's Boston law firm,<sup>18</sup> Berle enlisted in the army<sup>19</sup> and was placed on inactive duty to assist in sorting out the title system in American-occupied territories in order to boost sugar production, which was in high demand and short supply.<sup>20</sup> Berle was next assigned by the military to the Paris Peace Conference as an expert (which he was not) on Russian economics.<sup>21</sup> The destruction, disease, starvation, and general desolation of postwar Europe horrified and marked young Berle.<sup>22</sup> Upon returning to America, he spent a short time at a lucrative New York law firm before establishing a modest practice on Wall Street in 1924. This position freed Berle to pursue more legal scholarship and social activism.<sup>23</sup>

### *B. Berle's Foundation of a Shareholder Primacy Theory*

The beginning of the twentieth century was marked by a period of violent labor relations.<sup>24</sup> Berle regarded the trends toward the consolidation of economic power in the hands of elites as a dangerous misstep toward plutocracy and away from egalitarianism and democracy,<sup>25</sup> which could further destabilize American society. He feared that America could easily plunge into the same economic and class conflicts that were soon to destroy Europe for a second time.<sup>26</sup> Accordingly, Berle wanted to place economic and corporate power in the hands of the people.

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16. *Id.* at 13.

17. *Id.* at 13–17. *See generally id.* at 1–17 (for additional information on Berle's education).

18. *Id.* at 16.

19. *Id.* at 17.

20. ADOLF A. BERLE, NAVIGATING THE RAPIDS 1918–1971: FROM THE PAPERS OF ADOLF A. BERLE 4–7 (Beatrice Bishop Berle & Travis Beal Jacobs eds., 1973); *see also* SCHWARZ, *supra* note 14, at 18–19.

21. SCHWARZ, *supra* note 14, at 23–24 (writing of how his “expertise” consisted of a few months research after coming back from the Dominican Republic).

22. *Id.* at 28.

23. BERLE, *supra* note 20, at 19 (entry from Berle's personal diary on Aug. 25, 1932).

24. *See generally* GRAHAM ADAMS, JR., AGE OF INDUSTRIAL VIOLENCE, 1910–1915: THE ACTIVITIES AND FINDINGS OF THE UNITED STATES COMMISSION ON INDUSTRIAL RELATIONS (1971).

25. Berle suggests that the rise of Bolshevism in Italy and Russia was being caused by the needless division between capitalists and labor. *See* Adolf A. Berle, Jr., *How Labor Could Control*, 28 NEW REPUBLIC 37 (1921).

26. SCHWARZ, *supra* note 14, at 66. *See generally* PETER F. DRUCKER, THE END OF ECONOMIC MAN: THE ORIGINS OF TOTALITARIANISM 3–23 (2009) (arguing that the Great Wars were caused by the inability of the nineteenth-century liberalism to transform the mercantile system of the seventeenth and eighteenth centuries into a rational worldview that could bring equality to Europe by raising the material status of the masses, and also suggesting that, in Germany, the noneconomic fascism reverted to demonizing the Jewish population, manufacturing miracles using the propaganda machinery of the Third Reich, and generating positions of political power and status in order to circumvent preexisting economic power and status); KARL POLANYI, THE GREAT TRANSFORMATION

Berle published an early plan for how this transfer of power could be accomplished in a short article entitled *How Labor Could Control*.<sup>27</sup> In the article, he explained that the corporation could be used as a tool for the redistribution of wealth and power to “the staff of the plant, including, of course, the chairman of the board, the directors, as well as the oilers and feeders and loomfixers.”<sup>28</sup> He suggested that organized labor (unions) could pool its resources to purchase or create corporations, and then could grant the shares of such corporations to the “staff of the plant.”<sup>29</sup> Berle further explained:

How shall the stock be distributed? According to the fairest appraisal of the value of the employee-stockholder's services. The general manager ought to have more stock than the unskilled worker. His vote at a stockholders' meeting ought to be worth more. He has earned it. What about wages? Every employee ought to draw a regular base pay just as a partner in a firm is entitled to his drawing account; he must live. How about labor turnover? One hopes this scheme would lessen it; but men will always leave old jobs for new. When a man leaves his job he must leave his stock too, resell it to the corporation, to use the vocabulary of corporation law, for a price. What price? The amount by which the value of the stock has been increased while that employee held it.<sup>30</sup>

Each worker would be given ownership and control of the corporation in proportion to his contribution to the firm. Berle argued that if this occurred:

No single process in the industry would have to be changed, but each man would be working for himself and his “wage slavery” would become merely an occupation in cooperative endeavor.<sup>31</sup>

What about the role for traditional shareholders in the corporation? He suggested:

These stockholders are, in many corporations, not true investors; they “took a chance” . . . They would not say so, but they looked for something for nothing; they bought the stock for a rise, and to collect large dividends if they can. This class is under attack as exploiters.<sup>32</sup>

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3 (2d ed. 2001) (arguing that economic liberalism represented a “stark utopia,” which hurtled European society into the World Wars).

27. Berle, *supra* note 25.

28. *Id.* at 38.

29. *Id.*

30. *Id.*

31. *Id.* at 37.

32. *Id.* at 38.

So, Berle advocated for shareholder control of the corporation, but he wanted to change who populated the shareholder class. According to his article, if he had his way, the deserving “staff of the plant”<sup>33</sup> would replace the undeserving exploiter–gambler shareholders. That said, he did see a place in the shareholder class for manager–investor shareholders who, although rare, were of value to the corporation. He wrote:

The legitimate side to [the operation of traditional shareholders in corporate governance] lies in the fact that these stockholders have a power of management. . . . As matter of plain fact however they usually do not manage . . . [but a] small group do manage and earn much of what they receive.<sup>34</sup>

In summary, Berle not only advocated for keeping the corporate structure of the business organization, but also for repopulating the shareholder class. He wanted to remove those shareholders who merely bought, hoped, held, and cashed in “when they [could] reap where they did not sew.”<sup>35</sup> These shareholders did not deserve more than “the current rate of interest”<sup>36</sup> because “the value of their management was nil.”<sup>37</sup> Berle concluded that his argument was:

No . . . attack on private property; on the contrary, it [was] the emphasis of the strength of property. It [was] not a blow at our settled economic institutions; it [was] the sane use of them.<sup>38</sup>

After this article, Berle shifted his position slightly. He began to focus on how the American economy was evolving. He witnessed the greater dispersion of share ownership out of the hands of business elites and into the hands of the middle and working classes.<sup>39</sup> Berle viewed this transfer of power as a positive development, which could achieve the same ends as his previously devised scheme: the democratization of economic power.<sup>40</sup> To his disappointment, the legal community was compensating for this change in ownership by advocating for less shareholder control and more managerial control over the corporation. Berle thought that this advocacy of managerialism would compromise this transfer of

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33. *Id.*

34. *Id.* at 37–38.

35. *Id.* at 38.

36. *Id.*

37. *Id.*

38. *Id.* at 39.

39. See SCHWARZ, *supra* note 14, at 65–66.

40. *Id.* at 66.



power. In his more personal and candid writings, he revealed that these concerns motivated him to promote shareholder primacy.<sup>41</sup>

Berle envisioned how an empowered shareholder class, with its expanded working- and middle-class membership, could transform American society.<sup>42</sup> This corporate liberal revolution<sup>43</sup> was, as Berle put it, merely “the logical working out of [the American] system,” which, as a liberal, he believed to be a sound foundation for social order.<sup>44</sup> His vision of the corporate liberal revolution placed the corporation at its center because the corporation had the capacity to disperse ownership and economic power widely with little change to the legal structure of the corporation and the economy.<sup>45</sup> All the safeguards were in place to protect this emerging class of shareholders; all that was needed was the will to follow through.

Berle became convinced that the key to unlocking the potential of the corporation as a tool of economic revolution was to firmly establish the property and fiduciary rights of shareholders within the governance mechanism. This governance mechanism would be a safeguard against the action of powerful elite interests that would want to counteract the threats of the egalitarian operation of the corporation. Although too radical to be an explicit policy-reform agenda, the Corporate Liberal Revolution was at the core of the shareholder primacy argument that Berle would develop in the 1920s.

Berle's theory of the Corporate Liberal Revolution is significant to understand because it makes clear that his motivation for endorsing shareholder primacy was to shape the corporation to be a tool to democratize the American economy. Understanding this motivation helps one appreciate Berle's later shift away from shareholder primacy toward other strategies to bring economic power under democratic controls. Shareholder primacy was not an end for Berle, it was merely a means to an end.

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41. *Id.*; see also BERLE, *supra* note 20, at 19 (entry from Berle's personal diary on Aug. 25, 1932, in which he reflects upon how the fact that directors and managers abused their authority inspired him to advocate for greater fiduciary protection of shareholder rights from 1923 to 1926).

42. SCHWARZ, *supra* note 14, at 66.

43. Although Schwarz uses the terms “corporate,” “liberal,” and “revolution,” there is no clear evidence that Berle used this language. Yet this language aptly describes his vision. See *id.*

44. *Id.*

45. *Id.*

*C. Berle's Shareholder Primacy Theory*

Berle's 1923, 1925, and 1926 articles map the progress of his shareholder primacy theory.<sup>46</sup> Berle stated explicitly in his diary that these articles "led to the next stage of [his] career."<sup>47</sup> In a diary entry from August 1932, he further reflected upon these four articles, writing:

The attempt I was then making was to assert the doctrine that corporate managements were virtually trustees for their stockholders, and that they could not therefore deal in the freewheeling manner in which directors and managers had dealt with the stock and other interests of their companies up to that time. It was the beginning of the fiduciary theory of corporations which now is generally accepted.<sup>48</sup>

Put differently, Berle emphasized shareholder rights, arguing that managers were accountable to exercise their discretion within, and only within, the scope of their preexisting obligations to shareholders in order to ensure some measure of accountability within corporate operation and thus avoid at least some incidents of managerial opportunism.

The first article, published in 1923, argued that the discretion of management was not so broad that it could ignore the contracted procedure for the manner in which dividends were to be distributed.<sup>49</sup> In his second article, Berle advanced his theory, arguing that managers had an equitable duty that controlled managerial discretion when financial innovations (like the discretionary issue of non-par stocks) created holes in preexisting contractual obligations.<sup>50</sup>

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46. For a complete record of Berle's published works up to the early 1960s, see Henry G. Manne, *Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A. Berle*, 64 COLUM. L. REV. 1427 (1964).

47. BERLE, *supra* note 20, at 19 (entry from Berle's personal diary on Aug. 25, 1932).

48. *Id.* (entry from Berle's personal diary on Aug. 25, 1932).

49. Berle noted that the trend in corporate law to grant directors broad power to distribute dividends could violate shareholders' rights, which necessitated a more narrow interpretation of managerial power. Although the discretion to withhold dividends to bolster the capital of the corporation was absolute and equitable, if the corporation used the dividends of non-cumulative preferred stockholders, these dividends were not lost to this class, but had to be recorded and returned to them before common shareholders could receive dividends. See Adolf A. Berle, Jr., *Non-Cumulative Preferred Stocks*, 23 COLUM. L. REV. 358, 358-59, 367 (1923).

50. In this article, preexisting shareholders' rights were challenged by discretion to issue non-par stocks. This challenge was significant because such contractual arrangements could not have foreseen this innovation. Berle acknowledged that such unforeseen evolutions in corporate law created a crisis because they potentially freed management to act without regard for the interests of shareholders. To remedy this failure of the contract, Berle asserted that the rights of shareholders created an obligation for management (like agents) to manage the corporation in shareholders' best interests, regardless of whether this obligation was explicitly contractual. Berle appeared confident that courts would recognize that shareholders could rely on equity to protect their rights. See Adolf A. Berle, Jr., *Problems of Non-Par Stocks*, 25 COLUM. L. REV. 43, 43-46, 63 (1925).

The final two articles were both written in 1926. The first, published in the *Columbia Law Review*, argued that equity guided managerial discretion beyond contract. Essentially, when contractual safeguards failed to protect minority shareholders, management still had an equitable duty to defend weaker shareholders from powerful ones who might exercise their influence over management in a manner oppressive to the minority.<sup>51</sup> Finally, in his 1926 *Harvard Law Review* article, Berle furthered this argument by demonstrating that equity compensated for the de facto imbalance of power between shareholders. He argued that the law would ensure that management treated all shareholders evenhandedly, guaranteeing that the interests of ownership were not undermined.<sup>52</sup>

When these articles are read with Berle's biographical context in mind, it becomes clear that his prime concern was controlling the self-interested and irresponsible actions of management, who controlled one of the most important political actors within American society: the corporation.<sup>53</sup> More importantly, Berle's more candid writings indicate that he wanted the corporation to help American society avoid the internal strife that Europe appeared doomed to suffer.<sup>54</sup> Accordingly, his objective was to help empower shareholders (which he saw as representative of the middle and working classes) to make corporate managers firmly accountable to their control: in other words, the wider polity. He envisioned the distribution of corporate ownership through the middle and working classes as a mechanism to place the power of economic concentration under a form of democratic control through shareholder power. In fact, Berle had the bold ambition of becoming the prophet of the shareholder class, or as he so modestly put it, "the American Karl Marx."<sup>55</sup>

Berle's articles did not express his radical hopes for the corporate-liberal revolution. This restraint is understandable. As a young academic attempting to establish his reputation, it would have been unwise to frame his shareholder primacy theory in line with his radical labor and

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51. Berle explored how management allocated dividends (and losses) between share classes of the corporation. Once again, he employed the theory of the corporation as the private property of shareholders. He asserted that even after management allocated initial preferred dividends in accordance with explicit contractual requirements, the remaining surplus, if it was to be allocated as dividends, was subject to an equitable distribution. This illustrated how principles of equity, beyond contract, provided a rationale for ordering how dividends were to be portioned among shareholders. This protected weaker shareholders from the influence of powerful ones. See Adolf A. Berle, Jr., *Participating Preferred Stock*, 26 COLUM. L. REV. 303, 303, 305, 317 (1926).

52. See Adolf A. Berle, Jr., *Non-Voting Stock and "Bankers' Control,"* 39 HARV. L. REV. 673 (1926).

53. BERLE, *supra* note 20, at 19 (entry from Berle's personal diary on Aug. 25, 1932).

54. SCHWARZ, *supra* note 14, at 66.

55. Berle exclaimed to his wife that "his real ambition in life is to be the American Karl Marx—a social prophet." See SCHWARZ, *supra* note 14, at 62; see also Thomas K. McCraw, *Berle and Means*, 18 REV. AM. HIS. 578, 579 (1990).

anticapitalist views. Although the hostilities and violence that characterized America's industrial relations at the turn of the century seemed to have ended,<sup>56</sup> the "age of industrial violence" was still fresh in the minds of Americans.<sup>57</sup> Consequently, such extreme opinions would likely have been either rejected outright or would have drawn serious and unnecessary criticism to Berle's project. He figured that he did not have to preach the revolution because the market was evolving the corporate form toward an ever-more widely dispersed share ownership. So, as long as the rights of shareholders were protected, his more radical surreptitious agenda would be furthered without making his goals explicit. In other words, Berle predicted that the existing regulation and market function would guide the radical social work so long as the corporate legal infrastructure was in place to protect the rights of shareholders.

Confident in the direction the market was moving, Berle constructed arguments based on property rights, justifying shareholder authority over corporate management.<sup>58</sup> Each article followed a similar logic: the corporation was the private property of its shareholders, and because managers had a fiduciary relationship with these owners, managers owed a duty of care to owners. This relationship was captured in law by contract and, as Berle noted in later works, by equity as well. Each article noted how corporate management was granted discretion over the administration of shareholder rights, which *prima facie* appeared quite broad.<sup>59</sup> But each area of discretion was held in check by a broad interpretation of shareholder rights, and thus the range of managerial choice that actually existed was more restricted than an observer might have assumed.

It makes sense to track Berle's work up to 1927 because that is when he likely wrote the first article in the Berle–Dodd debate, *Corporate Powers as Powers in Trust*. And this article is a word-for-word reproduction of most of a chapter from *The Modern Corporation and Private Property* (a point noted in detail in the following sections). And because Berle's work on the book started in 1927, a draft of this article could have been written anytime between 1927 and 1931. Thus, the article could have been drafted in 1927.<sup>60</sup> This fact creates a reasonable end

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56. In 1928, only 694 strikes occurred representing the fewest since 1884, and in 1929, there were only 900 work stoppages, involving merely 1.2% of the labor force. For more details on how the rise of living standards in the 1920s helped smooth the way for more peaceful industrial relations, see ROBERT H. ZIEGER & GILBERT J. GALL, *AMERICAN WORKERS, AMERICAN UNIONS: THE TWENTIETH CENTURY* 45 (3d ed. 2002).

57. ADAMS, *supra* note 24.

58. Berle, *supra* note 49; Berle, *supra* note 50; Berle, *supra* note 51; Berle, *supra* note 52.

59. *See supra*, notes 44–47.

60. The obvious challenge to drawing a distinction as early as 1927 is that the footnotes in *Corporate Powers as Powers in Trust* make reference to cases as late as 1930. But this detail is less significant in light of the fact that in practice, drafts of articles are constantly modified prior to publi-

point for the consideration of Berle's shareholder primacy argument prior to the writing of *The Modern Corporation and Private Property*.

### III. THE MODERN CORPORATION AND PRIVATE PROPERTY

#### A. *The Making of The Modern Corporation and Private Property*

In 1927, a Harvard connection helped Berle to land a sizable grant from the Laura Spelman Rockefeller Foundation to study recent trends in corporate development.<sup>61</sup> The grant was contingent upon him obtaining an academic appointment,<sup>62</sup> which he soon received from Columbia University.<sup>63</sup> The grant requirements also demanded that the project use the expertise of an associate economist.<sup>64</sup> By chance, his old bunkmate from officer training at Plattsburg Camp,<sup>65</sup> Gardiner C. Means, had just enrolled at Harvard as a candidate for a Ph.D. in economics.<sup>66</sup> Means's interests in the economic implications of the separation of ownership and control dovetailed nicely with Berle's legal study of the modern corporation,<sup>67</sup> so Berle invited him to assist.<sup>68</sup> The end result was *The Modern Corporation and Private Property*.

Berle intended *The Modern Corporation and Private Property* to become a classic and purposefully crafted the book with this intention.

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cation so that they reflect the current commentary on the law. Therefore, it is very plausible that the footnotes only indicate that a revision of the article occurred during or after 1930, which is much different than the potential claim that a draft of the article could not have been written before 1930. Furthermore, one should consider how similar *Corporate Powers as Powers in Trust* is to the other law review articles up to 1927. In fact, this article could easily be regarded as a direct extension of the 1923, 1925, and 1926 articles. Thus, it is quite reasonable—even if unconfirmed by the historical record—to suggest that *Corporate Powers as Powers in Trust* might have been one of the first parts of the book written, making 1927 a cautious and prudent ending point for Berle's history up to the Berle–Dodd Debate.

61. Edwin F. Gay actually devised the project. Gay was an economic historian who became the founding dean of the Harvard Business School. He was advising various foundations (including the Social Science Research Council, which sponsored the Laura Spelman Rockefeller Foundation) on what types of economic issues deserved funding. For his Rockefeller project, he wanted to blend the expertise of a lawyer and an economist to study the modern corporation. See HERBERT HEATON, A SCHOLAR IN ACTION: EDWIN F. GAY 211 (1952).

62. BERLE, *supra* note 20, at 21 (entry from Berle's personal diary on Aug. 25, 1932).

63. C250 Celebrates Columbians Ahead of Their Time: Adolf Augustus Berle, Jr., COLUM. UNIV., [http://c250.columbia.edu/c250\\_celebrates/remarkable\\_columbians/a\\_a\\_berle.html](http://c250.columbia.edu/c250_celebrates/remarkable_columbians/a_a_berle.html) (last visited Apr. 20, 2011).

64. ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY, at xxxix (2d ed. 1968) (1932).

65. SCHWARZ, *supra* note 14, at 51; see also JULIUS GOEBEL, A HISTORY OF THE SCHOOL OF LAW, COLUMBIA UNIVERSITY: THE BICENTENNIAL HISTORY OF COLUMBIA UNIVERSITY 299–305, 316–17 (1955).

66. BERLE, *supra* note 20, at 20 (entry from Berle's personal diary on Aug. 25, 1932).

67. *Id.* at 51.

68. *Id.* at 20 (entry from Berle's personal diary on Aug. 25, 1932).

He wanted this work to make him an opinion-maker for the intellectual elites of America.<sup>69</sup> Berle was not in favor of antitrust measures because he believed that the large modern corporation, with a widely dispersed share base, ought to be the primary actor of the American economy. But he knew that in order to appeal to the legal intelligentsia, he would have to be careful to achieve the favor of American legal icons like Louis Brandeis and Felix Frankfurter, who were staunch critics of big business and strong advocates of antitrust measures.<sup>70</sup>

As planned, the book became famous as a warning of the potential threat of corporate managerial plutocracy over American society, demonstrating how modern corporations were consuming the American economy<sup>71</sup> and how unrestrained managers were controlling these modern corporations. By focusing on the latter and ignoring the former when making his recommendations, he could offer a sacrifice to powerful anti-trust advocates but still focus his recommendations on the distinct issue of the control of management. In short, he appeased the antitrusters for the time being while still progressing with his alternative agenda of transforming the corporation into a mechanism that ensured the greater democratization of economic power. In the end, Berle succeeded in his ambition; when published, the book was celebrated as one of the most important of its time.<sup>72</sup>

### B. The Modern Corporation and Private Property

Berle and Means pointed to the key features of the modern corporation's evolution, namely: an increase in corporate concentration of property<sup>73</sup> and a decrease in control over corporate management by owners,<sup>74</sup> which was a by-product of ever-increasing stock ownership dispersion.<sup>75</sup>

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69. SCHWARZ, *supra* note 14, at 62.

70. *Id.* at 14, 67–68, 83–85, 89, 104.

71. For a later and far more advanced understanding of how corporations capture economies, see Coase, *supra* note 6, 389–91.

72. In *Liberal: Adolf A. Berle and the Vision of an American Era*, Schwarz notes that the book review from the *New York Herald Tribune* applauded the book as a “masterly achievement of research and contemplation” and wondered if it could be “the most important work bearing on American statecraft” since the Federalist Papers. Jerome Frank wrote, “This book will perhaps rank with Adam Smith’s *Wealth of Nations* as the first detailed description in admirably clear terms of the existence of a new economic epoch.” Ernest Gruening called it “epoch-making.” Harry W. Laigler proclaimed it was “bound to make economic history.” In 1932, Justice Brandeis cited the book calling it the work of “able, discerning scholars” in the *Liggett v. Lee* case. By the spring of 1933, *Time* magazine dubbed it “the economic Bible of the Roosevelt administration.” SCHWARZ, *supra* note 14, at 60–61 (internal citations omitted).

73. BERLE & MEANS, *supra* note 64, at vii–viii, 44–45; see also Adolf A. Berle, *Property, Production and Revolution*, 65 COLUM. L. REV. 1, 1 (1965).

74. BERLE & MEANS, *supra* note 64, at 119–40.

75. *Id.* at 64–65.

They noted that this led to an increased concentration of power for corporate managers<sup>76</sup> and elite financial groups.<sup>77</sup> The book cast the threat of corporate hegemony over freedom, suggesting that plutocracy could supersede state democracy as the dominant form of social organization.

Berle and Means centered on the need for shareholders to have meaningful control over their corporations. What Means's empirical research proved was that the opposite was occurring,<sup>78</sup> resulting in a fracture between ownership and control of property.<sup>79</sup> The authors warned that this emergent situation might cause market distortions,<sup>80</sup> especially if the gap between ownership and control continued to widen, amplifying the perversion of the classic theory of market function.<sup>81</sup> To explain their logic, if profit was to work as a virtuous incentive, the traditional logic demanded that only a "fair return" be dispersed to the shareholders (as the owners of the property without control) and that the remainder go to the management (who control the property) because profit would induce the most efficient decision-making, and management made the decisions.<sup>82</sup> The authors concluded that: "The corporation would thus be operated financially in the interest of control, the stockholder becoming merely the recipient of the wages of capital . . . [running] counter to the conclusion reached by applying the traditional logic of property to precisely the same situation."<sup>83</sup>

What Berle and Means probably meant by "the traditional logic of property" is that there is control of that piece of property. Or, as Morris Cohen characterized it, a right over a possession,<sup>84</sup> which implicitly is assumed to grant a right to self-assertion,<sup>85</sup> or a claim to a sovereign power<sup>86</sup> over a possession, without the interference of government power.<sup>87</sup> To put the term more concretely, in the context of the authors' sug-

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76. Berle and Means prophesize:

What will be the development in the field of 'control'? It is not easy to proph[esize]. . . Economically, the problem is likely to change in form as corporations gradually increase in size and as stock distribution increases, to the point where the 'control' is virtually in the hands of a self-perpetuating Board of Directors . . .

*Id.* at 217–18.

77. *See id.* at 206. For an example of such control groups, see Berle, *supra* note 52, at 673–77.

78. BERLE & MEANS, *supra* note 64, at 128–31, 245; *see also* Gardiner C. Means, *The Separation of Ownership and Control in American Industry*, 46 Q. J. OF ECON. 68 (1931) (an article that Means published a year before with much of the core research findings).

79. BERLE & MEANS, *supra* note 64, at 303–08.

80. *Id.* at 302–08.

81. *Id.* at 302.

82. *Id.*

83. *Id.*

84. Morris R. Cohen, *Property and Sovereignty*, 13 CORNELL L.Q. 8, 12 (1927).

85. *Id.* at 18.

86. *Id.* at 29.

87. *Id.* at 11.

gestion, it means that owners ought to receive the profits of the corporation because they acquired ownership of the corporate venture and are the rightful benefactors of all corporate economic surplus to the exclusion of all nonowners.

Berle and Means predicted that separation of ownership and control would create a new logic for property,<sup>88</sup> which would be inspired by the better appreciation of the “economic relationships” between economic actors.<sup>89</sup> They did not provide any hints as to what these new “economic relationships” would be like. And no evidence exists that Berle ever seriously entertained the more radical ideas of the legal realists regarding property.<sup>90</sup>

### *C. A Note on the Use of Corporatism*

William Bratton and Michael Wachter discuss how Berle and Dodd competed in their advocacy of rivaling models of corporatism.<sup>91</sup> In Bratton and Wachter’s opinion, Berle endorsed planners’ corporatism,<sup>92</sup> which describes the cooperative relationship between business, civil society, and government. Together, these parties determine and coordinate policies that satisfy the public interest. Bratton and Wachter also suggest that Dodd endorsed business commonwealth corporatism.<sup>93</sup> Like planners’ corporatism, this form of corporatism focuses on the collaborative relationships shared by different groups in order to establish what is in the public interest.<sup>94</sup> After the public interest is established, policies are adopted, adapted, and coordinated among different groups in order to achieve the agreed-upon goals. The distinction between the two models of corporatism is that while planners’ corporatism advocates that the government take the lead role, business commonwealth corporatism argues for industrialists to take the lead, “relegating government to a back-stop, supporting role.”<sup>95</sup> This Article agrees that Berle could have been characterized as a planners’ corporatist, but rejects the notion that Dodd was a business commonwealth corporatist.

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88. BERLE & MEANS, *supra* note 64, at 302.

89. *Id.* at 308.

90. One’s imagination can easily attach Cohen’s critique of the long-established understanding of property rights and his seemingly sensible, but explosively contentious, redefinition of property rights as having “positive duties” to public interest included. See Cohen, *supra* note 84, at 15–21.

91. Bratton and Wachter adopt their models of corporatism from Ellis Hawley. See Bratton & Wachter, *supra* note 9, at 122–23; see also ELLIS W. HAWLEY, *THE NEW DEAL AND THE PROBLEM OF MONOPOLY* 36–43 (1966).

92. Bratton & Wachter, *supra* note 9, at 123.

93. *Id.*

94. *Id.* at 122–23.

95. *Id.* at 122 (Bratton and Wachter’s explanation of corporatism).



John Cioffi offers complexity to Bratton and Wachter's use of "corporatism." Cioffi argues that characterizing Berle as an advocate of corporatism is misplaced.<sup>96</sup> He argues that, at best, Berle advocated for "quasi-corporatist arrangements during the early New Deal," which were contradictory and vague in nature.<sup>97</sup> Mindful of Cioffi's position,<sup>98</sup> this Article will continue to use the term "corporatism" (more precisely, Bratton and Wachter's planners' corporatism and business commonwealth corporatism) in order to maintain a continuity of language between this Article and the ongoing discussion about Berle and corporatism that Bratton and Wachter sparked. This Article, however, is also mindful that planners' corporatism cannot be said to be a form of corporatism as classically defined.<sup>99</sup> To be clear, "corporatism" in this Article refers to the "quasi-corporatist arrangements" that Berle envisioned and not corporatism as classically defined.

*D. The Importance of The Modern Corporation and Private Property to the Berle–Dodd Debate*

It is important to sum up before moving forward so that the reader is mindful of the ground covered thus far. In the 1920s, Berle regarded the trends toward managerialism as a dangerous mistake that could destabilize American society. He feared that managerialism, without safeguards, could amplify the economic inequalities in America and provoke Bolshevik elements in American society. As a result, Berle started to construct arguments based on property rights, which justified shareholder authority over corporate management. Underpinning Berle's efforts (and this is important for understanding Berle's arguments throughout the debate) was the evolution of the public corporation with its ever-widening ownership class, which continued to increase the potential of democratizing economic power within American society. For this reason, if corpo-

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96. John W. Cioffi, *Fiduciaries, Federalization, and Finance Capitalism: Berle's Ambiguous Legacy and the Collapse of Countervailing Power*, 34 SEATTLE U. L. REV. 1081, 1085 (2011).

97. *Id.* at 1086.

98. Upon reflection, Cioffi's article ought to be considered in light of the role that corporatist thinking now plays in the merging forms of regulatory capitalism that are visibly emerging today. So much more could be said about Berle, corporatism, regulatory capitalism, and Cioffi's article, but an aside will have to do for now. For more on the role that corporatism is playing in regulatory capitalism, see David Levi-Faur, *Regulatory Capitalism and the Reassertion of the Public Interest*, 27 POL'Y & SOC'Y 181, 188 (2009).

99. Corporatism is classically defined as "a system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, non-competitive, hierarchically ordered, and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and support." Cioffi, *supra* note 96, at 1088 (quoting PHILIPPE C. SCHMITTER, *STILL THE CENTURY OF CORPORATISM?* (1974)).

rate managers could be compelled to act for the sole benefit of shareholders, the corporation ought to be the primary actor of the American economy. This ties his early shareholder primacy arguments firmly to the perceived needs of the broader polity of American society.

Against this background, the importance of *The Modern Corporation and Private Property* to the Berle–Dodd debate becomes clear. The first article in the debate was an exact replication of a chapter from the book, with one key omission. The article did not contain his candid admission that his arguments were constructed “with full realization of the possibility that private property may one day cease to be the basic concept in terms of which the courts handle problems of large scale enterprise.”<sup>100</sup> In the missing text, he also argued that it was possible that “the entire system [had] to be revalued” and that “the corporate profit stream in reality no longer [was] private property,” asserting that a new theory, which adequately explained the phenomenon of the modern corporation, would likely develop.<sup>101</sup> But he qualified these views as a matter of sociological study, which regardless of their factual merit, had not yet attained a standing as a “matter of law.”<sup>102</sup> He suggested that finding a superior theory to explain the distortion created by modern corporations upon private property was “rather the [reflection] of a movement which [was] likely to take form in the future, than the statement of a present ordering of affairs.”<sup>103</sup> Berle recommended that until a new corporate theory became a “matter of law,” lawyers and legal academics must do their best within the existing legal framework—that being to think “in terms of private property.”<sup>104</sup> And that is exactly what Berle did in the 1931 article with his bullish argument that “all powers granted to a corporation . . . are . . . at all times exercisable only for the ratable benefits of all the shareholders as their interest appears”<sup>105</sup> without qualification.

Berle’s apparent support for planners’ corporatism seems to contradict his argument for shareholder primacy. Berle’s arguments, however, are consistent because he only meant judicial protection of shareholder primacy to be an interim measure. He concluded that the shareholder primacy position, which he fully acknowledged was less than adequate, would need to be advocated until a satisfactory solution to the corporate power problem could be established.<sup>106</sup> Berle thought that the chapter

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100. BERLE & MEANS, *supra* note 64, at 219.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.* at 219–20.

105. *Id.* at 220; Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931).

106. See BERLE & MEANS, *supra* note 64, at 219–20.

endorsing planners' corporatism was the most important<sup>107</sup> because it pointed toward what he believed to be the future direction of corporate law. Thus, the book is rightly interpreted to be both endorsing planners' corporatism<sup>108</sup> and shareholder primacy. This clarification provides critical insight into the nature of his shareholder primacy argument and contextualizes it with the rest of the arguments from the book.<sup>109</sup> As a result, Berle's evolving position was not inconsistent, as most scholars suggest.<sup>110</sup> When Berle's arguments are fully contextualized with the fact that he only intended for shareholder primacy to be an interim measure until a more adequate clarification of the modern corporation was offered and accepted by the legal and business communities, his position is consistent.

This discussion leaves one final loose end: Berle's understanding of the corporation as a democratizing actor within modern society in the future. It can be argued that his vision of how the corporation related to the wider polity shifted from a vision of private government in which managers ran larger corporate actors, controlling the American economy for the benefit of shareholders representing all classes of American society, to a vision of hybrid public-private government in which a democratized corporate actor took a partnership role in the co-governance of the economy with government. But this shift is not such a dramatic shift as one might first assume. Both roads lead to the same end: using the path of democracy through the corporate governance mechanism to achieve the alignment of corporate action with public interest.

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107. SCHWARZ, *supra* note 14, at 63; *see also* Bratton & Wachter, *supra* note 9, at 121.

108. Bratton & Wachter, *supra* note 9, at 118–222.

109. It is unfortunate that neither Berle's personal writings, nor his biography, nor any of his other publications acknowledge this connection between the article *Corporate Powers as Powers in Trust* and *The Modern Corporation and Private Property*. As a result, no explanation exists for why he omitted this important insight from the 1931 article that was published just before the book was released. The missing text is critical to properly contextualize the Berle–Dodd debate. This insight clearly establishes that, although Berle appeared to be entirely committed to his shareholder primacy argument in the 1931 article, he undoubtedly acknowledged that this argument represented no more than an interim solution. Thus, although the argument in *Corporate Powers as Powers in Trust* appeared unequivocal, the missing text, which would soon appear in the book, established that his argument was equivocal.

110. *See* Bratton & Wachter, *supra* note 9, at 101 n.5. For allusions to the contradictions in Berle's work and thus the danger of misrepresenting his position, *see* David Millon, *Theory of the Corporation*, DUKE L.J. 201, 222 (1990), and *see generally* C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77, 95–99, 101–04 (2002) (describing Berle's transitions of opinion from 1931 up to the 1960s).

## IV. THE BERLE–DODD DEBATE

*A. Berle's Declaration: Corporate Powers as Powers in Trust*

While working on *The Modern Corporation and Private Property*, Berle continued to publish other pieces.<sup>111</sup> These works continued to argue for greater protection of shareholder rights. His writing inspired a range of reactions. Although some agreed that new safeguards were needed to protect shareholders (especially to secure a higher rate of investment),<sup>112</sup> the majority argued that Berle's assessment was a reactionary overstatement that ran "counter to the historical evolution of the corporation."<sup>113</sup> With *Corporate Powers as Powers in Trust*, he probably

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111. Those pieces were the following: ADOLF A. BERLE, JR., CASES AND MATERIALS IN THE LAW OF CORPORATION FINANCE (1930) [hereinafter CASES AND MATERIALS]; Adolf A. Berle, Jr., *The Organization of the Law of Corporation Finance*, 9 TENN. L. REV. 125 (1931); Adolf A. Berle, Jr., *Corporate Devices for Diluting Stock Participations*, 31 COLUM. L. REV. 1239 (1931); Adolf A. Berle, Jr., *Liability for Stock Market Manipulation*, 31 COLUM. L. REV. 264 (1931); Adolf A. Berle, Jr., *Compensation of Bankers and Promoters Through Stock Profits*, 42 HARV. L. REV. 748 (1929); Adolf A. Berle, Jr., *Promoters' Stock in Subsidiary Corporations*, 29 COLUM. L. REV. 35 (1929); Adolf A. Berle, Jr., *Investors and the Revised Delaware Corporation Act*, 29 COLUM. L. REV. 563 (1929); Adolf A. Berle, Jr., *Subsidiary Corporations and Credit Manipulation*, 41 HARV. L. REV. 874 (1928); Adolf A. Berle, Jr., *Convertible Bonds and Stock Purchase Warrants*, 36 YALE L.J. 649 (1927); Adolf A. Berle, Jr., *Publicity of Accounts and Directors' Purchases of Stock*, 25 MICH. L. REV. 827 (1927).

112. Karl McGinnis believed that the law was progressing toward greater protection of shareholders and that Berle's *Cases and Materials in the Law of Corporation Finance* was an important contribution toward understanding the problem of shareholder protection. See E. Karl McGinnis, Book Review, 10 TEX. L. REV. 122 (1931) (reviewing CASES AND MATERIALS, *supra* note 111). Irving Levy observed that Berle's suggestions in *Studies in the Law of Corporation Finance* were heterodox, acknowledging the protest of corporate lawyers to Berle's advocacy of the equitable control of management by shareholders. He explained that some practitioners believed that Berle's theory in action would be paramount to judicial interference with the ability of managers to exercise their professionally informed discretion over the corporation. That said, Levy sided with Berle because he believed that establishing safeguards over managerial discretion was prudent. See Irving J. Levy, Book Review, 7 N.Y.U. L.Q. REV. 552 (1929) (reviewing ADOLF A. BERLE, STUDIES IN THE LAW OF CORPORATION FINANCE (1928)).

113. Joseph L. Kline, who was a Wall Street corporate lawyer, argued, "Any movement to increase the power of shareholders as such runs counter to the historical evolution of corporations. Mr. Berle's thesis is therefore essentially reactionary." See Joseph V. Kline, Book Review, 42 HARV. L. REV. 714, 717 (1929) (reviewing ADOLF A. BERLE, STUDIES IN THE LAW OF CORPORATION FINANCE (1928)). Laylin K. James, in reviewing Berle's *Cases and Materials in the Law of Corporation Finance*, attacked his arguments for the greater protection of shareholders as too zealous. See Laylin K. James, Book Review, 26 ILL. L. REV. 712 (1932). Franklin S. Wood responded to Berle's 1926 article *Non-Voting Stocks and "Bankers' Control"*, arguing that Berle's equitable remedies solution to the problem of managerial control was unjustifiable under sound principles of law and equity. See Franklin S. Wood, *The Status of Management Stockholders*, 38 YALE L.J. 57 (1928). When reviewing Berle's *Studies in the Law of Corporation Finance*, Robert T. Swaine disagreed with Berle's position, but did not question his statement of the law, writing: "But, however much one may dissent from Mr. Berle's underlying philosophy, these essays must be recognized as an excellent and stimulating bit of advocacy. As a statement of the present state of the law they are of doubtful accuracy." See Robert T. Swaine, Book Review, 38 YALE L.J. 1003, 1004 (1929). And

expected more of the same criticism; however, his most formidable critic would be unexpected. In the *Harvard Law Review*, E. Merrick Dodd accused Berle of being a dangerous conservative. This was too much for the self-styled American Karl Marx to bear, and he promptly penned a reply in the following issue.<sup>114</sup>

In the initial article, Berle argued that because “all powers granted to a corporation . . . [were] at all times exercisable only for the ratable benefits of all the shareholders as their interest appears,”<sup>115</sup> a legal foundation existed to develop and enforce greater fiduciary ties between management and shareholders. He explained that the existing rights and restrictions of corporate law were no more than “nominal[]” rules,<sup>116</sup> in the sense that they were only guidelines for how corporate governance ought to function. But when these guidelines conflicted with the equitable rights of shareholders, he opined that equity prevailed.<sup>117</sup> As a result, managerial actions were bound by equity, no matter how absolute the power granted to managers might appear or how technically correct the exercise of such power was.<sup>118</sup> Although the argument was obviously anti-managerialist, he explained the nature of the equitable protections of shareholders in a manner that did not appear to be limiting managerial discretion; rather, he suggested that such interpretation of the rules expanded managerial authority to go beyond the technical limitations in order to better protect the interests of shareholders.<sup>119</sup>

Berle further described five scenarios<sup>120</sup> in which shareholders granted management wide discretion over corporate conduct.<sup>121</sup> In each, no matter how absolute the discretion appeared, such power had to be exercised in accordance with equitable limitations.<sup>122</sup> The underlying theory that bound managerial discretion to equitable control in each of

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Wilbur G. Katz argued that Berle overstated the law; he also rejected his shareholder primacy theory, arguing that Berle underemphasized the potential downside of his equitable solutions, condemning him for being too critical of management and being too eager to create the impression that the complexities of many financial and intercorporate transactions are all the result of “corporate skullduggery.” See Wilbur G. Katz, Book Review, 40 *YALE L.J.* 1125, 1128 (1931).

114. For the observation that Berle considered himself the American Karl Marx, see McCraw, *supra* note 55. For his outrage at being accused of being a Tory, see SCHWARZ, *supra* note 14, at 66.

115. BERLE & MEANS, *supra* note 64, at 220; Berle, *supra* note 105.

116. BERLE & MEANS, *supra* note 64, at 220; Berle, *supra* note 105.

117. BERLE & MEANS, *supra* note 64, at 220; Berle, *supra* note 105.

118. BERLE & MEANS, *supra* note 64, at 220; Berle, *supra* note 105, at 1050.

119. BERLE & MEANS, *supra* note 64, at 220; Berle, *supra* note 105, at 1049–50.

120. The five examples are: (1) power to issue stocks, (2) power to declare or withhold dividends, (3) power to acquire stocks in another corporation, (4) power to amend the corporate charter, and (5) power to merge with another enterprise. See BERLE & MEANS, *supra* note 64, at 221–40; Berle, *supra* note 105, at 1050–72.

121. BERLE & MEANS, *supra* note 64, at 220; Berle, *supra* note 105, at 1050–72.

122. BERLE & MEANS, *supra* note 64, at 221; Berle, *supra* note 105, at 1050.

the five scenarios was the understanding of the corporation as being exclusively private property, which supported the argument that all powers granted to management were exclusively for the benefit of shareholders.<sup>123</sup> But Berle hesitated to assert that this understanding of the fiduciary duty of management could evolve into a branch of trust law because such a duty must be less rigorous than other trust situations. Otherwise, the burden placed upon corporate management could be too great to reasonably optimize market efficiency.<sup>124</sup>

The timing of the publication of *Corporate Powers as Powers in Trust* is noteworthy because it occurred just months before the publication of *The Modern Corporation and Private Property*.<sup>125</sup> It was much like Means's publication of *The Separation of Ownership and Control in American Industry*, which was published at about the same time and was designed to have much the same effect in the world of economics.<sup>126</sup> Given the academic community's anticipation of the upcoming book, the article provided Berle with an opportunity to emphasize his central argument prior to its release.<sup>127</sup> This early exposure was important to Berle because he wanted to ensure that other important points in the book did not overshadow his shareholder primacy argument. In other words, the early release of this argument can be interpreted as Berle's effort to prevent shareholder primacy from becoming obscured by the pandemonium the book was anticipated to create about the looming threat of corporate power.

### B. Dodd, the Anti-Managerialist

Edwin Merrick Dodd, the son of a wool merchant, was born in Providence, Rhode Island, in 1888.<sup>128</sup> He entered Harvard College in 1910.<sup>129</sup> His first teaching position in law was at Washington & Lee,<sup>130</sup> but the Great War interrupted his fledgling career. During the war, he served as a member of the legal staff for the War Industries Board.<sup>131</sup> After the war, he practiced law for a short time but soon realized that he

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123. BERLE & MEANS, *supra* note 64, at 241; Berle, *supra* note 105, at 1072–73.

124. BERLE & MEANS, *supra* note 64, at 242; Berle, *supra* note 105, at 1074.

125. This original publisher decided shortly after the original publication that it “could not handle the book properly” and arrangements were made to transfer the book to Macmillan and Company. It was General Motors (a client of Corporation Trust) that pressured the publishing house to drop the book. SCHWARZ, *supra* note 14, at 67.

126. For the article in question, see Means, *supra* note 78.

127. SCHWARZ, *supra* note 14, at 62–64.

128. Zechariah Chafee, Jr., *Edwin Merrick Dodd*, 65 HARV. L. REV. 379, 379 (1952).

129. *Id.*

130. *Id.* at 380.

131. *Id.* at 380–81.

preferred academia.<sup>132</sup> He taught at both the Universities of Nebraska and Chicago<sup>133</sup> before returning to Harvard Law School in 1928,<sup>134</sup> where he taught for twenty-three years.<sup>135</sup>

Two recurring anti-managerialist leanings can be found in Dodd's work. First, he emphasizes the promotion of the fiduciary duty of corporate management. Second, he places importance on the protection of fairness and equity between classes of security holders.<sup>136</sup> Dodd consistently asserted that managers were in a position of trust and confidence, which led him to urge courts to be more diligent in enforcing managerial obligations.<sup>137</sup> His works indicated that he generally argued the anti-managerialist position, so one would assume that he would agree with Berle's position. But this was not the case, for although they may have shared much common ground, upon reading Berle's 1931 article (and possibly all of his legal articles up to 1931), Dodd deduced that Berle was too radical in his protection of shareholder rights. Berle's radical stance, from Dodd's perspective, was sacrificing the broader responsibility of managers to the community, as well as the potential that corporatism had to stabilize American capitalism at the time.<sup>138</sup>

In fact, Dodd was so disturbed by the implications of Berle's argument that he uncharacteristically employed a managerialist argument in order to attempt to undermine Berle's shareholder primacy theory. He determined that Berle's extreme stance was dangerous, making management no more than advocates solely for shareholders by limiting the

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132. *Id.*

133. *Id.*

134. Ralph J. Baker, *Edwin Merrick Dodd*, 65 HARV. L. REV. 388, 389 (1952).

135. Chafee, *supra* note 128, at 381.

136. Baker, *supra* note 134, at 389.

137. A review of examples that support this claim from the body of Dodd's work follows. In a two-part series, Dodd explored the limits of management power to alter corporate charters. See E. Merrick Dodd, Jr., *Dissenting Stockholders and Amendments to Corporate Charters*, 75 U. PA. L. REV. 585 (1927); E. Merrick Dodd, Jr., *Dissenting Stockholders and Amendments to Corporate Charters (Continued)*, 75 U. PA. L. REV. 723 (1927). In another particularly relevant article, Dodd traced the radical change in the impact of the fiduciary principle from small-scale to large-scale capitalism. See E. Merrick Dodd, Jr., *Modern Corporation, Private Property, and Recent Federal Legislation*, 54 HARV. L. REV. 917 (1941). In another, Dodd argued that corporate management's ability to purchase and redeem its own company shares ought to be brought within the fiduciary obligation. See E. Merrick Dodd, Jr., *Purchase and Redemption by a Corporation of Its Own Shares: The Substantive Law*, 89 U. PA. L. REV. 697 (1941). Dodd again argued that corporate management ought to act in light of their fiduciary obligation for the benefit of security holders in relation to their interest. See E. Merrick Dodd, Jr., *Fair and Equitable Recapitalizations*, 55 HARV. L. REV. 780 (1942). In the following article, he showed great concern for the fiduciary principles, especially in relation to the obligation of majority shareholders to minority shareholders or to a particular class of shares. See E. Merrick Dodd, Jr., *Liability of a Holding Company for Obtaining for Itself Property Needed by a Subsidiary—The Blaustein Case*, 58 HARV. L. REV. 125 (1944). For supporting commentary, see Baker, *supra* note 134, at 390; Chaffee, *supra* note 128, at 382.

138. Bratton & Wachter, *supra* note 9, at 124–28.

scope of managerial accountability to the maximization of profits, and when necessary, doing this at the expense of all other corporate constituents.

*C. Dodd's Response to Berle: For Whom Are  
Corporate Managers Trustees?*

Both authors had different views on to whom duties should be owed. Dodd argued that the managers' duty ought to be extended to other stakeholders. From his perspective, managers were granted many freedoms, whether through law or factual circumstance, to conduct business in a manner that would not necessarily maximize profits.<sup>139</sup> Dodd observed that this freedom appeared to have agitated Berle to place undue emphasis on the fiduciary relationship between managers and shareholders.<sup>140</sup> Dodd's assumption regarding Berle's motivations was incorrect, even at face value: Berle was clearly attempting to prevent managerial opportunism.<sup>141</sup> In other words, he wanted to bring managerial discretion under legal control, not line shareholders' pockets regardless of the consequences.

Dodd also wanted to maintain the gap between ownership and control of the modern corporation so that private property rights would not restrict management's decisions. He adopted an understanding of the underlying structure of the corporation and agreed with Berle that managers owed a fiduciary duty to the shareholders, not as individuals, but only to shareholders as a group.<sup>142</sup> What Dodd meant by this was that it was not the actual interest of shareholders, but a constructed interest of "the shareholder," to which management owed a duty. He argued that this conceptualization of shareholders required corporate managers to treat the corporation differently than merely an amalgamation of contractual and fiduciary obligations owed to actual and immediate shareholders. This created a space for management to find a balance between the optimal immediate and perpetual performance of the organization by serving the best interest of the corporation as a whole.

Dodd further asserted that his suggestion was not a dramatic shift of perception from Berle's understanding of the firm, for the picture was altered "more in form than in substance"<sup>143</sup> because the sole function of the corporation (to make profit for its shareholders) remained unal-

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139. E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1147 (1932).

140. *Id.*

141. BERLE & MEANS, *supra* note 64, at 302-08.

142. Dodd, *supra* note 139, at 1146.

143. *Id.*



tered.<sup>144</sup> But this statement was not altogether true. Although the sole function of the corporation was still profit-making, Dodd's perspective was jamming a wedge between ownership and control, aligning managerial discretion with the best interests of the corporation rather than the shareholders. This opened a debate as to what was in the best interests of the corporation. Such ambiguity was what Berle was attempting to eradicate, so as to limit managerial opportunism—at least in the interim. Dodd hoped that if this theoretical tweak were accepted, it would free management enough to take into consideration the interests of other stakeholders, even at the expense of maximizing profits.<sup>145</sup>

Dodd was aware that he was placing power into the hands of management. He argued for placing faith in management rather than shareholders to guide the corporation, asserting that the fiduciary relationship, as Berle conceived it, would create a serious obstacle to achieving socially responsible managers.<sup>146</sup> He suggested that one must look to the managers, not to the owners, for professionalized corporate conduct,<sup>147</sup> for it was “hardly thinkable” that absentee owners, who have little or no contact with their business other than collecting a dividend, would be filled “with a professional spirit of public service.”<sup>148</sup> Moreover, if corporate managers had a duty solely to shareholders, all other stakeholders with a vested interest in the corporation (including employees, consumers, and the community) would have to find protection from corporate power when their interests were contrary to maximizing profits for shareholders.<sup>149</sup> Therefore, to promote socially responsible behavior, corporate managers needed to be the guardians of all interests that the corporation affected, and this result could only happen if corporate managers were freed to be able to employ the corporation's “funds in a manner appropriate to a person practicing a profession and imbued with a sense of social responsibility without thereby being guilty of a breach of trust.”<sup>150</sup>

If freed from the constraints of a shareholder primacy agenda, why would managers use this broad discretion for the betterment of the community when they could use it to enrich themselves instead? Dodd acknowledged the problem of opportunism and then stated that it was not the concern of his article to question “whether the voluntary acceptance of social responsibility by corporate managers [was] workable, but whether experiences in that direction [ran] counter to fundamental prin-

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144. *Id.*

145. *Id.* at 1147–48.

146. *Id.* at 1162.

147. *Id.* at 1153.

148. *Id.*

149. *Id.* at 1162.

150. *Id.* at 1161.

principles of the law of business corporations.”<sup>151</sup> But he tacitly contradicted himself by appealing to the claims of high-minded managers who espoused the virtue of public duty.<sup>152</sup> He used this approach to establish that managers might be worthy of trust.<sup>153</sup>

Dodd merely employed optimism for the new generation of managers who claimed to be enlightened enough to use their discretion to assist other stakeholders, like employees, who needed protection from the inequities of their bargaining positions with the corporation.<sup>154</sup> He romanticized about the potential to transform modern business from a “purely private matter” into a “public profession,” in which managers would undertake a role as stewards of society.<sup>155</sup> His arguments were inspiring, but also lacking substance, rendering them no more than corporate futurism.

But, when one considers Dodd’s broader publication record,<sup>156</sup> it becomes questionable whether the suggestion that Dodd was a business commonwealth corporatist can stand up to scrutiny. Admittedly, Dodd’s argument from the 1932 article suggests that he was using the business commonwealth corporatists (in particular, Owen D. Young and Gerald Swope) as examples of professionalized corporate managers who voluntarily accepted a responsibility for achieving public-interest ends.<sup>157</sup> But when one puts the 1932 article to one side and reviews Dodd’s other writings before and after the 1932 article, it becomes clearer that Dodd was primarily an anti-managerialist. Therefore, one can conclude that Dodd was merely open-minded to Young and Swope’s business commonwealth corporatism, adopting a wait-and-see approach to “whether experiences in that direction [ran] counter to fundamental principles of the law of business corporations.”<sup>158</sup>

It is further submitted that Dodd sided with business commonwealth corporatists merely because he needed examples of potentially

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151. *Id.* at 1162.

152. *Id.*

153. But why would one attempt to wrench managers out of fiduciary relationships without understanding the outcome? As William Bratton has pointed out, the advocates of greater corporate responsibility have followed Dodd down this slippery slope ever since by asking observers to bet on the fact that if management had greater freedom from shareholder expectations, they would be more responsible to the community. See Bratton, *supra* note 11, at 73–74; William W. Bratton, *Never Trust a Corporation*, 70 GEO. WASH. L. REV. 867, 867 (2002) (arguing this point to Lawrence Mitchell in response to his book CORPORATE IRRESPONSIBILITY). For an example of such Doddish assumptions, see LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA’S NEWEST EXPORT 276–78 (2001).

154. Dodd, *supra* note 139, at 1146, 1148, 1151–53, 1165–67.

155. *Id.* at 1148.

156. Baker, *supra* note 134, at 388–93 (reviewing Dodd’s writing).

157. Bratton & Wachter, *supra* note 9, at 123–24.

158. Dodd, *supra* note 139, at 1162.

enlightened managers to counter what he believed to be Berle's alarmingly extreme shareholder primacy position. In other words, Dodd did not use the examples of Young and Swope because he genuinely endorsed their specific agenda, but merely because he was encouraged by their efforts, which appeared to be moving in the direction of corporate responsibility. Dodd's point was that such attempts at enlightened managerial behavior would be stamped out by Berle's strategy to bind managers to the whims of absentee profiteers.

In sum, Dodd's 1932 article ought to be regarded as a reaction to Berle's position. The argument in this article contradicted his own best judgment (as established by the archive of his work).<sup>159</sup> This is why he later admitted that this argument was "rash" and riddled with "legal difficulties."<sup>160</sup> Thus, it should be regarded more as a consequence of Berle's extremism and less as a sincere endorsement of business commonwealth corporatism. Dodd was merely petitioning those potentially lured by Berle's perceived extremism to keep an open mind and not to close the door on the potential for enlightened managerial behavior. And yet Dodd was overzealous in making this point, crossing the line of suggesting the potential of other options by fully advocating managerialism in a rash and reactionary manner. Therefore, though the case can be made that Dodd advocated business commonwealth corporatism, his level of enthusiasm actually skews a more accurate understanding of what Dodd was doing. To be more accurate, one must emphasize that the contradictory nature of Dodd's other writings, before and after this article, point to the conclusion that he was not a business commonwealth corporatist.<sup>161</sup>

*D. Berle's Reply: For Whom Corporate Managers Are Trustees: A Note*

One could imagine a number of ends to this story. For instance, Berle could have explained his position in a congenial manner, highlighting the similarities of his arguments with those of Dodd and explaining their differences as not so dissimilar after all. But this never happened. Instead, Berle's biographer explains that Berle was outraged by Dodd's accusation that he was a conservative, writing: "Dodd's real crime was making Berle seem like a Tory in the midst of an American revolution."<sup>162</sup>

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159. Baker, *supra* note 134, at 388–93 (reviewing Dodd's writing).

160. E. Merrick Dodd, Book Review, 9 U. CHI. L. REV. 538, 546 (1942) (reviewing MARSHALL E. DIMOCK & HAROLD K. HYDE, *BUREAUCRACY AND TRUSTEESHIP IN LARGE CORPORATIONS* (1940)).

161. Baker, *supra* note 134, at 388–93 (reviewing Dodd's writing).

162. *Id.* at 66.

Imagine how agonizing it must have been for the sometimes pompous Berle to endure such an affront on the eve of the release of his crowning achievement, which was to be (by his design) his coming-out party into the world of the left-leaning intellectual elites of America.<sup>163</sup> Berle had expected a managerialist attack from conservatives, who would rhetorically defend the status quo ante of managerial discretion, but he did not expect to be accused of being a conservative. Dodd was probably equally surprised that Berle's reply was left-leaning. This family feud of the left exposed Berle's argument as being less than ideal, based on the weak assumption that the interests of absentee owners would make management more accountable, while also exposing Dodd's corporate responsibility argument as being naively trusting of corporate managers.<sup>164</sup>

To address Dodd's criticism and, more importantly, to defend his own reputation and exact a little revenge, Berle elaborated on his main thesis that "all powers granted to a corporation . . . are . . . at all times exercisable only for the ratable benefits of all the shareholders as their interest appears."<sup>165</sup> He argued that the present law established that managers were required to manage the corporation in the interest of its shareholders, and that although many groups, notably labor, were gaining recognition as having claims against the corporation (which created legitimate cost to industry), the recognition of these costs (which reduced profits) did not alter the main objective of the corporate managers.<sup>166</sup> Berle continued to fire back at Dodd by arguing that the "real justification" for Dodd's opposition to his thesis stemmed from Dodd's underlying assumption that industrial managers of the day functioned more as government officials than as merchants,<sup>167</sup> which Berle tacitly (and spitefully) suggested was a foolhardy reason because managers did not see themselves as such.<sup>168</sup>

Berle did not dispute Dodd's suggestion that the corporation needed to be accountable to the wider polity.<sup>169</sup> This concession probably shocked Dodd because it was a slippery slope, which opened the door to the primacy of the public interest over property rights. This is an argument that a clever and conservatively minded liberal, like Dodd accused Berle of being, would never make. After making clear his colors, Berle

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163. See SCHWARZ, *supra* note 14, at 62.

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

165. BERLE & MEANS, *supra* note 64, at 220; Berle, *supra* note 105, at 1049.

166. Berle, *supra* note 164, at 1365.

167. *Id.* at 1367.

168. *Id.*

169. *Id.* at 1372.

then went on the attack, clarifying with slightly condescending undertones that managers did wield immense (government-like) power over society, but did not regard themselves as stewards of society and did not assume social responsibilities.<sup>170</sup> And to make matters worse, no mechanism existed to enforce the applications of Dodd's pseudo-theory of the corporation.<sup>171</sup> Furthermore, if the fiduciary obligation of managers to shareholders was ignored, then the management and *control*<sup>172</sup> would become "for all practical purposes absolute"—resulting in greater corporate irresponsibility.<sup>173</sup> Therefore, until such time as Dodd (or any others who sympathized with the noble manager) was prepared to offer a "clear and reasonable enforcement scheme of responsibilities," emphasis would have to be placed on the fact that the corporation's sole purpose was to make profits for their shareholders. This was because there existed no other legal control over corporate power, however imperfect it may be.<sup>174</sup> Berle emphasized that shareholder primacy was the best option available to take "responsibility for control of national wealth and incomes" in a manner that properly protected the majority of the community.<sup>175</sup> Basically, he was chastising Dodd for being quixotic, suggesting it was time for him to get his head out of the clouds and see what managers were actually doing.

Berle provided an echo of his corporate-liberal revolution by arguing that the only way to slip public interest through the backdoor of what today's observer would call corporate governance was through the shareholder primacy model. Berle noted that the working and middle classes were ever-more populating the American shareholder class and thus the construction of shareholder interests ought not be characterized as the interests of greedy profiteers, but as the interests of the average American. Admittedly, he does not come right out with this argument, but he did hint at its potential, writing:

The administration of corporations—peculiarly, a few hundred large corporations—is now the crux of American industrial life. Upon the securities of these corporations has been erected the dominant part of the property system of the industrial east. A major function of

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170. *Id.* at 1367.

171. *Id.*

172. Berle explained that "control" in this context refers to individuals or small groups of individuals who are able to mobilize or cast sufficient votes to elect a corporate board of directors. This is the sense in which the word is used in financial communities. *See id.* at 1366. He also contemplated "control" in his earlier works, for instance, see BERLE & MEANS, *supra* note 64, at 206, and Berle, *supra* note 52.

173. Berle, *supra* note 164.

174. *Id.*

175. *Id.* at 1368.

these securities is to provide safety, security, or means of support for that part of the community which is unable to earn its living in the normal channels of work or trade. Under cover of that system, certain individuals may perhaps acquire a disproportionate share of wealth. But this is an incident to the system and not its major premise; statistically, it plays a relatively minor part. Historically, and as a matter of law, corporate managements have been required to run their affairs in the interests of their security holders.<sup>176</sup>

In his conclusion, Berle reiterated that the law could not surrender the present fiduciary controls over management before a new order emerged, noting that “legal technique [did] not contemplate intervening periods of chaos,”<sup>177</sup> but would only respond to new outcomes or theories as they were established.<sup>178</sup> He foresaw that social theorists would guide the establishment of a revised institutional design of American society, and that at this point, the law could play a role stabilizing expectations and relations between stakeholders as they emerged.<sup>179</sup> But until such a time, lawyers were in a position where they needed legal tools to meet day-to-day situations. The fiduciary duty of management to shareholders was presently the best legal tool they had to control corporate behavior.<sup>180</sup> And as it stood, the shareholder primacy model worked as a method to ensure public interest, if envisaged in the correct manner.

Berle punctuated his reply to Dodd, declaring that “it is one thing to say that the law must allow for such developments. It is quite another to grant uncontrolled power to corporate managers in the hope that they will produce that development.”<sup>181</sup> Berle’s bad-natured reactions aside, he focused his attack on what Dodd had actually attempted to accomplish in his article, namely weakening the fiduciary obligations of managers to shareholders before social theorists could rationalize the modern corporation in a manner that could be adopted by law. Berle did so because he thought that the application of Dodd’s argument would result in a *carte blanche* for corporate irresponsibility, and because Dodd did not appreciate what Berle was attempting to accomplish with shareholder primacy.

In sum, Berle argued clearly that shareholders’ fiduciary controls over management could not be abandoned by lawyers until a new order emerged. He noted that “legal technique [did] not contemplate intervening periods of chaos,” but would only respond to new outcomes or theo-

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176. *Id.* at 1365.

177. *Id.* at 1371.

178. *Id.*

179. *Id.* at 1371–72.

180. *Id.*

181. *Id.* at 1372.

ries as they were established.<sup>182</sup> Berle's argument in the 1932 article mirrored the missing passages from the 1931 article (which were published in *The Modern Corporation and Private Property*). He argued that social science needed to better guide the legal understanding of the evolving corporate form and that only after this was done could the law play a role in the emerging new order.<sup>183</sup> Berle emphasized that lawyers needed new legal tools to bring corporate behavior under greater control.<sup>184</sup> Shareholder primacy was the only tool available.

*E. Berle's Reluctance in For Whom Corporate Managers Are  
Trustees: A Note*

One question may be nagging the reader at this point: Why did Berle not take the time to write a more thorough response to Dodd? If Berle had more to say about the future regulation of corporations and how the shareholder primacy argument was merely to be an interim solution before adoption of planners' corporatism, why did he not present it in the *Harvard Law Review*? *The Modern Corporation and Private Property* was merely weeks away from release, and his 1932 article could have been a great support for the book's launch, which Berle so desperately wanted to be a success. And yet, Berle was very guarded in his response to Dodd. A reasonable answer is that Berle was disgusted with the situation. He fired off a reply more as a knee-jerk emotional response than a thoughtful clarification of his position. Another possibility is that he feared alienating Brandeis-style antitrust advocates. But William Bratton and Michael Wachter provide a more provocative alternative, which could be easily overlooked. They write:

We suspect he thought that the timing was wrong. The battle between his progressive vision of corporatism and business commonwealth corporatism was taking place behind closed doors. Berle wanted to ensure his vision of corporatism was the one that would be adopted by the Roosevelt Administration and presumably was jealous to protect his influence.<sup>185</sup>

They note that Raymond Moley, a colleague at Columbia University, lured Berle away from full-time academia in 1932 by convincing him to join Roosevelt in his bid to win the presidency.<sup>186</sup> But the authors are vague as to when this offer was made, writing only: it was "early in

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182. *Id.* at 1371.

183. *Id.* at 1371–72.

184. *Id.*

185. Bratton & Wachter, *supra* note 9, at 128.

186. *Id.* at 109; *see also* SCHWARZ, *supra* note 14, at 71.

[Roosevelt's] 1932 presidential campaign."<sup>187</sup> The argument calls for more precision. If a connection is to be established between Berle's reply to Dodd and Berle's Roosevelt years, pinpointing months matters. So to be more exact, Berle was aware that he would be functioning in his new position as a political advisor for a presidential candidate in May.<sup>188</sup> Dodd published his reply to Berle on May 8, 1932,<sup>189</sup> and Berle fired back his reply to Dodd after that date in the following edition.<sup>190</sup> The "New Individual" speech (presented about three months later), which was penned by Berle for Roosevelt, clearly established that corporatism was on Berle's mind.<sup>191</sup>

The "New Individual" speech argued that citizens had the right to have their interest in the economy protected from the irresponsible exercise of corporate power, and that the government needed to protect this right.<sup>192</sup> As Bratton and Wachter explained, this speech called for "government controls" over managerial power so that managers would be compelled to "assume responsibility for the public good, end their internecine disputes, come together as industrial groups, and cooperate toward a common end."<sup>193</sup> If industrial groups failed to do so, the government would make them do so.<sup>194</sup>

Berle understood that shareholder primacy was only one manner of enforcing the public interest in corporate governance. In 1932, the political landscape was shifting. Berle believed that planners' corporatism, which he endorsed in the last chapter of the *Modern Corporation and Private Property*, was possible if Roosevelt won the election and if Berle could convince Roosevelt to see things his way. In sum, Berle wanted to ensure that corporate governance could be directed to take into consider-

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187. Bratton & Wachter, *supra* note 9, at 109.

188. Although some disagreement between Sam Rosenman (Governor Roosevelt's counsel at the time) and Moley existed as to when Moley joined Roosevelt's bid for the Presidency (Moley saying January 1932 and Rosenman saying March 1932), Berle could not have joined the campaign prior to Moley. Berle also noted that his first memorandum to Roosevelt was in May of 1932. For more on the disagreement, see SCHWARZ, *supra* note 14, at 71 (paraphrasing Berle), and see generally SAMUEL B. HAND, COUNSEL AND ADVISE: A POLITICAL BIOGRAPHY OF SAMUEL I. ROSENMAN (1979); RAYMOND MOLEY, AFTER SEVEN YEARS (1939); RAYMOND MOLEY, THE FIRST NEW DEAL (1966); SAMUEL I. ROSENMAN, WORKING WITH ROOSEVELT (1952). For evidence as to the date of his first memorandum to Roosevelt, see a passage from Berle's 1956 article entitled *The Reshaping of the American Economy*, reprinted in BERLE, *supra* note 20, at 31; see also SCHWARZ, *supra* note 14, at 71 (dating Berle's first memorandum to late May).

189. Dodd, *supra* note 139, at 1145.

190. Berle, *supra* note 164.

191. Draft of the "New Individual" speech delivered, with only a few minor changes, at the Commonwealth Club in San Francisco, Sept. 23, 1932. BERLE, *supra* note 20, at 62-70.

192. *Id.* at 69.

193. Bratton & Wachter, *supra* note 9, at 111.

194. *Id.*



ation the wider polity, and he believed that he had an opportunity to make this happen.

Bratton and Wachter, however, did not get it totally right. The battle behind closed doors was not between Berle's corporatism and business commonwealth corporatism. The battle was actually between: (1) his corporatism and the new individual, and (2) Brandeis-style anti-trust economics and the old individual.<sup>195</sup> The champion of the latter was Felix Frankfurter and his acolytes, whom Berle called "the would-be Brandeis followers of today" who "lacked the great man's admirable genius for being both radical and practical."<sup>196</sup>

The tension between Frankfurter and Berle goes back to their time at Harvard.<sup>197</sup> Frankfurter joined the faculty at Harvard when Berle was in his first year of law school.<sup>198</sup> Frankfurter's biographer describes his chief personality imperfection in the following passage:

Because his self-image was inflated, and because his psychological peace rested upon that self-image, Frankfurter could not accept serious, sustained opposition in fields he considered his domain of expertise; he reacted to his opponents with vindictive hostility.<sup>199</sup>

When one considers this idiosyncrasy in light of the following passage from Berle's biographer, one begins to appreciate how a young Berle would be particularly irritating to Frankfurter:

Later in life neither man cared to discuss the other, and there are only snippets of stories concerning their Harvard years. Yet, what emerges is an arrogant young Berle bent on cutting others down to size. The young Adolf relentlessly challenged Frankfurter in class, thereby making himself an unforgivable embarrassment to the professor. According to William O. Douglas, later a Columbia Law School and New Deal colleague, in the years following Berle's enrollment in Frankfurter's course, Berle began attending it for a second year in a row. Frankfurter was puzzled and asked Berle if he had taken the course the previous year. Berle replied affirmatively and Frankfurter asked, "Then why are you back?" "Oh," Berle responded, "I wanted to see if you had learned anything since last year." Another story had a vengeful Frankfurter blocking the young Berle from making the *Law Review*.<sup>200</sup>

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195. SCHWARZ, *supra* note 14, at 89.

196. *Id.* at 104.

197. *Id.* at 14.

198. *Id.*

199. H. N. HIRSCH, *THE ENIGMA OF FELIX FRANKFURTER* 5-6 (1981).

200. SCHWARZ, *supra* note 14, at 14-15.

From one perspective, Frankfurter's animosity was understandable. From another, it was not. It is difficult to image a pupil exhibiting such disrespect for a professor without inciting disciplinary action. But for Frankfurter to personally retaliate against the immature Berle (remember Berle started law school three or four year earlier than most students), thereby exhibiting transparent signs of vindictiveness to a poorly adjusted (yet arrogant) student might be seen as unprofessional.

Putting this relationship into relevant context, Roosevelt strategically divided his advisors so that no one camp within his ranks enjoyed the position of privileged insider,<sup>201</sup> thus creating a competitive decision-making process. Berle and Frankfurter fit this mold because any decision-making process that involved both men could be nothing less than competitive. While on the campaign trail before Berle had written the "New Individual" speech, Roosevelt invited Frankfurter's opinion regarding policy development. Berle's biographer writes:

Felix Frankfurter's intrusion into the campaign [was] intolerable. Aside from his old personal animus to the Harvard law professor, Berle saw in Frankfurter an ideological adversary—a Brandeisian "atomist" who opposed the brain trust consensus on large economic units for industrial planning.<sup>202</sup>

Berle warned Roosevelt that he should not make Frankfurter's "New Freedom" speech, which was similar to what Brandeis had drafted for Woodrow Wilson.<sup>203</sup> Berle thought that Brandeis-style individualism was what the Coolidge and Hoover Administrations used as a euphemism for inaction. He argued, "Whatever the economic system does permit, it is not individualism."<sup>204</sup> He then advised Roosevelt:

[I]t is necessary to do for [the American] system what Bismarck did for the German system in 1880, as [a] result of conditions not unlike these . . . . Otherwise only one of two results can occur. Either [the] handful of people who run the economic system now will get together making an economic government which far outweighs in importance the federal government; or in their struggles they will tear the system to pieces. Neither alternative is sound national policy.<sup>205</sup>

Berle pressured Roosevelt to make a "pronouncement" arguing for "public collective planning."<sup>206</sup> Berle suggested to Roosevelt that this pronouncement "would probably make at once [Roosevelt's] place in

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201. *Id.* at 88.

202. *Id.* at 76.

203. *Id.* at 77.

204. *Id.*

205. *Id.* at 78.

206. *Id.*

history and [have] political significance vastly beyond the significance of [his] campaign.”<sup>207</sup> Five weeks later, Roosevelt gave the “New Individualism” speech, which Berle named in order to contrast Frankfurter’s old freedom mantra and to make the statement that he had countermanded Frankfurter’s attempts to make individualism a core principle of the campaign.<sup>208</sup>

The antipathy between Berle and Frankfurter helps explain why Berle did not defend his ideas as strongly as he could have against Dodd. Indeed, the timing was wrong. But the battle was not between his corporatism and business commonwealth corporatism, it was between his vision and Frankfurter’s vision. As far as the business commonwealth corporatism model, no evidence exists that Frankfurter, or others in the democratic camp, directly advocated it. Furthermore, Berle did want, as Bratton and Wachter put it, “to ensure his vision of corporatism was the one that would be adopted by the Roosevelt Administration.”<sup>209</sup> He “was jealous to protect his influence,”<sup>210</sup> but not from his few members of the brain trust at the time (Moley, Rexford Tugwell, and James Warburg), rather from his old nemesis—Felix Frankfurter.

From the outset of joining Roosevelt’s campaign, Berle would probably have known that Frankfurter had been informally advising Roosevelt from the time that Roosevelt was Governor of New York State,<sup>211</sup> and that at some point Frankfurter would be called in to assume a similar role during this campaign. Furthermore, Frankfurter was Brandeis’s protégé, and Berle knew the ideological connection between Frankfurter and Brandeis.<sup>212</sup> So Berle, being a former student of Frankfurter and a young lawyer for a year at Brandeis’s law firm, would have known that a battle was coming. He also would have known the position that Frankfurter would be espousing to Roosevelt. Here, Berle had an advantage because he knew Frankfurter’s plan of action, but Frankfurter was blind to Berle’s. Berle’s biographer sets the scene in the following passage:

Both men were anxious to succeed and there developed between them a strong animus that would ripen into the bitterest and most ideological of New Deal rivalries . . . the issue between them being whether the antitrust laws should be used to break up big corporations and restore the competition [Frankfurter’s view] or whether

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207. *Id.*

208. *Id.*

209. Bratton & Wachter, *supra* note 9, at 128.

210. *Id.*

211. Max Isenbergh, *Claims of History? or What the Market Will Bear?*, 45 VA. Q. REV. 345, 347 (1969).

212. SCHWARZ, *supra* note 14, at 14.

big corporations were the products of natural economic forces and should be controlled through federal regulation [Berle's view].<sup>213</sup>

Berle would have appreciated that he had an ace up his sleeve, being that his planners' corporatism pitch to Roosevelt was unknown to Frankfurter. It is easy to imagine Berle wanting to write a much different reply to Dodd, outlining planners' corporatism, but Berle had not won the ideological struggle with Frankfurter by the time that Berle fired back his reply to Dodd.<sup>214</sup> Berle must have felt that it was too risky to reveal his position in the *Harvard Law Review* (Frankfurter's backyard). Berle could have foreseen the "vindictive" Frankfurter not only being aware of, but also enjoying, Dodd's reply to Berle on the eve of the much-anticipated release of *The Modern Corporation and Private Property*. Berle must have figured that publishing a full disclosure to Frankfurter of how he would advise Roosevelt in the coming months would not be worth the possibility of Frankfurter winning the opinion of Roosevelt on this issue at such a critically sensitive moment in American history. Having a hand in the future course of American society at a time when it was on the verge of economic collapse raised the stakes so high that Berle had to play his cards close to his chest.

#### F. A Final Word From Berle and Dodd

In the end, Dodd rejected his original arguments from the debate. In a 1942 book review, Dodd expressed regret for taking the position that he did in the debate, reflecting:

I was rash enough to suggest that our law of business corporations . . . might develop a broader view which would make the proposition that corporate managers are, to some extent, trustees for labor and for the consumer more than meaningless rhetoric. The legal difficulties which were involved were clear enough, as Mr. A. A. Berle was quick to point out.<sup>215</sup>

On the other hand, Berle never made such a concession.<sup>216</sup> Even when confronted by contemporaries for his apparent shift in opinion

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213. *Id.*

214. Berle would have been writing his reply to Dodd in May 1932, and Roosevelt had not agreed to Berle's "New Individualism" speech until about five weeks before the speech was delivered by Roosevelt at the Commonwealth Club in San Francisco on Sept. 23, 1932. *See id.* at 78.

215. Dodd, *supra* note 160.

216. Although it is claimed that maybe he did, such claims assume that the position he endorsed in *The 20th Century Capitalist Revolution* was contrary to his shareholder primacy argument. In fact, considering that he regarded shareholder primacy as merely an interim and inadequate measure, there is no inconsistency between his arguments. For his supposed concession, see ADOLF A. BERLE, JR., *THE 20TH CENTURY CAPITALIST REVOLUTION* 137 (1954).

without sufficient explanation,<sup>217</sup> he denied he ever made concessions—claiming that others misunderstood his writing.<sup>218</sup> Hopefully, revisiting the Berle–Dodd debate has clarified Berle's position, rectifying the long-held misunderstanding of his shareholder primacy argument.

## V. THE RISE OF FINANCE, BERLE, AND SHAREHOLDER PRIMACY

### A. Commoditization, Financialization, and Society

Commoditization means to treat something as though it were a product that could be bought and sold. Karl Polanyi's *The Great Transformation* tells the story of a critical point in the commoditization of English society.<sup>219</sup> It describes how starved peasant farmers were evicted from land that was communally used for generations and then were forced to accept harsh factory work. In other words, Polanyi explains the result of transforming the natural environment and the traditional ways of life of a people into commodities (property and labor)<sup>220</sup> and harnessing these commodities to the price mechanism in order to violently create a new social order.<sup>221</sup> Although Polanyi regarded this social experiment as a "stark utopia,"<sup>222</sup> others disagreed, arguing that it was an essential step in the birth of modern society.<sup>223</sup>

The financialization of society has much in common with this story of *The Great Transformation*. Financialization is an evolution of the commoditization process that Polanyi contemplated. Financialization holds great potential benefits for society by dispersing risk throughout

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217. For instance, John Lintner mockingly commented:

Berle . . . has had his vision somewhere on the road to Damascus, and now regards the concentrated authority of the nucleus of corporate management as being not merely inevitable but positively beneficent in important ways. It has probably enhanced the rate of industrial progress, and has stimulated pioneering and fundamental research which such corporations alone can do.

John Lintner, *The Financing of Corporations*, in *THE CORPORATION IN MODERN SOCIETY* 166, 170 (Edward S. Mason ed., 1966). Eugene Rostow also commented: "In 1954, Professor Berle accepted Professor Dodd's initial position, apparently because he concludes that the directors of endocratic corporations, as keepers of the public conscience, can now be safely trusted to exercise their vast power in the public interest, without the safeguard of either stockholder or effective public supervision." Eugene V. Rostow, *To Who and For What Ends Is Corporate Management Responsible?*, in *THE CORPORATION IN MODERN SOCIETY* 46, 62 (Edward S. Mason ed., 1966).

218. Berle denies his concessions by claiming that he was misunderstood. See Adolf A. Berle, Jr., *Foreword*, in *THE CORPORATION IN MODERN SOCIETY* xi, xii (Edward S. Mason ed., 1966).

219. POLANYI, *supra* note 26.

220. For his complete argument on commodity fiction, see *id.* at ch. 6.

221. *Id.* at 83.

222. *Id.* at 3.

223. For Hayek's arguments as to why the price mechanism is essential to ordering complex modern society, see Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 *AM. ECON. REV.* 519, 527–29 (1945).

society; however, it is also dangerous because it makes society more complex to manage by creating layers of interconnected markets for commodities. Maybe the best example of such financialization is the operation of derivatives. As Don Chance and Robert Brooks explain:

Derivatives are financial instruments whose returns are derived from those of other financial instruments. That is, their performance depends on how other financial instruments perform. Derivatives serve a valuable purpose in providing a means of managing financial risk. By using derivatives, companies and individuals can transfer, for a price, any undesired risk to other parties who either have risks that offset or want to assume that risk.<sup>224</sup>

In other words, derivatives are exchangeable instruments whose value depends on the future fate of an underlying commodity. Assessing whether the risk of holding a derivative is increasing or decreasing will determine its value. The result is that risk can be allocated to those who are in the best position to assume it.

To better appreciate why one might be concerned over the “rise of finance” or financialization,<sup>225</sup> one may imagine two worlds: the market world and the social world. The social world is that of everyday life. The market world is the complex array of rules that affects the buying and selling of commodities, derivatives, and other exchangeable instruments. It is an intangible world of information and transactions, which causes changes in how individuals understand risk and reward when making decisions, for example, how collateralized debt obligations and their assessment by credit rating agencies shifted the risk and reward for those that offered mortgages to clients.<sup>226</sup> This is a politically contentious story,<sup>227</sup> demonstrating how financialization creates social complexity by manufacturing new risks.<sup>228</sup> Regulators did not identify these manufac-

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224. DON M. CHANCE & ROBERT BROOKS, INTRODUCTION TO DERIVATIVES AND RISK MANAGEMENT 1 (2009).

225. Deakin, *supra* note 8, at 69; Mitchell, *supra* note 8, at 172.

226. Frank Partnoy, *Historical Perspectives on the Financial Crisis: Ivar Kreuger, the Credit-Rating Agencies, and Two Theories About the Function, and Dysfunction, of Markets*, 26 YALE J. REG. 431, 433 (2009).

227. For example:

A direct assault on Dodd-Frank would be so blatantly biased toward banks that it would be sure to provoke a public backlash. . . . The effort is partly ideological—an insistence that regulation is unnecessary, no matter the evidence to the contrary. It is also a campaign fund-raising ploy, because Wall Street will reward the opponents of reform. Of course, Democrats are themselves not indifferent to Wall Street campaign cash, which raises the question of how effectively they will counter the Republicans’ aims.

Editorial, *See Who Will Rescue Financial Reform?*, N.Y. TIMES, Mar. 27, 2011, <http://www.nytimes.com/2011/03/28/opinion/28mon1.html>.

228. Anthony Giddens, *Risk and Responsibility*, 62 MOD. L. REV. 1, 4 (1999).

tured risks in time,<sup>229</sup> resulting in serious social and economic consequences that will have a dramatic impact on the everyday lives of many people for years to come.

### *B. Three Causes of The Social Blindness of Investing*

The “rise of finance” suggests that investor empowerment is evolving into a new and powerful layer of global governance that may not adequately meet social needs.<sup>230</sup> It is fair to say that this observation may be justified, as there is good reason to believe that investors are largely blinded to how their choices affect the social world. Three potential causes of this blindness follow.

First, with the greater consolidation of the investment banking industry since 2008, governments cannot allow banks to fail and thus the public purse is the de facto underwriter of risk within the banking industry.<sup>231</sup> Some hold out hope that the Dodd-Frank Act can properly reallocate risk within the banking sector, but until it does so, this risk remains a serious concern. Being shielded from failure, banks become immune to the new risks they manufacture.<sup>232</sup> This is a dangerous situation,<sup>233</sup> encouraging the creation of complex financial instruments with uninhibited ambition to create wealth. It is questionable whether adequate incentive structures<sup>234</sup> are in place to ensure that those at the highest echelons of finance will be mindful of the impact that their decisions may have on the social world.

Second, innovations in capital-asset pricing models<sup>235</sup> and the maturing of algorithmic strategies<sup>236</sup> encourage investors to consider their investments within the framing of risk-return ratios on investments.<sup>237</sup>

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229. John C. Coffee, *What Went Wrong? An Initial Inquiry into the Causes of the 2008 Financial Crisis*, 9 J. CORP. L. STUD. 1, 3 (2009).

230. STEPHEN CLARKSON & STEPAN WOOD, *A PERILOUS IMBALANCE: THE GLOBALIZATION OF CANADIAN LAW AND GOVERNANCE* 227 (2010); Deakin 2008, *supra* note 8, at 69; Mitchell, *supra* note 8, at 172.

231. SIMON JOHNSON & JAMES KWAK, *13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN* 12–13 (2011).

232. Giddens, *supra* note 228.

233. JOHNSON & KWAK, *supra* note 231, at 12–13.

234. For instance, consider the broader implication of the relationship between adequate incentive structures and behavior. See Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. CHI. L. REV. 1159 (2003).

235. Eugene F. Fama & Kenneth R. French, *The Capital Asset Pricing Model: Theory and Evidence*, 18 J. ECON. PERSP. 25 (2004); but see Michael C. Jensen, *Capital Markets: Theory and Evidence*, 3 BELL J. ECON. & MGMT. SCI. 357 (1972).

236. *Algorithmic Trading, Ahead of the Tape*, *ECONOMIST*, June 23, 2007, at 85, available at [http://www.economist.com/node/9370718?story\\_id=9370718](http://www.economist.com/node/9370718?story_id=9370718).

237. Valeri Zakamouline & Steen Koekebakker, *Portfolio Performance Evaluation with Generalized Sharpe Ratios: Beyond the Mean and Variance*, 33 J. BANKING & FIN. 1242 (2009).

Such specialized information presents investment options as though they were in a vacuum, divorced from their consequences in the social world. In other words, financial information is coded in an abstracted language that solely focuses on investment consequences. As a result, investors are rarely informed or reminded of the social implications of their investment choices.

Third, disregard for social consequences has been observed, tolerated, and even rewarded within the market world. For example, institutional investors “rent seek” at the expense of the long-term value of the corporation and society.<sup>238</sup> If such destructive behavior can be established as having a pattern, then the sensible conclusion is that investors have too much discretion, and thus, the rise of finance as a governance tool must be more closely regulated.<sup>239</sup> But even if the political will existed, such regulation might spark massive global market disruptions and even further failures at a time when the global economy is less than stable.

### *C. Some Questions and Answers on Berle’s Shareholder Primacy and Today’s Rise of Finance*

Can corporate legal scholarship contribute to a better understanding of financialization? On one hand, stocks are different from other exchangeable instruments in the sense that only shares have rights attached to them that grant shareholders power within corporate governance.<sup>240</sup> Yet many shareholders treat stocks much the same as they would other exchangeable instruments: “buy, hope, hold, and cash in.”<sup>241</sup> In other words, they do not participate in corporate governance directly. As with financialization, the existence of stocks creates two worlds: the market world (stock markets) and the social world (the corporation’s social relationship<sup>242</sup> or “nexus of contracts”<sup>243</sup>). For these reasons, events in corporate governance that are affected by stock price and passive investors are comparable to the phenomena of financialization.

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238. For empirical evidence of the rent-seeking behavior of institutional investors, see Steen Thomsen, *The Hidden Meaning of Codes: Corporate Governance and Investor Rent Seeking*, 7 *EURO. BUS. ORG. L. REV.* 845, 849–52, 857–58, 861 (2006).

239. See Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 *BUS. LAW.* 1, 17–19 (2010).

240. CHARLES R. T. O’KELLEY & ROBERT B. THOMPSON, *CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS: CASES AND MATERIALS*, 156–58 (6th ed. 2010).

241. Berle, *supra* note 25, at 38.

242. Mark Granovetter, *Economic Action and Social Structure: The Problem of Embeddedness*, 91 *AM. J. SOC.* 481, 481–90 (1985).

243. STEPHEN M. BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE* 28 (2008).



Do Berle's thoughts provide insight on today's financialization? The answer is yes, but in considering today's political economy, Berle would likely want to revisit three of his more antiquated positions.

First is that government was capable of determining the course of the economy and that it could enforce this course.<sup>244</sup> Modern governance theory sinks this argument.<sup>245</sup> And yet, Berle believed in a responsible exercise of private economic power in harmony with public authority, which carried with it the implicit understanding that government would step in to protect the public interest as a measure of last resort.<sup>246</sup> In principle, this is not so far from what regulatory capitalism is attempting to do today.<sup>247</sup>

Second is that a new theory would resolve the public-private tension trapped within corporate theory.<sup>248</sup> One could argue that Bratton and Millon have made short work of the argument that a theory could have such influence.<sup>249</sup> But upon further inspection, it may not be a theory of the firm that resolves this public-private tension, since the "private" corporation will soon be crossing the Rubicon.<sup>250</sup> As will be explained below, there are ever-more frequent examples of the "private" corporation adopting roles once reserved for the very "public" welfare state, causing what Braithwaite calls the "reality of hybridity between the privatization of the public and publicization of the private."<sup>251</sup>

Third is that Berle argued that when a theoretical model of the corporation emerged, it would reject classical economic theory and might make the property theory of corporations obsolete.<sup>252</sup> To date, the winner of the race for a better theoretical model of the corporation appears to be Oliver Williamson and his theory of markets, networks, and hierarchies

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244. Adolf A. Berle, Jr., *Constitutional Limitations on Corporate Activity—Protection of Personal Rights from Invasion Through Economic Power*, 100 U. PA. L. REV. 933, 933–36 (1952); Adolf A. Berle, Jr., *The Developing Law of Corporate Concentration*, 19 U. CHI. L. REV. 639, 641–43, 660–61 (1952).

245. See generally JOHN BRAITHWAITE, *REGULATORY CAPITALISM, HOW IT WORKS, IDEAS FOR MAKING IT WORK BETTER* (2008); Colin Scott, *Regulation in the Age of Governance: The Rise of the Post-Regulatory State*, in *THE POLITICS OF REGULATION: INSTITUTIONS AND REGULATORY REFORMS FOR THE AGE OF GOVERNANCE* 145, 145–74 (Jacint Jordana & David Levi-Faur eds., 2005); Alfred C. Aman, Jr., *Law, Markets and Democracy: A Role for Law in the Neo-Liberal State*, 51 N.Y.L. SCH. L. REV. 801 (2007); Levi-Faur, *supra* note 98.

246. Adolf A. Berle, Jr., *The Developing Law of Corporate Concentration*, 19 U. CHI. L. REV. 639, 641–43, 660–61 (1952).

247. BRAITHWAITE, *supra* note 245, at 88–94.

248. BERLE & MEANS, *supra* note 64, at 219–20.

249. William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 464–65 (1989); Bratton, *supra* note 11, at 61–64; Millon, *supra* note 110, at 204–05, 240–51.

250. See *infra* Part V.D.

251. BRAITHWAITE, *supra* note 245, at 8.

252. BERLE & MEANS, *supra* note 64, at 219–20; see also Berle, *supra* note 10, at 435–36.

(New Institutional Economic Theory).<sup>253</sup> Williamson's work is derived from classical economic theory and is based on the cost of exchanging property (transaction cost theory).<sup>254</sup> Berle would certainly adjust his arguments to compensate for the realities of the modern corporation and governance today, but as suggested, at least in some cases, the adjustment need not be that drastic.

Taking into account Berle's body of work covered in this Article from 1921 to 1932, it can be concluded that he argued that the shareholder class needed to provide something more to the corporation and society than merely creating passive investors.<sup>255</sup> He envisioned three different ways that the shareholder class could be legitimized: first, by being a mechanism for the egalitarian distribution of profits and power to labor;<sup>256</sup> second, by being a mechanism for the egalitarian distribution of profits and power to the broader American population;<sup>257</sup> and third, by attracting sophisticated business expertise that could take an active and constructive role in managing the corporation toward the creation of a wealthier and more stable society.<sup>258</sup> Assuming that the shareholder class was legitimized, he argued that "all powers granted to a corporation [ought to be] at all times exercisable only for the ratable benefits of all the shareholders as their interest appears"<sup>259</sup> without qualification. But Berle did not have complete faith in its legitimacy, admitting that it was a less than fully satisfying interim measure to help eliminate the democratic deficit within the American economy.<sup>260</sup>

Would Berle still endorse shareholder primacy today? The answer is probably not. Consider the three different ways that he believed the shareholder class could legitimize their position within corporate governance. The first was the emancipation of labor through worker control of the shareholder class. This never happened and is only realizable in one's imagination today.<sup>261</sup>

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253. Williamson, *supra* note 7.

254. *Id.* at 3–4.

255. See, e.g., Berle, *supra* note 25, at 38.

256. For how labor could share the ownership of corporations, see Berle, *supra* note 25, at 38–39.

257. For how ever-wider distribution of shareholdings could create more egalitarian distribution of wealth and economic power, see SCHWARZ, *supra* note 14, at 66.

258. For how investors could legitimize their roles in corporations by contributing to management strategy, see Berle, *supra* note 25, at 37–38.

259. Berle, *supra* note 105.

260. BERLE & MEANS, *supra* note 64, at 219–20.

261. KATHERINE V.W. STONE, *The Future of Labor and Employment Law in the United States*, in *ENCYCLOPEDIA OF LABOR AND EMPLOYMENT LAW AND ECONOMICS* (Kenneth Dau-Schmidt, S. Harris & O. Lobel eds., 2008), available at <http://ssrn.com/abstract=1127885>.

The second was the egalitarian distribution of profits and power within the corporation through broader shareholder distribution. Today, the middle- and lower-wage workers that invest in shares generally do so through institutional investors (pension funds and mutual funds). These individuals have contracted away their rights, allowing that institutional investors can participate in corporate governance on their behalf with few exceptions.<sup>262</sup> In terms of profit, what these “shareholders” gain through such investments, they may be losing through pension privatization.<sup>263</sup> Thus, the egalitarian distribution of profits and power has not lived up to Berle’s high hopes.

The third can be posed as a question: Can today’s greater shareholder empowerment lead to the sort of active and constructive roles for management that Berle had in mind? In other words, can good decisions in the financial world translate into good decisions in the social world? The answer to this question is less than clear and invites debate. Yet, this tension is healthy<sup>264</sup> because private entrepreneurs and public lawmakers need to be reminded that the gaps between markets and society must be bridged as they create the new hybrid regulatory mechanisms of tomorrow.<sup>265</sup>

*D. The Hybrid Regulatory Mechanisms of Tomorrow:  
Bridging the Gaps Between Markets and Society*

The privatization of public services<sup>266</sup> and the use of meta-regulation<sup>267</sup> demonstrate how governments have placed the day-to-day regulation of public interest in the hands of private actors. Business readily accepts these government gifts when they are granted, and rightly so. Business wants the profits from managing segments of the public sector. It also wants to self-regulate in order to achieve flexibility and a competitive edge. At the same time, investors want to capitalize on a full menu of investment opportunities that are only limited by the capacity of the imagination of the financial engineers of Wall Street and the Square Mile.

These private actors may soon learn that there is a darker side to privatization and financialization. Private actors and governments are

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262. Eric John Finseth, *Shareholder Activism by Public Pension Funds and the Rights of Dissenting Employees Under the First Amendment*, 34 HARV. J.L. & PUB. POL’Y 289, 289–91 (2011).

263. Sarah M. Brooks, *Interdependent and Domestic Foundations of Policy Change: The Diffusion of Pension Privatization Around the World*, 49 INT’L STUD. Q. 273, 290 (2005).

264. Bratton, *supra* note 249; Bratton, *supra* note 11, 61–64.

265. See Brooks, *supra* note 263. See generally BRAITHWAITE, *supra* note 251; Aman, *supra* note 245; Levi-Faur, *supra* note 98; Scott, *supra* note 245, at 145–74.

266. Aman, *supra* note 245, at 802–04.

267. BRAITHWAITE, *supra* note 245, at 1–29.

blurring the line between government responsibility and private freedoms. This blurring of traditional roles is shifting some of the underlying assumptions about how society ought to be governed. Letting markets regulate society was supposed to fix the problems of political organization by removing government from governance.<sup>268</sup> But when the power of the market is unleashed, it can create as much vice as virtue.<sup>269</sup> Thus, the shift to the market may have solved some problems of political organization, but as the credit crisis demonstrated, it has also created new problems of market organization.

The problems associated with social organization, whether political or market based, will never go away. The shift to the market has resulted in two things. One is a transfer of power from the state to private actors. The other is confusion over whether public or private actors are responsible for areas in which there have been these transfers of power. As governments scramble to get away from welfare state obligations, investors and business actors gamble that they will be able to profit from these traditional areas of public interest without attracting greater social responsibilities. But a sober look at what is occurring today leads one to believe that this gamble is a bad bet for private interests in the long term. Fundamental changes in the public-private distinction are occurring, and private actors are being lured into a precarious situation.

What is this precarious situation? It is the circumstances in which private actors may find themselves if there is a swing in public opinion. To explain, Polanyi argued that there is a “double movement” within society in which people eventually refuse to tolerate the market overwhelming other social needs.<sup>270</sup> Simon Deakin has emphasized the opposite side of the “double movement.” He explains that when social needs overwhelm the needs of the market, then there is a backlash from business interests.<sup>271</sup> If this “double movement” exists, then there will be a constant tension between favoring the needs of markets and the needs of society. According to Deakin, the pendulum is now swinging toward the needs of markets,<sup>272</sup> but if Polanyi is correct, this shift will not be permanent.

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268. Hayek, *supra* note 223.

269. For the theory of how markets create virtue and vice, see JOHN BRAITHWAITE, *MARKETS IN VICE, MARKETS IN VIRTUE* 3–15 (2005).

270. For a detailed commentary on the double movement, see Fred Block, *Introduction*, in KARL POLANYI, *THE GREAT TRANSFORMATION*, at xxiii, xxiii–xxvii (2d ed. 2001).

271. Deakin, *supra* note 8.

272. Deakin argues that the rise of finance “takes many forms,” including: hostile takeover bids, private-equity deals, hedge-fund activism, rise in stock-market values relative to national wealth, the use of shareholder-value metrics to measure corporate performance, stock-based remuneration, and the shifting boundary between the public and private sectors. *See id.* at 67–68.

As these swings occur, New Institutional Economics suggests that institutions and organizations will not remain the same, but will evolve in correspondence with these swings.<sup>273</sup> As the pendulum's weight swings, the pendulum's pivot shifts as well, thus the weight never returns to precisely the same point. In other words, if Polanyi's "double movement" is right again (as it was in 1944), and the primacy of the political over the economic is once again restored, there will be no welfare state welcoming the swing back, nor will there be a classic twentieth-century public-private divide to protect the interest of capital. What is unnerving about this precarious situation is that the permutations of how it could be mismanaged dramatically dwarf the potential productive ways it could be managed. One thing is for certain: the smaller the gap between the needs of markets and the needs of society, the easier it will be for the swing to be managed prudently.

#### VI. CONCLUSION

In sum, it is suggested that a more robust dialectic about the pros and cons of the rise of finance is needed in order to properly deal with the present developments and their potential impacts on markets and society. Furthermore, it is suggested that Berle's insights into the possibilities for, and limitations of, shareholder primacy offer a starting point for a more nuanced conversation about how today's investors can attempt to meet the challenges of governance in a manner that protects both their own interests and the interests of society.

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273. DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 92–106 (1990).