

Rethinking the Separation of Ownership from Management in American History

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Between 1905 and 1907, financier Clarence Mackay purchased some five percent of AT&T's outstanding shares, giving him four times as much stock as the next largest owner.¹ Such a large stake, Mackay argued, entitled him to representation on the company's board of directors. As Mackay wrote to AT&T president Frederick P. Fish, "[N]ot one of your eighteen Directors . . . owns over 2,000 shares of your stock in his own right . . ." ² Control rested in the hands of AT&T managers. Thirty-six percent of the stock was in the company treasury, voted by the AT&T directors through a trust agreement. Directors voted an even higher percentage when proxies were added in.³ Mackay had pointedly raised the issue of control in a corporation composed of numerous stockholders. It was an issue that would grow enormously important in the coming decades with AT&T as one of the central firms in the debate over who had the right to control and manage big firms.

After consulting with other AT&T directors, Fish penned a lengthy reply. Each director, he wrote, had an obligation to serve "each and all of the stockholders," and it was "unwise to have any stock interest specifically represented on the Board." This was somewhat disingenuous

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1. FCC, Telephone Investigation, Special Investigation Docket No. 1: Report on Control of Telephone Communications, vols. 62–63, pp. 35–39, 41 (1937) [hereinafter FCC Investigation].

2. *Id.* at 41.

3. *Id.* at 30, 49.

because AT&T had several constituencies on its board. As Mackay noted, for example, the telegraph giant Western Union owned just 20% of the stock of New York Telephone (a large AT&T subsidiary), yet held five of thirteen directorships.⁴ But most outrageous, in Mackay's opinion, was what he termed Fish's "new theory" that a large owner was somehow *disqualified* from management. By that logic, Mackay scoffed, "it would be better if the directors own no stock whatsoever, which, of course, is contrary to the theory on which corporations . . . are organized."⁵

On its face, then, this seems a clear case of an owner losing control to managers. In *The Modern Corporation and Private Property*, Adolf Berle and Gardiner Means would use AT&T as a prime example of what they saw as a dangerous new trend, the replacement of ownership-based capitalism with giant corporations controlled by a small group of propertyless managers. Indeed, AT&T became Berle and Means' favorite example. In the 1930s, the Federal Communications Commission (FCC) would interpret the Mackay incident in a like manner: an example of the separation of ownership and management and subsequent loss of control by owners.

Statistics seem to paint a clear picture of the process whereby owners lost control of AT&T. In 1900, the telephone corporation had about 7,000 shareholders.⁶ By 1920, shareholders had increased to 140,000, and were well over 400,000 by the time Berle and Means' famous book appeared in 1932. This growth in shareholders, Berle and Means argued, was one way that owners lost control of their property. The decline of ownership concentration at AT&T told the same story: dispersing shares across many owners, each of whom only had a small ownership percentage. The average shareholder owned 67 AT&T shares in 1911, but only 35 shares by 1920. Eighty-five to ninety percent of shareholders owned 100 or fewer shares over that same period.⁷ As Mackay observed, directors' and officers' personal ownership stakes were low, only 2% by 1905.⁸ With few managers owning any significant number of shares, AT&T seemed a perfect example of the emerging trend of managerial capitalism.

As we shall see, however, the claim that AT&T was a leading example of the separation of ownership from management is incomplete. More importantly, the common interpretation of Berle and Means' work

4. *Id.* at 41–42.

5. *Id.* at 43.

6. *Id.* at 26.

7. See AT&T, ANNUAL REPORTS (1911–1920).

8. FCC Investigation, *supra* note 1, at 22–23, 25, 39, 49.

is mistaken, placing the emphasis incorrectly on the number of shareholders and reading modern concerns over conflict between principals (owners) and agents (managers) into the past. In fact, AT&T was quite exceptional in number of shareholders and lack of ownership concentration. Compared to other nations, the United States lagged in the use of the stock market and many American firms retained substantial family ownership. A close look at *The Modern Corporation and Private Property* shows a rather different set of concerns than those underscored in contemporary agency theory. Principal-agent conflict was only part of Berle and Means's story, and not the most important part. The problem the book tackled was not separation of ownership and management, leading to principal-agent conflict. Rather it was the problem of the separation of ownership and control. Control pointed to a new set of issues about power and responsibility in an economic institution—the managerial corporation—that had grown in size and taken over substantial areas of economic activity.

Berle and Means brought popular attention to an issue of power in the modern corporation that continues to be debated until the present. Yet, over time, their insights were lost in economic theories that placed almost exclusive emphasis on efficiency rather than power. The results were, by the 1970s, corporate policies that sought to correct the problem of principal-agent conflict in ways that greatly exacerbated the problem that Berle and Means had warned was far larger—the ability of insiders to control corporate property and use it in ways detached from issues of social responsibility.

BERLE AND MEANS IN THE HISTORY OF CORPORATE GOVERNANCE

Few works by economists have enjoyed wider circulation than Berle and Means's classic text *The Modern Corporation and Private Property*. Indeed, it has attracted historians, economists, policy makers, and the popular press, all of whom accepted its thesis on the separation of ownership and management in the modern corporation. More than fifty years after publication, it was being cited by financial economists as the starting point for their own inquiries into agency conflicts.⁹ Yet, the text they understand is not the one that Berle and Means actually wrote. Almost from the moment it appeared, *The Modern Corporation and Private Property* was read in ways that ignored its central thesis about corporate power and responsibility.

9. Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 288 (1980). Robert Hessen called it "a living classic" in 1983. See Robert Hessen, *The Modern Corporation and Private Property: A Reappraisal*, 26 J. L. & ECON. 273 (1983).

Such readings began with economist Robert Gordon. In his 1930s articles and his 1945 book, *Business Leadership in the Large Corporation*, Gordon set the tone for the “managerial” interpretation of Berle and Means’ text that would soon follow.¹⁰ Gordon argued that the firm was composed of various interests and stakeholders, including managers. Power was a matter of balance and competition among these groups. This was not strictly in line with Berle and Means’ original intent. Indeed, as Means responded, it seriously slighted the problem of control. To Berle and Means, “manager” was not a category of identity but the residue of power. Whoever could set corporate policy was a manager, and whoever managed by definition had control.¹¹ The central question was thus how control was obtained.

But beginning with Gordon, managers and management were reduced to just one faction among many. They were not distinguished by control (the “control group” Berle and Means termed them) but recognized by their roles and characteristics. Managers were skilled professionals responsible for firm strategy and operations. They had their interests, to be sure, but their power could be checked by banks, large shareholders, and when it came to implementing decisions, even lower level employees.¹²

Gordon’s perspective placed agency theory at the center of Berle and Means’ project. He focused on the small degree of compensation that executives received through stock ownership and the potential of salaries to distort executive behavior.¹³ Others soon elaborated these points.

In his 1940 text on the economics of the corporation, N. S. Buchanan called “the corporation problem” the tendency of executives to grow “lax and inefficient” because they did not have an incentive to maximize profit. Executives would seek “growth not profits,” he wrote, behavior

10. R. A. Gordon, *Financial Control of Large-Scale Enterprise*, 29:1 AM. ECON. REV. SUPP. 61, 85–99 (1939).

11. James Washington Bell, Dr. Scott, Gardiner C. Means & Paul M. O’Leary, *Financial Control of Large-Scale Enterprise*, 29 AM. ECON. REV. SUPP. 109, 109–17 (1939). There is a problem of evolving terminology here. Gordon sees Means discussing something else, “power,” a point that is actually not inconsistent with what we see here as the thrust of Berle and Means’ actual argument. And in the article cited here, Means himself seems to accept a more relative concept of control, though it seems clear that the original intent of *The Modern Corporation* was to deal with control in more absolutist terms, with questions of relative power operative outside the narrower scope of control/management. The important contrast to Gordon and those who follow, however, is that for Berle and Means, management was a function of control, not a third category.

12. As we shall see, Berle himself came around to roughly this position in his 1959 book, ADOLF A. BERLE, JR., *POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN THE AMERICAN POLITICAL ECONOMY* (Harcourt, Brace & Co., 1959).

13. Robert A. Gordon, *Ownership and Compensation as Incentives to Corporation Executives*, 54 Q.J. ECON. 455, 455–73 (1940).

that harmed both shareholders and consumers.¹⁴ However, Buchanan found little evidence of actual harm from the separation of management and ownership.¹⁵ By contrast, Gordon found mixed evidence that some executives actually had significant ownership stakes in their firms, and he recognized that non-pecuniary motivations might well offset the decline of ownership in other cases. But, either way, Buchanan, Gordon and others were shifting the emphasis from Berle and Means' original notion of control to the somewhat different notion of management and managerial motivation.

As the managerial perspective gained ascendancy, it spun off further elaborations. For some, the loss of property-ownership control could be a good thing, or at least not the problem that neo-classical economists imagined. In perhaps the first use of the term, journalist and popular political theorist James Burnham explored this "managerial revolution" in his 1941 book of the same name. In essence, Burnham argued "good riddance" to traditional ownership. Property holding merely got in the way of long term growth and efficiency given the technical complexity of modern production. Eventually, Burnham predicted, managers would turn to the state to gain full control over corporate property, which he believed had already happened to a degree in Fascist Italy, New Deal America, and Communist Russia.¹⁶

As novelist George Orwell pointed out, Burnham was positing that capitalism would yield not to socialism but to "a new kind of planned, centralized society, which will be neither capitalist nor democratic." It was a nightmare vision of Thorstein Veblen's soviet of engineers, with the managers a new elite running industrial "super-states" that would vie for control of the earth. The great mass of men and women, Berle and Means' citizen-property owners, would be reduced to "semi-slaves at the bottom." Not surprisingly, Orwell used Burnham's ideas as the basis of his dystopian novel, *1984*.¹⁷

The grim future Burnham predicted for managerialism, far beyond Berle and Means' critique, made it important for liberals to distinguish managerialism in the United States from other ideologies. Liberals were on board with some of Burnham's notions, such as the need for planning, but they did not see the state as the end point of the managerial revolution. A moderated managerialism soon emerged in the 1950s, as liberals argued that democratic societies could embrace the efficiency advantages

14. NORMAN S. BUCHANAN, *THE ECONOMICS OF CORPORATE ENTERPRISE* 446–48 (1940).

15. *Id.* at 448.

16. JAMES BURNHAM, *THE MANAGERIAL REVOLUTION: WHAT IS HAPPENING IN THE WORLD* 72, 88–89, 96, 133 (John Day Co. 1941).

17. George Orwell, *Second Thoughts on James Burnham*, *POLEMIC*, Summer 1946.

of the managerial revolution without succumbing to authoritarianism.¹⁸ The mixed economy of postwar America helped to contain corporate power by boosting the power of other actors.

Liberal economist John Kenneth Galbraith explained how countervailing powers held by labor, government, and consumers kept business in check while fostering technical efficiency in corporate management. Here was a pluralistic response that accepted the need for managerial expertise, but that answered fears that the modern corporation would yield either “the power of the few to manage the economic life of the nation,” or some form of statism, as Burnham predicted earlier. Galbraith offered a third way, with “private economic power . . . held in check by the countervailing power of those who are subject to it.”¹⁹

Galbraith’s ideas fit a postwar liberalism that emphasized the virtues of professionals (in this case professional managers) as disinterested experts. In this regard, the “hired” manager was superior to the property-owning manager, as the editors of *Fortune* magazine noted, because “like all professional men he has a responsibility to society as a whole.” This did not conflict with the manager’s primary job, to make money for the firm. The manager’s “ability to make money is the prime measure of his company’s efficiency.” But his power was held not by the divine right of property, a narrow and ultimately self-limiting justification. The professional manager conducted business affairs in ways that were equitable and balanced among all stakeholders.²⁰

By the 1950s, even Adolf Berle made peace with the modern corporation and accepted the managerial thesis. The further ownership and management separated, he wrote, the more the corporation would become essentially a political entity in a liberal political economy. His earlier writings, Berle now stated, reflected the early stage of this process of separation, when control was merely plutocratic—in the hands of the insiders—and not yet fully democratic.²¹ But with growing use of internal financing and shares being held by insurance companies and pension funds, Berle foresaw “the increasing elimination of proprietary owner-

18. See Edward S. Mason, *The Apologetics of “Managerialism,”* 31:1 J. BUS. 1, 1–11 (1958).

19. JOHN KENNETH GALBRAITH, *AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER* 56–57, 111–13, 168–70, 200 (2d ed. 1956). On the post-war decline of questions of power in economics more generally, see Alan Brinkley, *The New Deal and the Idea of the State*, in *THE RISE AND FALL OF THE NEW DEAL ORDER 1930–1980*, at 85–121 (Steve Fraser & Gary Gerstle eds., 1989).

20. RUSSELL W. DAVENPORT ET AL., *U.S.A: THE PERMANENT REVOLUTION* 68, 78–80 (1951).

21. ADOLF A. BERLE, JR., *POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN THE AMERICAN POLITICAL ECONOMY* 61–69 (1959). Modern notions of ownership do not give the shareholder the right to, as Berle vividly put it, walk off with the telephone poles just because one owns shares in a telephone company. A possessory owner would have that right.

ship itself, and its replacement by, substantially, a power system.”²² As property lost its original, holistic meaning, power became plural, divided among managers, workers, boards of directors, and institutional shareholders. Berle celebrated this pluralism as a check on the plutocratic danger that arose when a small, self-selected group controlled everything.²³

This positive interpretation of managerialism was shadowed by another, more negative one. The negative interpretation could be traced back to Gordon’s seminal reading of *The Modern Corporation*, but it focused more on the microeconomic elements of organization and managerial motivations. Herbert Simon and his followers in the 1950s accepted Gordon’s position that the motivation of the professional manager was the most significant issue of modern corporate capitalism. Simon took for granted that managers had control and that their interests were not linked in any significant way to the financial performance of the firm.²⁴ As the managerial thesis narrowed to a micro-economy of individual self-interest, economists wielding the tools of microeconomic analysis grew more engaged. In 1959, American economist William Baumol, and later, in 1964, British economist Robin Marris, started with the position that professional managers ran large firms and that shareholders and other financial interests had been successfully pushed to the background.²⁵ According to Baumol and Marris, the perquisites of control were largely rendered as salary, staff, and discretionary investments. Managers sought to expand the size of their departments at the expense of profit maximization.²⁶

Some economists, such as Marris, engaged the larger social implications of the firm in the hands of professional managers. Marris understood Berle and Means to be saying that managers were “disembodied entrepreneurs enjoying many of the fruits of capitalism without them-

22. *Id.* at 164.

23. *Id.* at 56–57. Berle criticized pension fund managers for not becoming more active in the firms whose shares they held. If they did, Berle believed, then the individual voices of the great majority of shareholders could find expression through the concentration of ownership in the pension or mutual fund. Berle relied heavily on a rather vague notion of a public consensus that will prevent managers from straying too far. Public consensus may have made sense at a moment when liberals believed the United States was a consensus society. *Id.* at 107–19.

24. Certainly the behaviorists did not dismiss self-interest. But the emphasis on other forms of motivation fit with an understanding of the firm as a complex organization of multiple interests where traditional, narrow definitions of owner self interest were no longer adequate.

25. WILLIAM J. BAUMOL, *BUSINESS BEHAVIOR, VALUE AND GROWTH* (New York 1959); ROBIN MARRIS, *THE ECONOMIC THEORY OF MANAGERIAL CAPITALISM* (The Free Press 1964); Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes*, 19 J. ECON. LIT. 1537, 1559 (1981).

26. See also RICHARD M. CYERT & JAMES G. MARCH, *A BEHAVIORAL THEORY OF THE FIRM* 239–52 (Prentice Hall, 1963).

selves providing much capital or taking proportionate risks.” Yet, as he perceptively noted, “[t]here is nothing in the rules of traditional capitalism to require the owner-manager to exclude all forms of satisfaction other than money.”²⁷ Thus, rather than departing from strict profit maximization, the professional manager might well be more focused on profit and performance than the classic owner-manager, with his or her diverse menu of subjective motivations. Indeed, as the fiduciary agents of others, managers had a greater obligation than did property owners to suppress their self-interest.

Whereas liberals in the 1950s had argued that pluralism assured legitimacy and social responsibility, economists were more skeptical. They looked for some self-disciplining system akin to the competitive market. This was especially so among American economists. As Marris noted, “[T]here can be little doubt that in the United States, somewhat in contrast to the other Western countries, the ideological yearning to legitimize the modern system by restoring classical-type motivation is powerful.” Shareholder value in the United States soon became the “normative axiom” for construing managerial behavior.²⁸

In 1959, Yale law school dean Eugene Rostow threw down a neo-conservative gauntlet to New Deal liberalism when he wrote that unless firms were responsible solely to their shareholders, the results would be “failed planning.”²⁹ Gone were the non-pecuniary motives of the early administrative school or the countervailing powers of Galbraith. Taking efficiency, as defined by neo-classical economics, as the point of the legal system, a group of property rights theorists followed Rostow, arguing that there was only one best way to structure shareholder rights to achieve efficient outcomes. The emphasis on property rights would coalesce into a full blown intellectual movement as scholars, such as Friedrich Hayek and Milton Friedman, launched assaults on liberal notions of social responsibility.³⁰

27. MARRIS, *supra* note 25, at 10, 14.

28. *Id.* at 72.

29. Edward Mason, *Apologetics of 'Managerialism,'* in *THE CORPORATION IN MODERN SOCIETY* 10 (E. Mason ed., Harvard Univ. Press, 1959).

30. Friedman stated in his famous article that the only social responsibility of managers was to increase profits for stockholders. Interestingly, Friedman allows the possibility that stockholders as citizens might have social values and interests, but appears to hold that as stockholders they must only have an interest in firm profits. Indeed, the article specifies the firm's profits, not the well-being of shareholders. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970. In addition, Friedrich von Hayak's classic attack on state planning appeared much earlier, in his 1944 *The Road to Serfdom*, but would be revived in the 1970s and 80s by anti-government conservatives. F. A. HAYAK, *THE ROAD TO SERFDOM* (Univ. of Chicago 1944).

Property rights theorists took inspiration from the writings of British-born economist Ronald Coase. A few years after Berle and Means published their book, Coase wrote what at the time was a little noticed article on the nature of the firm. He recognized that production in modern economies was coordinated by administrative means³¹ and the reason, he concluded, had to do with the cost of transactions. Where transactions costs were high, firms arose. Behind transactions costs, Coase argued, lay the costs of establishing relationships between different factors of production, mostly attributable to the difficulties of forming contracts.³² Firms emerged as a set of ordered, legally-bound relationships between entrepreneurs and workers that were much easier to effectuate than multiple, arms-length contracts. Gradually the contractual view would be applied to the relationship between owners, or the suppliers of capital, and managers. Any deviation from this strict contractual relationship was soon seen as inefficient, or worse.

It actually fell to legal scholars rather than economists to bring Coase's insights to bear on the financial relationships of the modern corporation. A young law professor at St. Louis University with an undergraduate background in economics, Henry Manne, focused on the potential for conflicts between the interests of shareholders and managers.³³ Ironically, Manne was attempting to refute what he took as the primary charges of *The Modern Corporation*: excessive managerial compensation, growing monopoly power, and frustration of shareholders' democratic rights to vote their shares. But his larger point was the need to apply modern economic theory to the legal and contractual issues that Berle and Means had first identified. Manne excised any discussion of power, wealth, or their distribution that did not fit into the question of "the production and allocation of scarce goods, services, and capital."³⁴

Economists influenced by Coase soon filled out Manne's agenda, starting with the position that the firm was a collection of more or less

31. Since Coase took the firm to be directed by the owner-entrepreneur, he was not primarily interested in financial relations or even the role of managers.

32. Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386, 391–92, 401–04 (1937).

33. Henry G. Manne, *The "Higher Criticism" of the Modern Corporation*, 62 *COLUM. L. REV.* 399, 399–400 (1962). Eugene Rostow in *To Whom and For What Ends Is Corporate Management Responsible*, in Mason, *supra* note 29, at 67, had written that, "The literature of 'managerialism' from Commons and Veblen to Drucker, Burnham, and Berle, suggests no criteria to replace the standards for judging the propriety of wages and prices which the economists have painfully developed during the last century or so." *Id.*

34. Manne, *supra* note 33, at 407, 430–31. One might say that Manne emphasized those aspects of the book most amenable to modern economic analysis and reinterpreted the book's intellectual agenda in a like manner.

efficient contractual arrangements.³⁵ Managers coordinated labor divisions and monitored workers to ensure that they performed as directed. However, managers were also the agents of owners, and as such, needed watching. The watchers were those who owned the firm, or at least those entitled to the firm's residual income.³⁶ Some economists argued that the contractual model could encompass a variety of stakeholders, including labor, consumers, and the public, each of whom might be seen as having an interest in the firm's activities. The narrower version tended to emphasize managers' contractual obligations to shareholders only.³⁷

By the mid 1960s, the part of Berle and Means' argument that focused on managerial behavior and motivation was the only one being discussed. Those devoted to "law and economics" believed that markets structured efficient arrangements between contracting parties. Managers were agents obligated to maximize shareholder value. Principal-agent conflict was theoretically a problem, although many writers, following a long tradition dating back to Gordon, did not believe it was much of an issue in real life. Others, however, were not so sure.

In their seminal 1976 article, financial economists Michael Jensen and William Meckling noted that "[i]t should be no surprise to discover that the issues associated with the 'separation of ownership and control' in the modern diffuse ownership corporation are intimately associated with the general problem of agency."³⁸ Berle and Means' favorite term, "control," now returned to the discussion, but only as what Michael Jensen and Chicago School economist Eugene Fama called "decision control" or ratifying and monitoring the decisions of management. The problem now was not the separation of ownership (and ancient notions of

35. Manne and Rostow had started with the proposition that the firm was a social institution with social responsibilities.

36. The contractual position on the firm is perhaps made most clearly in Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972). They placed emphasis on the manager's role in monitoring and coordinating workers and on the owner's role in policing the managers. The logical corollary of this position, as Alchian and Demsetz spelled out, is that those who direct and manage labor, or more broadly firm inputs, should be paid as or as though he were a residual claimant. Alternatively in large corporations, competitive markets for corporate control and for the shareholders capital might likewise keep managers in line.

37. The shift is discussed well in ALLEN KAUFMAN, L. ZACHARIAS & M. KARSON, *MANAGERS VS. OWNERS: THE STRUGGLE FOR CORPORATE CONTROL IN AMERICAN DEMOCRACY* (Oxford Univ. Press 1995). Manne discusses the connection between his work, the law, and the economics work of Demsetz, Alchian, and others in his essay, Henry G. Manne, *How Law and Economics was Marketed in a Hostile World: A Very Personal History*, in *THE ORIGINS OF LAW AND ECONOMICS: ESSAYS BY THE FOUNDING FATHERS* 309-327 (Francesco Parisi & Charles K. Rowley eds., 2005).

38. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). See also Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980).

property) from control, as termed by Berle and Means. Rather, it was the “[s]eparation and specialization of decision management and residual risk bearing” that created a divergence of interests between agents and residual claimants, which led to “the problem of separation of ownership and control that has long troubled students of the corporation.”³⁹

Converging lines of inquiry had, by the 1970s, substantially redefined concepts such as firm, ownership, property, and production, away from the perspective available at the time of Berle and Means’ original writing. Now, production was reduced largely to a division of labor overseen by managers and the firm became a set of contracts with incentives for performance. Managers were the overseers of the work done by the firm’s division of labor and owners were those with a contractual right to residual income who monitored the managers. A whole spate of issues connected to power, social responsibility, and democracy that had been central to Berle and Means faded away.⁴⁰ The corporation problem was a technical matter of writing contracts, aligning interests, and giving residual claimants the authority they needed to keep the firm on the straight and narrow path of maximizing shareholder value.

By 1980, Berle and Means’ book stood on its head. *The Modern Corporation* sought to explain the rise of the managerial corporation and warn about its dangers. Pro-management writers of the 1950s and 1960s found ways to justify the managerial corporation and celebrate its advantages. However, critics of managerialism, such as Michael Jensen, believed corporations should not exist at all in well-functioning market economies. If firms simply “disgorged” their retained earnings to the owners, then the owners would make wiser investments than the professional managers. In the late 1980s, Jensen wrote that the long established public corporation was in eclipse because new institutions, without public shareholders, would be better able to “designate agents to manage and monitor on their behalf and bind those agents with large equity interests and contracts governing the distribution of cash.”⁴¹ America could finally return to the days when owners were active managers, the days

39. Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 301–04, 308 (1983).

40. Ownership in any sense of possessing property disappeared, and entrepreneurship became simply management and risk bearing. As Alchian and Demsetz explained in *Production, Information Costs, and Economic Organization*: “Instead of thinking of shareholders as joint owners we can think of them as investors, like bondholders, except that the stockholders are more optimistic [i.e. less risk averse] than bondholders about the enterprise prospects.” Alchian & Demsetz, *supra* note 36, at 789.

41. Michael C. Jensen, *The Eclipse of the Public Corporation*, 89 HARV. BUS. REV. 61–74 (1989). On Jensen’s view of the dire macroeconomic consequences of the behavior of corporate agents, see also Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. FIN. 831 (1993).

presumably before the phenomena identified by Berle and Means had arisen.

But not everyone was prepared to go this far. Indeed, business historians studying the evolution of modern enterprise argued exactly the opposite of Jensen, that the modern corporation was a salutary development. Still, business historians built their defense on their own particular reading of Berle and Means' text, a text they rarely cited. In fact, in business historian Alfred Chandler's two mammoth volumes, *The Visible Hand* and *Scale and Scope*, there is just one reference to Berle and Means, and that is in a list of economists who studied the firm. Yet, Chandler and those who followed him took the managerial reading of Berle and Means' work as central to their understanding of how the managerial corporation arose and came to dominate many sectors of the economy by the 1920s. This reading, quite like that of the agency theorists, rested squarely on the notion that the modern corporation was defined by the separation of owners from managers. In *The Visible Hand*, Chandler wrote, "As the multiunit business enterprise grew in size and diversity and as its managers became more professional, the management of the enterprise became separated from its ownership."⁴² Rather than seeing managers diverging from the interests of owners, Chandlerians argued that Berle and Means had identified the starting point of a more efficient and productive managerial capitalism. Dispersed owners lacked the skills, knowledge, and patience to guide a modern firm. Berle and Means were right about corporate structure and governance, business historians concluded, but wrong in failing to see the modern corporation as the most productive engine capitalism had ever known.⁴³

Both skeptical financial economists and pro-managerial business historians reduced Berle and Means' complex book to one issue—the implications of professional managers running corporations of which they were not owners. As we shall now see, that message is a stripped

42. ALFRED D. CHANDLER, JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* 9 (Belknap Press 1977).

43. *Id.* at 5; ALFRED D. CHANDLER, JR., *SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM* 248–49 (Belknap Press 1990). William Lazonick and Mary O'Sullivan also claim that for most of the 20th century stockholders exerted little control, and assume stockholders were dispersed. William Lazonick & Mary O'Sullivan, *Finance and Industrial Development: Part I: The United States and the United Kingdom*, 4 FIN. HIST. REV. 7 (1997); William Lazonick, *Financial Commitment and Economic Performance: Ownership and Control in the American Industrial Corporation*, 17 BUS. & ECON. HIST. 115 (1988). A wide variety of works in business history continue to follow the assumption that ownership and control had separated and control was in the hands of managers earlier in the United States than elsewhere. See, e.g., H. THOMAS JOHNSON & ROBERT KAPLAN, *RELEVANCE LOST: THE RISE AND FALL OF MANAGEMENT ACCOUNTING* 94 (Harvard Business School Press 1987); Jeffrey Fear & Christopher Kobrak, *Divergent Paths: Accounting for Corporate Governance in America and Germany*, 80 BUS. HIST. REV. 1 (2006).

down version of what Berle and Means really wrote, which was about the separation of ownership from *control*.⁴⁴ It was the control problem that motivated Berle, Means, and others who first studied the large scale corporation, and this control carried with it questions of social responsibility.

PEELING THE INTERPRETIVE ONION

One less noted aspect in the intellectual legacy of *The Modern Corporation* is how scant the evidence was for principal-agent problems. Studies found few examples of corporations resorting to internal finance to escape capital market discipline.⁴⁵ Even as early as 1945, the business journal *Fortune Magazine* concluded, “It is clear that the idea of absentee ownership as usually interpreted is largely a fiction.”⁴⁶ Perhaps this was because, as several close readers of *The Modern Corporation* discovered, little of the book actually addressed such conflict. Chicago school luminary George Stigler was puzzled by the text’s “peculiar” emphasis on changing legal boundaries of permissible corporate behavior, and he criticized Berle and Means for failing to address the “problems posed by the employment of agents” and “[t]he actual incentives and behavior of corporate officials.”⁴⁷ Stigler concluded, “The actual effects of the separation of ownership and control are left undetermined and even unstudied.”⁴⁸

It was not only critics from the right, such as Stigler, who had trouble with Berle and Means’ book. Marxian economist Paul Sweezy

44. It is clear from a reading of the original reviews that readers in the 1930s understood Berle and Means to be discussing the separation of ownership from control, and not providing a critique of the behavior of non-owner managers. Stigler provided a table of quotations from contemporaries, lawyers in particular, who gave the book a strong favorable review. Each of those reviewers commented on how Berle and Means had demonstrated the dangers resulting from the divorce of ownership from control, not management from ownership. See George J. Stigler & Claire Friedland, *The Literature of Economics: The Case of Berle and Means*, 26 J.L. & ECON. 237 (1983); Thomas K. McCraw, *In Retrospect: Berle and Means*, 18 REVS. AM. HIST. 578 (1990).

45. John Lintner, *The Financing of Corporations*, in *THE CORPORATION IN MODERN SOCIETY* 166–201 (Mason, ed., 1959).

46. ROBERT AARON GORDON, *BUSINESS LEADERSHIP IN THE LARGE CORPORATION* 44 (Brookings Institution 1945) (quoting *Fortune Magazine*).

47. Stigler & Friedland, *supra* note 44, at 240. Manne commented that the “least satisfying part of Berle and Means’ book was the discussion of the return of profits to the shareholders by managers. Manne, *supra* note 33, at 402.

48. Stigler & Friedland, *supra* note 44, at 238–39, 240. For another skeptical view of the empirical relationship between separation and poor performance, see Harold Demsetz & Kenneth Lehn, *The Structure of Corporate Ownership: Causes and Consequences*, 93 J. POL. ECON. 1155 (1985). The law and economics approach, which Stigler embraced in this article, assumed that markets would allow “contracting parties to minimize agency costs,” something that later agency theories were much less sure of. See Douglass C. North, *Comment on Stigler and Friedland: “The Literature of Economics: The Case of Berle and Means,”* 26 J.L. & ECON. 293 (1983).

dismissed the notion that a new class of professional managers was now in charge of capitalism.⁴⁹ Power still rested in the hands of property owners, he asserted. Sociologist Maurice Zeitlin's 1974 critique came to the same conclusion. Like the old leftist Sweezy, the new leftist Zeitlin was skeptical of claims that professional managers, rather than a capitalist class, ran things in America.

Critics from both the right and left drew from the same well of evidence in their disagreement with Berle and Means. The critics used a study conducted for the Temporary National Economic Committee by Raymond Goldsmith, which appeared at roughly the same time as Berle and Means' book but came to rather different conclusions.⁵⁰ Goldsmith found considerable ownership concentration and surprising resilience of family capitalism in the American corporate sector of the 1930s. Only 44% of firms fit Berle and Means' own definition of managerial control, while some 32% were privately owned, controlled by a majority of shareholders, or controlled through such devices as pyramids and voting trusts.⁵¹ There were also evidentiary problems with claims that managers lacked proper motivation to maximize profits. Sweezy may have been the first to point out that it was not the percentage of a firm's stock held by managers that mattered, but it was the value of that stock in managers' personal portfolios that determined their motivation.⁵² By this measure, a significant amount of executive wealth, if not annual compensation, was held in the stock of the firms they managed.⁵³

More recent work tends to show that separation of ownership from control was neither as rapid nor as thorough as conventional readings of Berle and Means text assume. Business historian Leslie Hannah demonstrated that the dispersal of corporate shares in the United States was limited compared to other nations in 1900. Far from being at the forefront of modern corporate finance, the New York Stock Exchange lagged behind its peers in Britain, France, and elsewhere. Many of the largest American corporations did not list their shares in New York, and al-

49. Paul Sweezy, *The Illusion of the 'Managerial Revolution,'* 6 SCIENCE AND SOCIETY (1942), reprinted in PAUL SWEEZY, *THE PRESENT AS HISTORY* 39-66 (Monthly Review Press 1953).

50. The TNEC study caused Robert Gordon to hedge his own interpretation, noting that there was still some evidence that managers had significant financial stakes in the firms they managed.

51. Stigler & Friedland, *supra* note 44, at 247.

52. Sweezy, *supra* note 49, at 45.

53. Gordon, in *Business Leadership in the Large Corporation*, notes that executive compensation averaged \$35,000 in 1936, but that contrary to popular belief, "it is not correct to assume that executives have little or no ownership stake, in dollar terms, in their companies." GORDON, *supra* note 46, at 280. Indeed, he finds that in 46 of 116 firms, executives held more than \$1 million in their firms and median value holdings were nearly \$300,000, or a substantial multiple of their annual compensation. *Id.* at 299, 302. At least to a quarter of industrial executives stock is "a very important element among financial incentives available to them." *Id.* at 303.

though some used regional exchanges, even taken together, the United States stock markets listed fewer shares than did the markets of other industrial nations.⁵⁴ Hannah's work undercut claims that big American corporations were at the forefront of the financial innovations that would lead to a dispersal of ownership. It was possible to have managerial capitalism and still have owners in control of big firms.

One reason that owners could maintain substantial control in the United States, as historian Colleen Dunlavy points out, is that unlike in many European nations, American corporate law had moved decisively to "plutocratic" ownership. That is, one share of stock entitled the owner to one vote in corporate governance; one thousand shares yielded one thousand votes, and so on without limit. Elsewhere in the industrial world, corporate ownership was more democratic, meaning that above a certain level more shares did not increase one's voting power, or at least did not increase it proportionally. Therefore, American corporate law gave owners the ability to accumulate substantial power within the corporation.⁵⁵

Thus, contrary to the progressive view offered by Alfred Chandler, whereby America leapt to the forefront of managerial capitalism, or the counter-argument declension thesis offered by Michael Jensen, in which America's broad dispersal of stock gave managers too much discretion, through 1945 at least corporate ownership in America remained closely concentrated by late twentieth century standards, and families continued to exert substantial control.

Let us take AT&T, Berle and Means' favorite example. As we have seen, the total number of stockholders increased substantially to some 450,000 in 1929, a dispersal that fits with Berle and Means' argument. There was just one problem: AT&T was the exception, not the rule among large American corporations. Only one other American firm had 400,000 shareholders, the utility holding company Cities Services. After that the numbers fall fast. Middle West Utilities had 296,389 stockholders, the Pennsylvania Railroad 196,119. Only ten corporations in all had more than 100,000 stockholders, and six of these were utilities or railroads, not the manufacturing firms usually seen as the progenitors of managerial capitalism.

Of course, one hundred thousand shareholders is still substantial, but looking down the list of the 200 largest corporations in the United

54. Leslie Hannah, *The 'Divorce' of Ownership from Control from 1900 Onwards: Recalibrating Imagined Global Trends*, 49 *BUS. HIST.* 404 (2007).

55. Colleen Dunlavy, *From Citizens to Plutocrats: Nineteenth-Century Shareholder Voting Rights and Theories of the Corporation*, in *CONSTRUCTING CORPORATE AMERICA: HISTORY, POLITICS, CULTURE* 66–93 (Kenneth Lipartito & David Sicilia eds., 2004).

States circa 1930, the number of shareholders drops off rapidly. Among the top fifty firms ranked by assets, the average number of shareholders in 1930 was 65,000. (See Table 1.) For industrial firms, it was substantially lower at 41,000. Ranking the 200 largest firms by number of shareholders rather than assets allows us to see that the median number of shareholders in large American firms was even smaller than the average. Shareholder data is not available for all of the largest 200 firms, and some of the most significant American corporations, such as Ford, were family owned (more on that below). But most of those on the list are in the top 100 corporations by assets, and even the smallest, General Asphalt—with \$46 million in assets—was the 250th largest firm in the United States. The average firm by assets on this stockholder-ranked list is \$445 million, which would place it 55 or 56 on the company size chart. Certainly, the list includes the larger corporations in the nation.

Using the median figure reduces the weight of the small number of firms with a very large number of shareholders, yielding a more accurate picture of how many firms had a strong separation of ownership and control. The median number of shareholders for the top 100 firms is 36,000, and for the industrials it is 30,000. For all 74 industrials on the list, the median is 21,000, and for the entire list of 150 corporations, the median number drops to 19,000. The firms with available shareholder numbers were substantially larger than those which were not, \$445 million in assets versus \$117 million, suggesting that even these shareholder figures are the upper bound on dispersal in the United States. Asset size alone, however, did not determine shareholder number as some large firms like the Reading Company and Erie Railroad had less than 10,000 shareholders. In general, larger firms had more shareholders, as one would expect with the greater need for capital. Even so, the numbers of shareholders they had were modest by modern comparisons or in comparison with the few exceptional cases, such as AT&T.

Therefore, contrary to our image of widely dispersed ownership, most corporations, even fairly large ones, had only about one-tenth, or in many cases, one-twentieth the number of shareholders as AT&T did at the time of Berle and Means' writing. A few prominent industrials, such as General Motors, appear to have been well dispersed.⁵⁶ A more refined

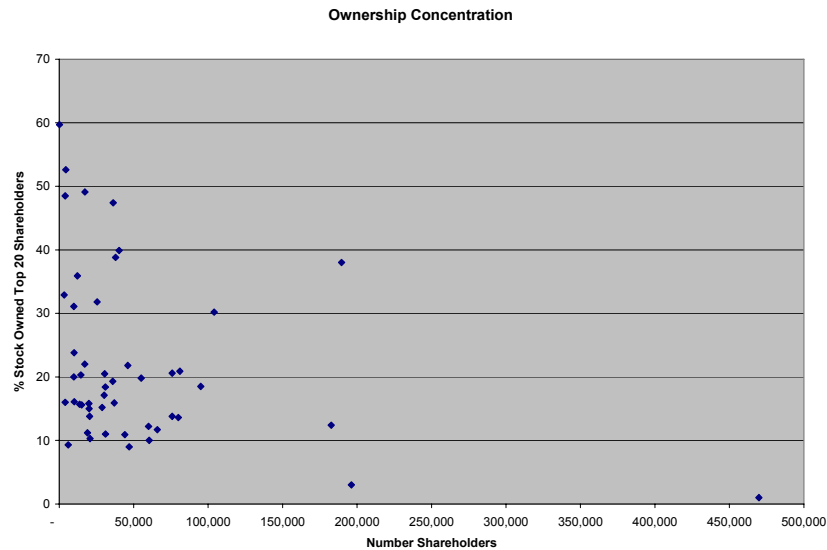
56. GM, Ford, and DuPont had a small number of large owners who were members of the same family. Family control was at quite the opposite end of the scale from highly dispersed public ownership of shares. DuPont retained a strong family presence even though it innovated modern managerial practices, such as decentralization, practices thought to be closely connected to the separation of ownership and control. As economist Randall Morck noted, even today in many capitalist nations family control and pyramid structures remain common ways of concentrating ownership. Randall Morck, Daniel Wolfenzon & Bernard Yeung, *Corporate Governance, Economic Entrenchment and Growth*, 43 J. ECON. LITERATURE 655, 655 (2005).

portrait suggests that one block of corporations had between 10,000 and 50,000 shareholders, and another group had less than 10,000 shareholders.⁵⁷

How significant are these numbers? Some firms, not surprisingly AT&T and the Pennsylvania Railroad, had successfully ended any threat from large shareholders by placing their shares broadly among the public. Others, such as R. J. Reynolds and Deere, were clearly controlled by a small group of large shareholders. And still other firms that we might think of being widely held, such as Standard Oil and DuPont, remained in the hands of an inside group. As Table 2 shows, concentration was quite substantial, with a median level of ownership among the top 20 shareholders of 18.5%. In firms with less than 50,000 shareholders—the large majority of big corporations—the top 20 shareholders owned at least 10% of the stock, and upward of 50%, with the average at 25%.⁵⁸

57. Although more Americans owned stocks in the 1920s than ever before, Gardiner Means retorted that this did not indicate a shift in the ownership structure of the corporation, for lots of little stockholders possessed tiny fractions of stock that did little to shift control out of the hands of the few. Gardiner C. Means, *The Diffusion of Stock Ownership in the United States*, 44 Q. J. ECON. 561 (1930).

58. These figures are consistent with those calculated from the same data by Robert Gordon, who largely interpreted them to mean a lack of concentration. But Gordon also noted that the use of pyramids and holding companies concentrated ownership even more than these figures suggest. As he put it succinctly, “large scale intercorporate ownership is not an indication of an association of ‘control’ and ownership It is rather a means of reducing the ownership needed for control by groups of individuals.” GORDON, *supra* note 46, at 37.



A broader measure of concentration shows a similar pattern of concentration greater than one would expect if the separation of ownership from control had taken place by 1929. If we take the 250 largest corporations (by assets) and examine shareholders owning more than 5,000 shares, we see that even for firms widely held, a few dozen to a few hundred people or institutions could control between 25–40% of the outstanding common stock (*see* Table 3). The average is 77 shareholders owning 42% of the common stock.⁵⁹ Overall, 48% of American corporate stock was held by the 0.25% of shareholders who had more than 5,000 shares.⁶⁰

At the very moment that Berle and Means were claiming the era of the stockholder had passed, 45% of the nation's largest corporations had substantial ownership among their 20 largest shareholders. In fact, if we are a bit more generous with our definition of ownership control and set it at 10% of common stock, then the 20 largest stockholders owned at least 10% of the stock in 78% of the nation's largest companies in the early 1930s.⁶¹ Distribution of ownership varied rather substantially over

59. Goldsmith's study revealed that the top 20 shareholders controlled 50% of the stock in one quarter of the largest 200 corporations, and between 25–50% in another 20%. RAYMOND W. GOLDSMITH, ET AL., *THE DISTRIBUTION OF OWNERSHIP IN THE 200 LARGEST NON FINANCIAL CORPORATIONS*, at Temporary National Economic Committee Monograph No. 29 (1940). It was this study that Stigler used to refute some of Berle and Means' contentions.

60. *Id.* at 36.

61. *Id.* at 81. Robert Gordon used the same data, but in the end still concluded that ownership and control had separated. Gordon also used other data from the SEC on new stock issues, and

the largest corporations, so Berle and Means were not totally wrong by emphasizing wide dispersal of corporate stock. In some, but very few cases (3 of 208 for which we have data), the single largest owner had less than 1% of the stock. But, in a far higher number (32 of 208), the single largest owner had half or more.⁶² Looking backward from today when managerial control is more common, one could argue that the early decades of the twentieth century were an era of strong owner control, rather than the start of an era of dispersed ownership and weak owners.⁶³

Finally, a significant number of large American corporations remained closely held, or even family enterprises, where control could be exercised by a small number of owners. Family business and traditional close corporations were, in the literature emphasizing the rise of corporate capitalism, the legacies of the past that progressive American firms had abandoned. As Goldsmith showed, a handful of families, notably the Du Ponts, Mellons, and Rockefellers, controlled among them 15 of the largest 200 corporations.⁶⁴ Other, less famous families had substantial minority holdings in a number of significant firms.⁶⁵ Family members who owned as little as 5% of a company's stock remained heavily represented on the boards of firms.⁶⁶ Goldsmith reckoned that in 40% of the largest 200 firms a family or small number of families had either ab-

found that the largest 20 shareholders took 23% of the stock issued. GORDON, *supra* note 46, at 32–33.

62. *Id.* at 91. Like Berle and Means, Goldsmith was uncertain when control passed from owners to managers, though he set a reasonable figure of at least 30% ownership, and in some cases as little as 10% ownership as giving an owner significant power. It depended, of course, on how many owners had significant minority stakes like this.

63. *The Modern Corporation and Private Property* rests on the proposition that if 40% of a firm's stock was closely held, then it was owner controlled, although sometimes Berle and Means lowered this percentage to 20% if a small number of shareholders were involved. But as Zeitlin pointed out, Berle and Means “merely assumed, rather than demonstrated, that once a cohesive ownership interest having at least a minimum specified portion of the stock disappears,” then the corporation “slips imperceptibly and inevitably under ‘management control.’” Maurice Zeitlin, *Corporate Ownership and Control: The Large Corporation and the Capitalist Class*, 79 AM. J. SOC. 1073, 1090 (1974). For a related critique see Stigler & Friedland, *supra* note 44, at 247.

64. The DuPont's owned 38.5% of DuPont, 20% of General Motors, and 11.5% of U.S. Rubber. The Mellons owned 29% of Aluminum Company of America, 42% of Koppers, 70% of Gulf Oil, and 10% of Pullman. GOLDSMITH, ET AL., *supra* note 59.

65. *Id.* at 117–19, 124. The Harkness family had 2.13% of the stock of Socony Vacuum Oil, 3.44% of Standard Oil of California, 2.92% of Standard of Indiana, and 4.3% of Standard of New Jersey (but only 0.19% of AT&T). *Id.*

66. *Id.* at 113. A popular version of this was put forth in a book by Ferdinand Lundberg published soon after *The Modern Corporation*, which argued that a handful of families really ran the large corporations. Though overstated, Lundberg's thesis fit well with the Goldsmith study and the anti-monopoly tradition that was part of the New Deal era. See FERDINAND LUNDBERG, AMERICA'S SIXTY FAMILIES (Vanguard Press 1937).

solute or effective working control, and in another 30% of firms, control was exercised by another corporation.⁶⁷

Were Berle and Means then simply alarmist in their charges against the modern corporation? No. The figures only call into question the claim that stock dispersal was key to placing power in the hands of non-owners. The figures also highlight the difference between ownership and management and ownership and control. Large corporations could be managed by professionals who owned little or no stock, even when the corporate stock was closely held. But Berle and Means' main focus was not management but control, a concept pushed to the margins by later writers. Therefore, the evidence on the limited extent of dispersal and the high degree of concentration only undercuts the later readings of *The Modern Corporation and Private Property* that highlighted stock dispersal and the professional managers' rise as agents of shareholders.

The data supports the aspects of Berle and Means' text that have largely been ignored by financial economists and later interpreters. *The Modern Corporation and Private Property* argued that control of a corporation could be achieved in a variety of ways, without necessarily distributing the corporate stock widely among the public. At one extreme, families could retain control of firms, even while gaining access to capital markets for growth and installing professionals to manage the firm. At the other end were corporations, such as AT&T, with wide public ownership of stock. Most large corporations fell between these poles. Dispersed stockholding was merely a special case of a more general problem of control and the modern corporation.⁶⁸

67. GOLDSMITH, ET AL., *supra* note 59, at 36. As recent scholarship on family ownership argues, "What is crucial is the extent to which a family is able to mold company decisions through personal influence on leadership succession, sometimes unfettered by any formal institutional regulation of governance." Andrea Colli, Paloma Fernandez Perez & Mary B. Rose, *National Determinants of Family Firm Development? Family Firms in Britain, Spain, and Italy in the Nineteenth and Twentieth Centuries*, 4 ENTERPRISE & SOC'Y 28–64, 31 (2003); JEFFREY FEAR, ORGANIZING CONTROL: AUGUST THYSSEN AND THE CONSTRUCTION OF GERMAN CORPORATE MANAGEMENT 25 (2005), notes that Chandler in *The Visible Hand* privileged the "site" of control—family, entrepreneur, manager. Chandler did not investigate how control is exercised, how decisions are actually made.

68. One could still argue that in those cases where a few hundred shareholders owned no more than 15% or 20% of a firm's stock, owners were indeed weak and managers ran the show. But consider that Clarence Mackay pressed his claim for greater control with only 5% of AT&T's outstanding stock. True, AT&T fended him off, but it already had one of the most dispersed patterns of stock ownership, and it would move to still higher levels of dispersal following the Mackay incident. Morck, Wolfenzon, & Yeung, in *Corporate Governance*, point out that typically literature finds that much less than 50% ownership is needed to effect control. *Supra* note 56, at 6. Indeed 20% or even 10% is sufficient, and the majority of corporations in many countries have owners with 10–20% stakes, even in advanced industrial nations. The average seems to be about 36% of firms worldwide can be considered widely held, with the percentages much higher in the U.S. and U.K.

BACK TO CONTROL, AND THE TEXT

Instead of projecting forward and seeing Berle and Means as anticipating the future of corporate finance, let us look back to the times in which they wrote. Even before their work appeared, others had commented on the growth of corporations and the fading of individual owners. One of the most important predecessor works, as Berle and Means acknowledged, was William Z. Ripley's widely read 1928 exposé, *Main Street and Wall Street*. Ripley began with corporate governance rather than ownership, but by governance Ripley meant something different from what it means today. He looked to the great legal commentator Blackstone, who wrote that the corporation was best seen as a "little republic."⁶⁹ Berle, in his 1920s legal writings, took a similar position. Like Ripley, Berle saw corporations as voluntary associations with mutual obligations, rights, and duties between members and the community.⁷⁰ New financial devices, such as non-voting stock, trusteeships, and most of all, no par value stock, disrupted these mutual obligations and interests and fostered inequality in the republic of the corporation. Ripley and Berle emphasized a variety of financial and legal devices that contributed to this inequality, and wide dispersal of shares was one among several.⁷¹

No par stock came in for a special drubbing by Ripley and Berle. When the law required stock to carry a par value, it contemplated investors as equals, contributing their capital to the collective enterprise they would own and operate as a group (the "little republic"). The move to no par issues, though seemingly just a minor technical matter, actually indicated a substantial shift in the conception of the corporation. Now "owners" were not capitalists risking their capital, but simply, as Ripley put it, claimants to "a certain aliquot part of the net value of the enterprise."⁷² There was no longer a presumption that governance and control went hand-in-hand with property ownership. Berle railed at length at no-par stock. If the corporation could issue shares for no paid-in cash, then

69. WILLIAM Z. RIPLEY, *MAIN STREET AND WALL STREET* 74 (1926). Ripley and Berle were part of a generation of American social and economic thinkers who had rejected the strictures of nineteenth century laissez faire economics and took a social rather than individualistic view of property. See DANIEL T. RODGERS, *ATLANTIC CROSSINGS: SOCIAL POLITICS IN A PROGRESSIVE AGE* 100 (1998).

70. Berle had a weakness for seeing a more organic society in the past. As Isaiah Berlin observed, he had "a nostalgia for preindustrial civilization and the Middle Ages . . ." JORDAN A. SCHWARTZ, *LIBERAL: ADOLF BERLE AND THE VISION OF AN AMERICAN ERA* 180 (1987).

71. RIPLEY, *supra* note 69, at 76–77, 85, 121.

72. *Id.* at 46. The use of the legal term "aliquot" was itself telling, for it means a definite fraction of the estate of a deceased. The sense of definite portion, rather than speculative profit and the link to the dividing up of a static estate are both meant to suggest the passive role of the shareholder with respect to firm income earning potential.

it had virtually limitless power to alter the capital structure in ways that rewarded some owners at the expense of others.⁷³

Here was the crux of the matter, for it was not so much the efficiency implications as the social issues that bothered Berle and Ripley. Letting the financially clever manipulate the corporate structure in their favor undermined the moral basis of capitalism. New financial structures, Ripley argued, led to “the growing dissociation of ownership of property from responsibility for the manner in which it shall be put to use.”⁷⁴ Following Louis Brandeis, he held that there was “no innocent shareholder.”⁷⁵ Shareholders as owners should take a responsibility for their property in a manner similar to that expected of owners of any business. All property owners had obligations to refrain from harming others and for acting in a manner consistent with social, moral, and community values. Once shareholders were rendered passive, however, they were disconnected from these obligations. With their property managed by others hidden behind the corporate veil, all sorts of evil could be worked without shareholder knowledge or consent.⁷⁶ The corporation ceased to be a morally accountable entity.

Lack of transparency and information were part of the problem, and both Ripley and Berle endorsed Brandeis’s injunction that sunshine was the best disinfectant.⁷⁷ But good information did more than give shareholders the means to pursue their pecuniary interests—it let shareholders see what corporations were doing in their names. Brandeis, Berle, and Ripley assumed that informed shareholders would not simply demand a bigger piece of the pie; they would demand moral accountability and ethical behavior of “their” property, once it was theirs again. It was precisely this connection between moral accountability and property that the modern corporation severed. If it could not be restored, these progressive thinkers feared that unchecked power would inevitably spill over into the political system. Just as the little republic of the corporate association had been corrupted by powerful insiders, so too would the big republic be imperiled by the wealthy and powerful few—no par stock given away for political favors or whatever else the insiders deemed to be in their interest.

73. ADOLF BERLE, *STUDIES IN THE LAW OF CORPORATION FINANCE* 64–91 (Callaghan & Co. 1928). There is a tendency here to disregard the secondary market for shares, which would tend to mitigate the diluting effects of new shares issued.

74. RIPLEY, *supra* note 69, at 116.

75. *Id.* at 79.

76. *Id.* at 67–68. Berle backed Ripley and Wilson on this point. BERLE, *supra* note 73, at 46–50, 179, 182–83.

77. The latter chapters of *The Modern Corporation* discuss the value of disclosure and equal access to information in some detail.

Power was all of a piece for thinkers like Berle, Brandeis, and Ripley. They saw intimate connections between the corporation's financial power to exploit the passive shareholder, its monopoly power to exploit the consumer, and its political power to corrupt government. Where a contemporary economist would compartmentalize these issues, dividing principal-agent conflicts from monopoly and monopsony power, Berle and Means followed the tradition of treating power as unitary and lumped them together. All were manifestations of the same danger—a new class of corporate potentates wielding power that had not been rendered legitimate by the rights of property.⁷⁸

The Modern Corporation is best seen as part of a tradition stretching back to the progressive and populist critiques of the growing concentration of wealth and power in America. Indeed, wealth, power, and corporate social irresponsibility were the issues highlighted in most early reviews of Berle and Means' book.⁷⁹ The problem was not just who claimed the firms' residual earnings, but who made fundamental decisions about production and distribution, a handful of corporate insiders or the broad class of citizens?

Berle and Means' understanding of the dangers of unchecked corporate power led them to focus on the concept of control, the fundamental power from which the other powers flowed. Owners had an interest in the firm and managers made decisions, but the "control" had final authority, particularly the authority to select (or act as) managers. Control served better than power to explain what happened inside the corporation. Power was scalar and relative. Control was final. It was the absoluteness of control that was the root problem, even if control was achieved with but a slight balance of power. "Control," explained Means in another work, "should commonly be applied only to the major powers over an enterprise, just as ownership and management are usually applied only to the major interests and acts."⁸⁰ Not surprisingly then, in some cases, "managers" still owned substantial stakes in the firm, while in other cases they did not. Management was an artifact of control, however control was achieved.⁸¹ It made little difference whether one gained

78. Given that the guiding intellectual spirit of the project, Adolf Berle, was a lawyer, this emphasis on legal legitimacy and property is not surprising. In a deft reading of Berle and Means, McCraw notes the centrality of power, though he incorrectly states that it was only monopoly power that they were worried about. McCraw, *supra* note 44, at 582–84.

79. McCraw, *supra* note 44, at 579.

80. Gardiner C. Means, *The Separation of Ownership and Control in American Industry*, 46:1 Q.J. ECON. 68, 70 (1931).

81. *Id.* at 68–100.

control through majority ownership, minority ownership, by a clever legal strategy, or simply by holding a management position.⁸²

Following this way of thinking about how control was achieved, then “managerial discretion” was not necessarily a problem and forms of compensation mattered little. Indeed, Berle had written earlier that managers should “have wide discretion in conducting the business affairs of the corporation.”⁸³ In *The Modern Corporation and Private Property*, Berle and Means endorsed independent managerial judgment as well. “No better principle in carrying out business,” they wrote, “has yet been worked out than to find able men and give them the completest latitude possible in handling the enterprise.”⁸⁴ To the extent that professionals brought expertise (what Berle called “technical powers”) to bear on corporate matters, economists Frank Taussig and W. S. Baker noted that in America the long-followed principle was that the rewards of management were wages, while profits rightly belonged to the owners.⁸⁵ In Europe, by contrast, compensation was commonly linked to earnings, the *tantieme* system popular in France and elsewhere.⁸⁶ It was in fact Berle and Means’ insight to recognize that trouble began precisely when management, or more precisely the control group, used its position to enhance its rewards. The control group could take extra profit at the expense of other shareholders, exploit insider knowledge, and make sweetheart deals. Compensation beyond a salary for professional expertise was the first sign that something had gone wrong in a corporation and was not a method for linking managers’ interests to those of owners.

The conflict that Berle and Means emphasized was not between managers and owners, but between owners and owners. In one corner were the significant minority shareholders (the tiny percentage owning over 5,000 shares); in the other, the prototypical small shareholder.⁸⁷ It

82. *Id.* at 72.

83. BERLE, *supra* note 73, at v-vi. For more on Berle’s distinction between this dangerous property rights power and his acceptance of managerial discretion over policy and technical matters, see BERLE, *supra* note 74, at 29.

84. A. A. Berle, Jr. & Gardiner C. Means, *Corporations and the Public Investor*, 20 AM. ECON. REV. 60 (1930).

85. On Berle’s use of term “technical powers” of management, see BERLE, *supra* note 73, at 28–29.

86. F. W. Taussig & W. S. Barker, *American Corporations and Their Executives: A Statistical Inquiry*, 40 Q.J. ECON. 1 (1925). Taussig and Barker also found executive ownership decline was not directly related to firm size, and that there were plenty of cases where managers were substantial owners. They noted that “the functions of ownership and management are combined in all sorts of ways, and may not be combined at all.” *Id.* at 18. They also noted that in more than half their cases, executives were related or closely connected to others who owned stock in their firms.

87. McCraw points out that control can take many forms, including large shareholders. McCraw, *supra* note 44, at 585–86. He points out correctly that “Berle and Means saw the problem more as an injustice wrought by one group of stockholders against another.” *Id.*

was not the large shareholder who was excluded from management, only the small shareholder.⁸⁸ As Berle observed in his earlier writings, “control of American corporations by holders of a minority of the capital stock is no novelty to business men or lawyers.”⁸⁹ “A compact minority,” he wrote, “will settle both the personnel and the policy of management.”⁹⁰ Even more significant, though, was the control group’s “power over private property.”⁹¹ Although “technical power” over management decisions was fine as far as Berle was concerned, the control group “sought and secured a new type of power . . . to determine and adjudicate property rights between the participants in the corporate entity.”⁹² The problem came when “management” not only had business judgment but “power to determine which of the various groups in a corporation shall receive the income” It was not the failure to reward owners adequately that Berle and Means were denouncing, but the distribution of rewards, or the shifting of “the profits of the enterprise and . . . the underlying assets . . . from one group of stockholders to another.”⁹³ Control allowed the insider group to transfer wealth into its hands, regardless of who owned the corporation.⁹⁴

This emphasis on control and property (or control *over* property) helps to explain why very little of Berle and Means’ book speaks about principal-agent conflict. The principal-agent issue appears only in some of the early pages, specifically on page four: “The direction of industry by persons other than those who have ventured their wealth has raised the question of the motive force back of such direction and the effective distribution of the returns from business enterprise.”⁹⁵ The words suggest that lack of proper financial motivation might be a problem, though exactly what problem is unclear. Over the next few pages, Berle and

88. See Zeitlin, *supra* note 66, at 1083; LUNDBERG, *supra* note 66.

89. BERLE, *supra* note 73, at 41–42.

90. *Id.* at 190. Here, too, Berle admitted that this insider power could be wielded by an “entrenched management” or by bankers, but these were merely variants on the theme.

91. *Id.*

92. *Id.* at v–vi. For more on Berle’s distinction between this dangerous property rights power and his acceptance of managerial discretion over policy and technical matters, see *id.* at 29.

93. Berle, Jr. & Means, *supra* note 84, at 65, 71. Because there are so many stockholders and others involved in the modern, large scale corporation, the problem of “intra-corporate rights” loomed large. BERLE, *supra* note 73, at 2.

94. This transfer of wealth had happened, Berle believed, as corporate charters became broad and general. Before the powers, rights and duties of each member of the capital structure had been clearly spelled out. In freeing managers to make business decisions, the states had freed managers of the old set of fiduciary duties to other stockholders. This fit Berle’s point about the decline of private property in its old form.

95. Stigler was again puzzled when he noted that “The problems posed by the employment of agents are . . . ignored,” an observation that would appear to question the usefulness of Berle and Means for later agency theorists. Stigler & Friedland, *supra* note 44, at 240.

Means note that the loss of owner control will lead to inefficiency and underperformance. But what about the other 380 pages of text? A statement on the efficiency and behavioral implications of ownership-management separation never appears again. Leaving aside the statistical presentation, the remainder of the book takes up the issues of control, power, and their social consequences in the corporate age.

Though this seemed strange to later economists such as Stigler, it should now be clear that control and social responsibility were the most important economic issues of Berle and Means' times.⁹⁶ Their lengthy disquisition on corporate law reflected an unease with American legal traditions that gave minority stockholders so little voice. It did not matter, however, if minority owners were being exploited by propertyless managers or by other, somewhat larger "minority" owners. As Berle and Means explained, "The device used for 'control' seems to be immaterial—whether it be voting trust, domination by a stockholder, or possibly even domination by a creditor."⁹⁷ New classes of non-voting stock, no par value stock, and preference shares were all mechanisms for transferring wealth and power to the control group, and they were, astonishingly, perfectly legal. Indeed, the control group could go so far as to take rights from one group of shareholders and give them to others.⁹⁸

Actions by the control group that might look questionable today often passed muster with the courts before the creation of the Securities and Exchange Commission in 1934. "There is . . . a range of neutral activity in which the management of the corporation, without acting adversely to the corporation, may nevertheless benefit itself," Berle and Means noted.⁹⁹ Insider trading that did not reduce the overall value of the firm, favors tendered to selected owners, and corporate cash held in the banks of friends were perfectly legal. Indeed, if the book had little to say about poor managerial decisions reducing shareholder value, it had much to say on value-neutral actions that impoverished one subgroup of owners and enriched another.¹⁰⁰

96. *Id.* at 239–41.

97. ADOLF BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 239–40 (1933). All references to this text are from the first edition.

98. *Id.* at 213–19. Means also discusses control by minority shareholders, though Means notes that it becomes generally impossible when no shareholder owns more than one or two percent. Means, *supra* note 80, at 84. But it is quite possible when that number rises to 14 or 20%. *Id.*

99. BERLE & MEANS, *supra* note 97, at 231.

100. Berle and Means went to considerable length to establish the pervasiveness and dangers of control, but in some of their most telling examples, it was control by a group of shareholders, not by a cadre of propertyless managers. When, for example, William Fox wanted to acquire Loews Theatre, he paid a high price for the shares of a small group of dominant stockholders, simply because that group exercised control. *Id.* at 243–44.

In addition, aggrieved owners who lacked control were largely powerless to stop these redistributions. Sometimes, in fact, pursuit of a remedy was worse than the original grievance: “hazardous in the extreme,” wrote Berle and Means. Their most striking example was the takeover of the New York and Northern Railroad by the New York Central Railroad. Minority shareholders in the acquired railroad complained that Central was diverting traffic onto its own tracks, siphoning off substantial revenue. In response, the New York Central simply allowed the bonds of the New York and Northern Railroad to go into default. The subsequent receivership wiped out the common stock of the New York and Northern, the shareholders’ case, and their property.¹⁰¹ The court’s position, Berle and Means lamented, was that “the interests of the individual may be sacrificed to the economic exigencies of the enterprise as a whole, the interpretation of the board of directors as to what constitutes an economic exigency being practically final.”¹⁰²

Such unchecked power could be wielded by managers in the standard principal-agent manner, but the data on ownership presented above and Berle and Means’ own examples suggest that more often it was a case involving a small group of privileged inside owners running roughshod over smaller and less powerful owners. Berle and Means most often described control as the power to exploit others: the “controlling group” will have “free rein, with the corresponding danger of a corporate oligarchy coupled with the probability of an era of corporate plundering.”¹⁰³ The image they painted was not of managers swilling martinis at lunch while shareholder value plummeted, but rather lambs being sheared.

Recent scholarship has tended to confirm the problems of minority owners in American corporations. Economic historians Naomi Lamoreaux and Jean-Laurent Rosenthal find the “plight” of minority shareholders a grim one in America before World War II, explaining that the courts let the controlling shareholders act as “dictators.”¹⁰⁴ Meanwhile, “minority shareholders only had limited ability to protect themselves

101. *Id.* at 240.

102. *Id.* at 277–78.

103. *Id.* at 355.

104. Naomi R. Lamoreaux & Jean-Laurent Rosenthal, *Corporate Governance and the Plight of Minority Shareholders in the United States Before the Great Depression*, at 4 (Nat’l Bureau of Econ. Research, Working Paper No. 10,900, 2004), available at <http://www.nber.org/papers/w10900>. Writing of an earlier period, Eric Hilt notes, “‘minority control,’ where firms were operated by managers holding stakes that were large enough to make them unaccountable to the other shareholders, was quite common.” Powerful owners, Hilt writes, held sweeping powers to use corporate resources for their own benefit, which is exactly what Berle and Means saw a century later. Eric Hilt, *When Did Ownership Separate from Control? Corporate Governance in the Early Nineteenth Century*, 68 J. ECON. HIST. 679 (2008).

against abuse,” hemmed in by reluctant courts, a strong “business decision” doctrine, and the one vote per share rules that allowed those with even a small concentration of shares to swing elections in their favor.¹⁰⁵

The problem of insider power was not just minority versus majority owners, but rather that a substantial minority clique could obtain control and realize all the benefits of majoritarian power so long as the remaining shareholders were small, weak, and disorganized. Any coalition in a position to appoint the directors also effectively possessed unchecked power. As the great legal scholar James Willard Hurst wrote, in the twentieth century power within the corporation shifted to the “active insiders.” Hurst observed that the same conditions of dispersed ownership that Berle and Means thought signaled the rise of a propertyless managerial class could also give power and control to active minority insiders.¹⁰⁶ This is why Berle and Means could use the same data to show dispersal of ownership that Goldsmith would use to show concentration; both were true. A small number of large, although still technically minority, holders wielded disproportionate power, while most shareholders held only a few shares and remained inactive, with little hope of challenging the control group.

CORPORATE SOCIAL RESPONSIBILITY

In addressing issues of control, power, and distribution inside the modern corporation, Berle and Means examined the social as well as the economic implications of corporate capitalism.¹⁰⁷ Strengthening shareholder rights would not simply allow shareholders to make more money, it would assure that no insider used the corporation to serve his or her own narrow ends. The objective was to prevent plutocrats from controlling the key economic institution of modern capitalism.

Corporate plutocracy was especially worrisome before the New Deal, when it seemed that “the power of corporate management is becoming practically absolute, while social controls upon [it] remain almost embryonic.”¹⁰⁸ Although Berle relented quite a bit on this position after World War II, it was only because he believed that property had

105. *Id.* The protections for those not in control were so weak that American entrepreneurs were motivated to form partnerships, despite extremely liberal incorporation laws. The one effective check on directors’ power came when the corporation took action that went beyond its charter, or in legal terminology, *ultra vires*. Yet as Berle and Means noted, even this limitation was easily overcome.

106. JAMES WILLARD HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780–1970* 70 (1970).

107. BERLE & MEANS, *supra* note 99, at 352. See also Berle & Means, *supra* note 85, at 54–71.

108. BERLE, *supra* note 73, at 25–27.

evolved and that the corporation had indeed become a social institution, checked by a much stronger state.¹⁰⁹ By contrast, the current economists' view turns shareholders into little more than managers of their own portfolio of assets, a far cry from Berle's notion that property carried deep social rights and responsibilities. Whereas modern economists treat corporate social responsibility as a problem, Berle and Means saw it as the solution.

The Modern Corporation ends with a question: should the corporation be made to serve society in the broader sense? The question reflected a lively debate, which had taken place on the pages of the *Harvard Law Review* just before the book's publication. In a 1931 article, Berle attempted to specify rules of equity that would force the corporate control group to act in the interests of all shareholders. Berle's model was the fiduciary trust, and the control group should be constrained by law to act as trustees for the interests of all shareholders. It was just the sort of compromise Berle liked, keeping the corporation private, allowing managers wide latitude on technical matters, but yet protecting classes of stockholders weakly positioned in the corporate structure.¹¹⁰

In a reply to Berle that appeared in the law review the next year, legal scholar E. Merrick Dodd concluded that corporations held so much power over labor and consumers as to be by their mere existence broadly affected with a public interest.¹¹¹ Dodd shifted the emphasis to managers and agents, and away from internal corporate power struggles. He interpreted the problem as "giving stockholders much-needed protection against self-seeking managers" In contrast to later agency theory, however, Dodd assumed that such a narrow definition of corporate purpose could never do because large firms, indeed in some industries even small traditional firms, were simply too caught up with public purposes and interests to be reduced to vehicles for shareholder wealth maximization. Instead, Dodd proposed that "the law is approaching the point of view which will regard all business as affected with a public interest."¹¹² The fiction that corporations were mere private, profit seeking bodies of shareholders should be abandoned in favor of a view that corporations

109. Berle was still bothered by its legitimacy, now that the ownership basis of legitimacy had atrophied. Yet, his hopes for pension funds reflect his efforts to find a property basis for legitimacy.

110. A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931). Even a quick reading shows that Berle was not focused on managers and did not identify the interests of "shareholders" in the abstract, but rather different subgroups and power blocks among shareholders. The phrase "all the shareholders" is telling. It clearly does not mean all in the undifferentiated or collective sense, but all the component parts of a collection. As Berle also points out, his principal would in some ways allow managers even greater autonomy.

111. E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932). See also SCHWARTZ, *supra* note 70, at 43-45.

112. Dodd, *supra* note 111, at 1149.

were real institutions serving a diverse lineup of what today might be called stakeholders. The corporation, Dodd wrote, “once it becomes a going concern, takes its place in a business world with certain ethical standards which appear to be developing in the direction of increased social responsibility.”¹¹³

Despite the debate with Dodd, Berle did not disagree that the corporation, as he put it, “exists to serve life, not to determine it.”¹¹⁴ But Berle clung to the shareholder, fearing that otherwise there would be no principle for legitimizing the power of the controlling group. If those in charge understood at least a fiduciary duty to shareholders, then the republic of shareholders would be able to insist on both equitable and ethical behavior from their corporations. It was a bit of a stretch, but Berle was certain his position fit the longer history of the rights, duties, and obligations of private property. Once the interests of all stockholders were equally and fairly protected, the dispersal of ownership could become a force for social good, as the shareholder group became, in effect, the community. Private property could co-exist with social responsibility, as long as the concentrations of corporate power were broken up. This coexistence required some active intervention from government, which is why Berle joined the New Deal and helped to structure the Securities and Exchange Commission in 1934.¹¹⁵

In Berle and Means’ time, the debate over control and corporate structure was never confined to the narrow sense of self interest used by economists today. Indeed, both Berle and Dodd agreed on this point—giving shareholders more rights and greater power would broaden their interests. It was the narrow self interest of corporate insiders that was the problem, after all. Berle’s hope was not to return to the older definition of private property or to reinstitute the traditional close corporations but to “broaden wealth to expand the shareholding class,” which would make for a more ethical corporation.¹¹⁶

113. Dodd, *supra* note 111, at 1161.

114. BERLE, *supra* note 12, at 118. A nearly identical statement appears in Ripley’s, *Main Street and Wall Street*. RIPLEY, *supra* note 69, at 8. It was a difficult position intellectually for Berle, for those who emphasized the underlying individuals in the corporation, such as business lawyer Victor Morowetz, did so for conservative purposes that limited the corporation’s social responsibilities. See BERLE, *supra* note 73, at 2–8.

115. A. A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932). Berle’s fear with Dodd’s stakeholder scheme was a repeat of what the battle for control had already loosened inside the corporation—group after group trying to get the most they could for themselves.

116. SCHWARTZ, *supra* note 70, at 65.

MACKAY AND AT&T ONCE AGAIN

With this context we can now understand the Clarence Mackay and AT&T story. Before managers could be seen as the agents of passive investors, stock ownership not only had to become dispersed but conflicts of power within the corporation had to be resolved in ways that permitted managers to act independently of powerful coalitions and factions. This is precisely what was going on in the AT&T-Mackay conflict, a progenitor of things to come.

Clarence Mackay's request for a place on the corporate board was part of an on-going internal struggle for control among the active insiders, and existing AT&T board members understood his request in just this way. Investment banker T. Jefferson Coolidge put it bluntly: "The Mackay Co.'s have nerve. Their interests are opposed to ours and of course . . . cannot secure representation."¹¹⁷ Coolidge had just helped AT&T end a significant threat from a competing telephone firm, the Erie Company, in a complicated bit of strategic maneuvering involving Mackay. The Erie Company had marketed its securities through Coolidge's Old Colony Trust Company. When the Erie Company collapsed, AT&T scooped up its stock at a bargain price with Coolidge's help. Mackay, meanwhile, was seeking to connect AT&T to his own Postal Telegraph Company (Postal). Postal was a rival to Western Union, and Western Union was a significant stock owner in several AT&T operating companies.¹¹⁸ This was all pretty standard corporate warfare and exactly the sort of financial maneuvering that provoked Ripley, Berle, and others.

The new wrinkle was AT&T President Frederick Fish's argument that he had to serve all stockholders, not just one class. This fit neither Coolidge nor Mackay's view that corporate management should reflect the interests of the most powerful insiders (not necessarily majority shareholders, but those with enough ownership to claim a seat on the board of directors). Where had Fish come up with his "novel theory" of management? One source was political, the new spirit of antitrust emanating from President Theodore Roosevelt. Though Fish was not specific, in the recent Northern Securities case the Supreme Court had dissolved this railroad trust under the Sherman Antitrust Act. Fish seemed to be alluding to the case, and antitrust more generally when he reminded Mackay that "at the present time it would be a very great mistake for one large corporation to have a definite and specific representation on the

117. FCC Investigation, *supra* note 1, p. 41.

118. J. WARREN STEHMAN, FINANCIAL HISTORY OF THE AMERICAN TELEPHONE AND TELEGRAPH COMPANY 97-104, 118 (1925).

Board of another larger corporation.” This would “probably be true under any conditions,” Fish continued, “but is . . . of special weight in a case like [this] where your company is interested in such a large number of other companies, including some of our most aggressive competitors.”¹¹⁹ Fish spoke on the broader issue of concentrated economic power, the sort that grew out of internal struggles for corporate control and ownership, as Berle and Means recognized.

Fish’s novel move was to step away from the “plutocratic” world of corporate power struggles. In the 1920s, large corporations like AT&T would achieve legitimacy by focusing on the technical aspects of operations and promoting themselves under the umbrella of public service. Here, Theodore Vail was a crucial figure. Once the general manager of AT&T, Vail had departed in 1887 but continued to sit on the AT&T board. Before writing to Mackay, Fish consulted Vail, who replied with the language of fiduciary trusteeship: “I have always considered myself as a representative of all the stockholders. I do not understand that Mr. Mackay has any interests . . . not common to all stockholders.” Vail may have been somewhat disingenuous, as he apparently had once agreed to act as Mackay’s agent at AT&T.¹²⁰

In 1907, Vail replaced Fish as AT&T president and effectuated a compromise with the Department of Justice, ending the threat of an anti-trust suit. Vail also purchased Western Union, aligning for a time the telephone and telegraph giants, and spurning Mackay’s offer of such an alliance with Postal Telegraph. At the same time, Vail began to extend AT&T stock to small investors. As AT&T shareholders grew into the hundreds of thousands, never again would a Clarence Mackay have chance to threaten control of the firm.¹²¹

Consistent dividends, dispersed ownership, and the negation of insider control all defined the new “socially responsible” AT&T. Vail paid shareholders a steady 8% dividend per year after 1907. At the time, public utilities usually offered low, if dependable dividends. AT&T offered high and dependable dividends, a policy that assured small investors a

119. FCC Investigation, *supra* note 1, at 42.

120. *Id.* at 41. Vail wrote to Fish, “[a]s to the individual interest in certain of the shares standing in my name, that is a personal matter between Mr. Mackay and myself . . . which I will not go into.” *Id.*

121. Vail’s return was at the behest of investment bankers lead by J. P. Morgan. Morgan did not challenge Mackay through common stock. Instead, he acquired some \$150,000,000 in AT&T convertible bonds, and from such financial heights exerted considerable control over firm management. When it came to stock ownership, AT&T was soon in a position to promote its shares directly to the public without investment bankers. This move fit well with the sentiments that Vail had expressed in the Mackay matter: managers represented the interest of all stockholders. This was much easier to maintain when there were many small and diverse investors, than when there were a few dominant investors, or even a few large minority holders.

predictable stream of income, while limiting insider manipulation of assets.¹²² Rather than serving the interests of large investors or investment bankers, AT&T adapted the sort of financial policy that soon earned it the well-deserved reputation as the “widows and orphans stock.” By 1921, more women than men owned AT&T shares and 78% of AT&T’s stockholders owned twenty-five shares or less.¹²³ So long as AT&T maintained broad stock distribution and kept out special classes of large investors (such as Mackay), it would be able to keep its rates low enough to stave off government regulators, while still attracting sufficient capital for the large capital needs of telecommunications.

Few firms in the United States went quite so far as AT&T in connecting their financial policies to a publicly enlightened operating strategy, but the company’s wide stock distribution fit the pattern of dispersed ownership that Berle and Means identified. AT&T also became an example that Dodd would point to, whereby the dispersal of shareholder power led logically to a law of corporations that stressed the broader social purpose and duties.¹²⁴ Although, AT&T was the exception, rather than the rule.

THE LEGACY OF *THE MODERN CORPORATION*

The original message of *The Modern Corporation* was lost when commentators shifted their reading of the book to principal-agent conflict and reduced corporate responsibility to just one issue—maximizing shareholder value.¹²⁵ Modern financial theory starts from the position that the capital structure and distribution of rewards inside the firm can be set *ex ante*. To the extent that this is true, it is true precisely because a combination of financial market reform and self-reform by corporations

122. For a discussion of Vail’s policies in this regard, see ROBERT GARNET, *THE TELEPHONE ENTERPRISE: THE EVOLUTION OF THE BELL SYSTEM’S HORIZONTAL STRUCTURE, 1876–1909*, at 166 (1985).

123. AT&T, 1921 ANNUAL REPORT 44 (1922). Thirty-seven percent of AT&T stockholders owned five shares or fewer.

124. Dodd actually quoted Owen D. Young of General Electric on this point, but GE and Young, like AT&T and Vail and Vail’s successors, was a corporation that took social responsibility and stakeholders very seriously. Vail expressed this interlocking series of policies in a number of places, such as his extensive and highly informative letters to stockholders in AT&T’s *Annual Reports*, as well as his numerous public speeches. See, e.g., T. N. Vail Articles, 1909–1919, “An Address before the Greater Vermont Association,” (May 13, 1915) (on file at AT&T Archives, box 1091).

125. Agent in the sense it would have been understood by men like Clarence Mackay and T. Jefferson Coolidge had a much less benign ring to it than it does in principal-agent theory. The agent was the director who did the bidding of those with sufficient power to place the agent in that position in the first place. The problem, as Vail and AT&T understood, was to free the corporation from just these sorts of exploitative relationships, so that it could go on to become a value creating enterprise that profited the entire population of shareholders.

greatly reduced the sort of unequal shareholder power that had existed earlier. The conditions that make it possible for shareholders not to worry about insiders have depended on the sort of disinterested corporate management that financial economists now criticize.

In their exclusive focus on principal-agent conflict, contemporary economists risk recreating exactly the sort of internal corporate power struggles that existed in Berle and Means' day. The exclusive focus on owners and managers in principal-agent theory typically results in solutions that place control firmly in the hands of the "active insiders."¹²⁶ Such cures for the (supposed) disease of professional management reflect an ignorance about the myriad ways control was exercised historically in corporations, ways that Berle and Means went to such lengths to illustrate. The recent waves of insider scandal and abuse—with Enron just the most spectacular—are a perfect illustration of how pay tied to performance completely fails to address the problem of power derived from control, a power that can manipulate all the supposed objective structures and information sources on which financial measurement and performance depend.¹²⁷

If it seems ironic that a management incentive system (which seeks to eradicate principal-agent conflict) ends up creating a new, and perhaps even worse forms of insider abuse, this would not have surprised Berle and Means. They understood the issue was control, and not any one particular way in which control was exercised.¹²⁸ They also understood there was no way to separate the power exercised inside corporations from the power corporations exercised beyond their walls. In attempting to "discipline" management by connecting managerial behavior to financial market performance, modern economists have succeeded in unleash-

126. Randall Morck, Daniel Wolfenzon & Bernard Yeung, in *Corporate Governance, Economic Entrenchment and Growth*, 30 (NBER Working Paper No. 10692, 2004), point out that pyramids and other methods of control that do not involve dispersed shareholder/managerial discretion model can be as bad or worse as agency and power problems with the dispersed owners /managerial discretion model.

127. Enron and related corporate scandals are the most spectacular, but the use of stock options—another agency theory inspired "reform"—is a more general example. In theory, stock options merely provide motivation for efficient and profitable management, but in practice the insider power of managers allows them to manipulate the options so they make money no matter corporate performance.

128. Hessen makes the case that Berle and Means' book influenced the securities reforms of the New Deal, with their emphasis on full disclosure, transparency and their monitoring of financial relationships between bankers, large stock holders and corporate management. These reforms would have helped to re-empower shareholders and presumably hold managers to account while limiting concentration. Hessen, *supra* note 9, at 281. The breaking up of insider groups combined with social and regulatory discipline of managers avoided Enron-type problems in America in the 1940–1980 period.

ing the sort of asocial corporate creature that Berle in particular warned against. Shareholders are now defined as those only interested in the most that they can get for their shares, rather than citizens responsible for the behavior of the corporations they own. Managers without property, who claim to be maximizing shareholder value can, if they wish, disclaim all other social obligations. And no one focuses on the issue of control, the central point of Berle and Means's book.

TABLE 1: SHAREHOLDER DATA OF TOP 200 U. S. CORPORATIONS, 1929-30

Average Number Shareholders of Top 50 Corporations (by assets; excludes Ford, AT&T, and five others with no shareholder data)	65,590
Average Number Shareholders, Top Fifty Industrials (by assets; excludes Ford and others with no data)	41,767
Median Number of Shareholders, Top 20 Non Industrials	90,000
Median Number of Shareholders, Top 20 Industrials	60,000
Average Number Shareholders of Top 100 Corporations (by shareholders)	56,000
Average Number Shareholders of Top 100 Industrials (by shareholders)	40,718
Median Number of Shareholders Top 100 Corporations (by shareholders)	36,000
Median Number of Shareholders Top 100 Industrials (by shareholders)	30,000
Median Number of Shareholders, Top 75 Industrials (by assets)	21,000
Median Number of Shareholders, 151 Large Companies (by assets)	19,000
Source: ALFRED D. CHANDLER JR., <i>SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM</i> 644-50 (Belknap Press, 1990); BERLE & MEANS, <i>THE MODERN CORPORATION AND PRIVATE PROPERTY</i> 86-105 (1932).	

TABLE 2: TOP 20 SHAREHOLDERS

Corporation	# of SHs 1929	% Ownership Top 20 Shareholders 1937-38
American Telephone & Telegraph Co.	469,801	1
Pennsylvania R.R. Co.	196,119	3
Swift & Co.	47,000	9
Continental Can Co.	6,100	9.3
General Electric Co.	60,374	10
American Sugar Refining Co.	20,690	10.3
Westinghouse Electric & Manuf. Co.	44,004	10.9
National Dairy Products Co.	31,074	11
Atlantic Refining Co.	19,000	11.2
Texas Corp.	65,898	11.7
Radio Corp. of America	60,000	12.2
United States Steel Corp.	182,585	12.4
Armour & Co.	80,000	13.6
Borden Co.	75,876	13.8
American Radiator Corp.	20,404	13.8
American Smelting & Refining Co.	20,110	15
Union Carbide & Carbon Corp.	28,780	15.2
B. F. Goodrich Co.	15,000	15.6
Union Oil Associates	13,712	15.7
National Biscuit Co.	19,881	15.8
Pure Oil Co.	37,000	15.9
Allis-Chalmers Manufacturing Co.	4,056	16
American Rolling Mill	10,113	16.1
Pullman Inc.	30,162	17.1
Kennecott Copper Corp.	31,009	18.4
Anaconda Copper Corp.	95,050	18.5
Chrysler Corp.	36,000	19.3
Standard Oil Co. of California	55,077	19.8
Wilson & Co.	9,800	20

Proctor & Gamble Co.	14,581	20.3
American Tobacco Co.	30,459	20.5
Bethlehem Steel Corp.	75,876	20.6
Standard Oil Co. of Indiana	81,022	20.9
Goodyear Tire & Rubber Co.	46,025	21.8
American Car & Foundry	17,152	22
Corn Products Refining Co.	10,000	23.8
Standard Oil Co. of New Jersey	104,000	30.2
National Lead Co.	9,786	31.1
United States Rubber Co.	25,486	31.8
Phelps Dodge Corp.	3,359	32.9
Liggett & Myers Tobacco Co.	12,219	35.9
General Motors Corp.	189,600	38
International Paper and Power Co	37,849	38.8
International Harvester Co.	40,200	39.9
E. I. Du Pont de Nemours & Co.	36,238	47.4
Pittsburgh Plate Glass Co.	4,000	48.5
Richfield Oil Co. of California	17,256	49.1
Deere & Co.	4,451	52.6
R. J. Reynolds Tobacco Co.	163	59.7
<i>See Table 1; and George Stigler & Claire Friedland, The Literature of Economics: The Case of Berle and Means, 26 J.L. & Econ. 237-68, app. (1983)</i>		
Median % Ownership Top 20 Shareholders	Average % for Firms of Less Than 50,00 Shareholders	
18.50%	24.73%	

TABLE 3: SHAREHOLDERS WITH MORE THAN 5,000 SHARES IN 250 LARGE CORPORATIONS, 1929-30

Average # Shareholders > 5,000 Shares	77
Average % Ownership by Shareholders With More Than 5,000 Shares	42%

Source: ALFRED D. CHANDLER JR., *SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM* 644–50 (1990); BERLE & MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 86–105 (1932); RAYMOND W. GOLDSMITH, ET. AL., *THE DISTRIBUTION OF OWNERSHIP IN THE 200 LARGEST NON FINANCIAL CORPORATIONS* 242 Nos. 1, 7; 254-69 (1940).