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**FENNER L. STEWART, JR.**

**BERLE’S CONCEPTION OF SHAREHOLDER PRIMACY:  
A FORGOTTEN PERSPECTIVE FOR RECONSIDERATION  
DURING THE RISE OF FINANCE**

**Abstract:** Adolf A. Berle is celebrated as the grandfather of modern shareholder primacy, but this glosses over his opposition to how Henry Manne used his argument. If Berle were alive today, he would certainly reject this praise. This is not always appreciated in commentaries of his shareholder primacy argument. For this reason, this article offers a nuanced understanding of Berle’s argument, providing a clear observation point for examining the shift from his shareholder primacy argument to the one of today. From this point of observation, the reader can see distinctions within, and potentials for, the shareholder primacy argument and thus the variety of ways that investor empowerment can develop during the current “rise of finance”.

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## I. INTRODUCTION

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

Manne's success can be attributable, at least in part, to how he redefined the interests of shareholders by "flipping"<sup>1</sup> Adolf A. Berle's shareholder primacy argument.<sup>2</sup> For the Berle of the 1920s and 1930s, shareholders were the middle and working class Everyman. He believed that if shareholder empowerment was ensured, it would correct the democratic deficit that existed in the management of the American economy. For Manne of the 1960s, shareholders were much different; they were the personification of the market. While Berle believed that the democratization of the shareholder class would make the corporation a tool for the wider polity, Manne used shareholder primacy to focus managerial efforts on economic efficiency. When Manne's thoughts on shareholder primacy were married with those of Ronald Coase,<sup>3</sup> what emerged was a powerful reconceptualization of the corporation in legal thought.<sup>4</sup> With the success of Manne's perspective, the shareholder wealth maximization norm was born, firmly defining the interest of shareholders and planting the seeds for financialization of the firm.

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<sup>1</sup> For more on how arguments can be flipped, see DUNCAN KENNEDY, *A CRITIQUE OF ADJUDICATION: FIN DE SIÈCLE* (1997); and see also KERRY RITTICH, *FUNCTIONALISM AND FORMALISM: THEIR LATEST INCARNATIONS IN CONTEMPORARY DEVELOPMENT AND GOVERNANCE DEBATES*, 55 U. OF T. 853 (2005).

<sup>2</sup> For Manne's work on shareholder primacy, see HENRY G. MANNE, *ACCOUNTING FOR SHARE ISSUES UNDER MODERN CORPORATION LAWS*, 54 NW. U. L. REV. 285 (1959); HENRY G. MANNE, *CURRENT VIEWS ON THE MODERN CORPORATION*, 38 U. DET. L. J. 559 (1961); HENRY G. MANNE, *CORPORATE RESPONSIBILITY, BUSINESS MOTIVATION, AND REALITY*, 343 THE ANNALS 55 (1962); HENRY G. MANNE, *THE 'HIGHER CRITICISM' OF THE MODERN CORPORATION*, 62 COLUM. L. REV. 399 (1962) (Hereinafter: MANNE 1962); HENRY G. MANNE, *SOME THEORETICAL ASPECTS OF SHARE VOTING-AN ESSAY IN HONOR OF ADOLF A. BERLE*, 64 COLUM. L. REV. 1427 (1964) (Hereinafter: Manne 1964); and HENRY G. MANNE, *MERGERS AND THE MARKET FOR CORPORATE CONTROL*, 73 J. POL. ECON. 110 (1965).

<sup>3</sup> RONALD COASE, *THE NATURE OF THE FIRM*, 4:16 *ECONOMICA* 386 (1937).

<sup>4</sup> See OLIVER WILLIAMSON, *CORPORATE CONTROL AND THE THEORY OF THE FIRM*, in HENRY MANNE, ED., *THE REGULATION OF CORPORATE SECURITIES* (1969), 281; and OLIVER E. WILLIAMSON, *THE MODERN CORPORATION: ORIGINS, EVOLUTION, ATTRIBUTES*, 19 J. OF ECONOMIC LITERATURE 1537 (1981); but also see ARMEN A. ALCHIAN AND HAROLD DEMSETZ, *PRODUCTION, INFORMATION COSTS, AND ECONOMIC ORGANIZATION*, 62 AM. ECON. REV. 777 (1972); and MICHAEL JENSEN AND WILLIAM MECKLING, *THEORY OF THE FIRM: MANAGERIAL BEHAVIOR, AGENCY COSTS, AND OWNERSHIP STRUCTURE*, 2 J. FIN. ECON. 305 (1976) (Hereinafter: Jensen and Meckling 1976).

Today Berle is celebrated as the grandfather of modern shareholder primacy,<sup>5</sup> but this glosses over his opposition to Manne's flip of his argument.<sup>6</sup> If Berle were alive today, he would certainly reject this praise. This is not always appreciated in commentaries of his shareholder primacy argument. For this reason, this article offers a nuanced understanding of Berle's argument, providing a clear observation point for examining the shift from his shareholder primacy argument to the one of today. From this point of observation, the reader can see distinctions within, and potentials for, the shareholder primacy argument and thus the variety of ways that investor empowerment can develop during the current "rise of finance".<sup>7</sup>

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

## II. BACKGROUND TO THE DEBATE: UP TO 1927

### A. Berle's Protest Against Managerialism

Before diving into Berle's protest against managerialism, it is advantageous to introduce Adolf Augustus Berle Jr. He was homeschooled<sup>8</sup> by his father, who taught him how to learn what he needed to know before others could detect his ignorance.<sup>9</sup> This probably served him well, as he entered Harvard at the age of 14.<sup>10</sup> By the age of 21, he had received three Harvard degrees, including a law degree,<sup>11</sup> and was the youngest student

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<sup>5</sup> For support of this observation, see WILLIAM W. BRATTON AND MICHAEL L. WACHTER, *SHAREHOLDER PRIMACY'S CORPORATIST ORIGINS: ADOLF BERLE AND 'THE MODERN CORPORATION'*, 34 J. OF CORP. L. 99 (2008), 104 (Hereinafter: Bratton and Wachter 2008).

<sup>6</sup> ADOLF A. BERLE, *MODERN FUNCTIONS OF THE CORPORATE SYSTEM*, 62 COLUM. L. REV. 433 (1962) (Hereinafter: Berle 1962). And for what inspired Berle to reply to Manne, see Manne 1962, *supra*, note 2.

<sup>7</sup> SIMON DEAKIN, *THE RISE OF FINANCE: WHAT IS IT, WHAT IS DRIVING IT, WHAT MIGHT STOP IT? A COMMENT ON "FINANCE AND LABOR: PERSPECTIVES ON RISK, INEQUALITY AND DEMOCRACY" BY SANFORD JACOBY*, 30 LAB. L. & POL'Y 67 (2008), 679 (hereinafter: Deakin 2008).

<sup>8</sup> JORDAN A. SCHWARTZ, *LIBERAL: ADOLF A. BERLE AND THE VISION OF AN AMERICAN ERA* (1987), 7-9 (Hereinafter: Berle's Biographer). More generally, see ADOLF A. BERLE, SR., *THE SCHOOL IN THE HOME* (1914).

<sup>9</sup> Berle's Biographer, *ibid.*, 23.

<sup>10</sup> Berle's Biographer, *ibid.*, 13.

<sup>11</sup> For greater information into Berle's education, see Berle's Biographer, *ibid.*, Chapter 1.

ever to graduate from Harvard Law School. After a year at Louis Brandeis's Boston law firm,<sup>12</sup> Berle enlisted in the army.<sup>13</sup> After officer's training at Plattsburg Camp, where he first befriended Gardiner C. Means,<sup>14</sup> Berle was placed on inactive duty to assist Mr. Ralph Rounds, a New York attorney, in sorting out the American-occupied land title system in order to boost sugar production, which was in high demand and short supply.<sup>15</sup> Rounds, a friend of Berle's father, also offered Berle a post-war position in his lucrative New York law firm (Rounds, Hatch, Dillingham & Debevoise),<sup>16</sup> which Berle accepted at war's end.<sup>17</sup> But before going to work as a New York lawyer, Berle was assigned by the military to the Paris Peace Conference as an expert on Russian economics,<sup>18</sup> where the destruction, disease, starvation and general desolation of post-war Europe horrified and marked young Berle.<sup>19</sup> Returning to America, Berle spent only a short time at Rounds, Hatch, Dillingham & Debevoise, before establishing a modest practice in 1924 at 67 Wall Street with Guy H. Lippitt (a colleague from service in the Dominican Republic),<sup>20</sup> which freed Berle to pursue more legal scholarship<sup>21</sup> and social activism.<sup>22</sup>

By the 1920s, greater dispersion of share ownership had transferred greater economic power to the middle and working classes. Berle viewed this transfer of power as a positive development in American society.<sup>23</sup> For this reason, he began advocating for shareholder empowerment. In his more personal and candid writings, he reveals another

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<sup>12</sup> Berle's Biographer, *ibid.*, 16.

<sup>13</sup> Berle's Biographer, *ibid.*, 17.

<sup>14</sup> Berle's Biographer, *ibid.*, 51.

<sup>15</sup> *Interview with Alfred A. Berle from 1969*, in: BEATRICE BISHOP BERLE AND TRAVIS BEAL JACOBS, EDS., *NAVIGATING THE RAPIDS 1918-1971: FROM THE PAPERS OF ADOLF A. BERLE*, (1973), 4-7 (**Hereinafter**: Berle's Personal Writings). Also see, Berle's Biographer, *ibid.*, 18-19.

<sup>16</sup> Berle's Biographer, *ibid.*, 19.

<sup>17</sup> Berle's Biographer, *ibid.*, 37.

<sup>18</sup> Berle's Biographer, *ibid.*, 37 (writing of how his "expertise" consisted of a few months research after coming back from the Dominican Republic).

<sup>19</sup> Berle's Biographer, *ibid.*, 28.

<sup>20</sup> Berle's Biographer, *ibid.*, 45.

<sup>21</sup> The word "more" is used, because he had already started writing before he left Rounds, Hatch, Dillingham & Debevoise, *see* ADOLF A. BERLE, JR., *NON-CUMULATIVE PREFERRED STOCKS*, 23 COLUM. L. REV. 358 (1923) (**Hereinafter**: Berle 1923).

<sup>22</sup> *Entry from Berle's personal diary on August 25, 1932*, in: Berle's Personal Writings, *supra*, note 15 at 19.

<sup>23</sup> ADOLF A. BERLE, JR., *HOW LABOR COULD CONTROL*, 28 THE NEW REPUBLIC, 37 (1921) (**Hereinafter**: Berle 1921). Also *see* Berle's Biographer, *supra*, note 8 at 66.

underlying and inseparable motivation for promoting shareholder primacy:<sup>24</sup> he was worried that the legal community, by overreacting to the change in ownership from a sophisticated business class to the middle class, was making a grave mistake. Berle thought that placing greater discretion into the hands of managers without safeguards was merely stoking the fire of a far more serious problem facing America – that being: “the freewheeling manner in which [managers] had dealt with the stock and other interests of their companies up to that time”.<sup>25</sup> He regarded the trends toward managerialism as a dangerous misstep, which could destabilize American society.

Berle’s concern of managerialism was linked to his fear that the peace negotiated in 1919 would likely not hold. He also shared these fears with other progressives who were at the conference like President Wilson. In particular, he shared the belief with President Wilson that: 1) Bolshevist doctrines developed under the pressures of capitalism, 2) capitalists were creating similar restlessness in America, 3) an evolving Bolshevism could overturn existing governments, but 4) such revolutionary ideas could be countered by a more meaningful egalitarian order.<sup>26</sup>

For Berle, that order would be a kinder capitalism. In the interim, he feared that America could easily plunge into the same perverse conflicts which were to soon destroy Europe for the second time.<sup>27</sup> However, he held out hope for America, envisioning how an empowered shareholder class, with its expanding working and middle class membership, could transform the corporation into a mechanism which ensured a more equitable distribution of wealth and economic power throughout American society.<sup>28</sup>

This corporate liberal revolution<sup>29</sup> was, as Berle put it, merely “the logical working out of the [American] system”, which as a liberal, he believed to be a sound foundation for social ordering.<sup>30</sup> His vision of the corporate liberal revolution placed the corporation at

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<sup>24</sup> Berle’s Biographer, *ibid.*, 66.

<sup>25</sup> *Entry from Berle’s personal diary on August 25, 1932*, in: Berle’s Personal Writings, *supra*, note 15 at 19.

<sup>26</sup> MARGARET MACMILLAN, *PARIS 1919: SIX MONTHS THAT CHANGED THE WORLD* (2002), 67-82.

<sup>27</sup> KARL POLANYI, *THE GREAT TRANSFORMATION* (2<sup>ND</sup> ED., 2001), 3 (arguing that economic liberalism represented a “stark utopia”, which hurtled European society into the World Wars). Also see PETER F. DRUCKER, *THE END OF ECONOMIC MAN* (1939) (arguing that the Great Wars were caused by the inability of the nineteenth century liberalism to transform the mercantile system of the 17<sup>th</sup> and 18<sup>th</sup> century into a rational worldview that could bring equality to Europe by raising the material status of the masses, and also suggesting that, in Germany, the non-economic Fascism reverted to demonizing the Jewish population, manufacturing miracles using the propaganda machinery of the Third Reich, and generating positions of political power and status in order to circumvent pre-existing economic power and status).

<sup>28</sup> Berle’s Biographer, *supra*, note 8 at 66.

<sup>29</sup> Although Berle’s biographer uses the language “corporate liberal revolution”, there is no clear evidence that Berle used this language. Yet this language aptly describes his vision. For the biographer’s uses of the phrase, see Berle’s Biographer, *ibid.*, 66.

<sup>30</sup> Berle’s Biographer, *ibid.*, 66.

its center because the corporation had the capacity to disperse ownership and economic power widely, so that the middle and working classes could eventually achieve a satisfactory level of equity within society.<sup>31</sup> The key to unlocking the potential of the corporation as a tool of revolution was to firmly establish the property and fiduciary rights of shareholders within the governance mechanism, so as to safeguard against the action of powerful elite interests who would want to counteract the threat of the egalitarian operation of the corporation upon their privileges. The corporate liberal revolution was at the core of the shareholder primacy arguments that Berle would develop in the 1920s through the early 1930s.

The closest Berle came to approximating in a published work how this revolution could be accomplished was in a short article entitled *How Labor Could Control*.<sup>32</sup> In the article, he explained that the corporation could be used as a tool for the redistribution of wealth and power to workers by reallocating the corporation's shares to them. This redistribution would provide greater financial reward to labour for their efforts as well as provide protection for their interests in production by subjecting management to labour's influence. The following passage from Berle's article reflects his conviction regarding such shareholder primacy:

Here is no ... attack on private property; on the contrary, it is the emphasis of the strength of property. It is not a blow at our settled economic institutions; it is the sane use of them.<sup>33</sup>

Berle appeared to be envisioning shareholder primacy as a tool to proceduralize the democratization of the American economy through the evolution of the corporate form. This insight is an important one, because Berle's later shift away from shareholder primacy (as early as with the publication of *The Modern Corporation and Private Property* in 1932) becomes more understandable in light of this early glance at his underlying motivations.

#### B. Berle's Foundation of a Shareholder Primacy Theory: 1923-1927

If one is attempting to understand the thought of Berle prior to when he picked up his pen to write the first article of the Berle-Dodd debate, then 1927 is the logical stop date, because "Corporate Powers As Power in Trust", which is the first article of the debate, is a word-for-word reproduction of most of a chapter from *The Modern Corporation and Private Property* (a point noted in detail in the following sections). And since Berle's work on the book started in 1927, a draft of this article could have been written anytime between 1927 and 1931. Thus, the article could have been drafted in 1927.

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<sup>31</sup> Berle's Biographer, *ibid.*, 66.

<sup>32</sup> Berle 1921, *supra*, note 23.

<sup>33</sup> Berle 1921, *ibid.*, 39.

The obvious challenge to drawing a distinction as early as 1927 is that the footnotes in “Corporate Powers As Power in Trust” make reference to cases as late as 1930. But this detail is less significant in light of the fact that in practice, drafts of articles are constantly modified prior to publication so that they reflect the current commentary on the law. Therefore it is very plausible that the footnotes only indicate that a revision of the article occurred during or after 1930, which is much different than the potential claim that a draft of the article could not have been written before 1930. Furthermore, one should consider how similar *Corporate Powers As Power in Trust* is to the other law review articles up to 1927. In fact, this article could easily be regarded as a direct extension of the 1923, 1925 and 1926 articles (as will be described below). Thus, it is quite reasonable – even if unconfirmed by the historical record – to suggest that *Corporate Powers As Power in Trust* might have been one of the first parts of the book written, making 1927 a cautious and prudent ending point for Berle’s history up to the Berle-Dodd Debate.

To understand Berle’s work up to 1927, one must reference his 1923, 1925 and 1926 articles, which map the progress of Berle’s shareholder primacy theory.<sup>34</sup> Berle stated explicitly in his diary: “that set of articles [the 4 in question] led to the next stage of my career”,<sup>35</sup> which was a position at Columbia University and the start of his research on the *Modern Corporation and Private Property* in 1927, before publishing *Corporate Powers As Power in Trust* in 1931 just before the publication of *Modern Corporation and Private Property* in 1932.

In 1923, Berle published the first of four articles in which he sets out to establish his shareholder primacy theory. In a diary entry from August 1932, he reflected upon these four articles, writing:

The attempt I was then making was to assert the doctrine that corporate managements were virtually trustees for their stockholders, and that they could not therefore deal in the freewheeling manner in which directors and managers had dealt with the stock and other interests of their companies up to that time. It was the beginning of the fiduciary theory of corporations which now is generally accepted.<sup>36</sup>

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

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<sup>34</sup> For a complete record of Berle’s published works up to the early 1960s, see *IN HONOR OF ADOLF A. BERLE*, 64 COLUM. L. REV. (1964) 1371, 1374.

<sup>35</sup> *Entry from Berle’s personal diary on August 25, 1932*, in: Berle’s Personal Writings, *supra*, note 15 at 19.

<sup>36</sup> *Entry from Berle’s personal diary on August 25, 1932*, in: Berle’s Personal Writings, *ibid.*, 19.

Berle's articles were not as radical as his hopes for the corporate liberal revolution. This is understandable. As a young academic attempting to establish his reputation, it would not be advisable to contextualize his shareholder primacy theory within his grandiose project, which had questionable ties with radical labour and anti-capitalist sentiments. During the 1920s, the hostilities and violence that characterized America's industrial relations at the turn of the century seemed to have ended,<sup>37</sup> but the "age of industrial violence" was still fresh in the minds of America.<sup>38</sup> Consequently, it is quite likely that such extreme opinions would either have been rejected outright without publication or would have drawn serious and unnecessary criticism to Berle's project. He figured that he did not have to preach the revolution, because the market was evolving the corporate form toward an evermore widely distributed share ownership at any rate. So, as long as the rights of shareholders were protected, his more radical surreptitious agenda would be furthered without making light of it. In other words, Berle predicted that the invisible hand of the market would guide the radical social work so long as the corporate legal infrastructure was protecting the rights of shareholders.

As a result, Berle started to construct arguments based on property rights, which justified shareholder authority over corporate management. He published four articles between 1923 and 1926, building a shareholder primacy argument prior to his most famous position on shareholder primacy: *Corporate Powers as Power in Trust*<sup>39</sup>. Each followed a similar logic: the corporation was the private property of its shareholders, and since managers were the agents of these owners, they owed a duty of care to them, which was captured in law by contract, and as Berle noted in the later works, by equity as well. Each article noted how corporate management was granted discretion over a particular aspect of the function of the corporation, which *prima facie* appeared quite broad. However, Berle then reminded his reader that the particular managerial discretion in question was held in check by shareholder rights, and thus the range of managerial choice that actually existed was more restricted than an observer might have assumed.

In the first article, which was published in 1923, Berle argued that the discretion of management was not so broad that they could ignore the contracted procedure for the manner in which dividends were to be distributed.<sup>40</sup> In his 1925 article, Berle advanced

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<sup>37</sup> In 1928, only 694 strikes occurred representing the fewest since 1884 and in 1929 there were only 900 work stoppages, involving merely 1.2% of the labor force. For more details on how the rise of living standards in the 1920s helped smooth the way for more peaceful industrial relations, see ROBERT H. ZIEGER AND GILBERT J. GALL, *AMERICAN WORKERS, AMERICAN UNIONS: THE TWENTIETH CENTURY* (3<sup>rd</sup> ed., 2002), 45.

<sup>38</sup> ADAMS, GRAHAM, JR., *AGE OF INDUSTRIAL VIOLENCE, 1910-1915. THE ACTIVITIES AND FINDINGS OF THE UNITED STATES COMMISSION ON INDUSTRIAL RELATIONS* (1971).

<sup>39</sup> ADOLF A. BERLE, JR., *CORPORATE POWERS AS POWER IN TRUST*, 44 HARV. L. REV. 1049 (1931) (Hereinafter: Berle 1931).

<sup>40</sup> Berle noted the trend in corporate law to grant directors broad power to distribute dividends could violate shareholders' rights, which necessitated a more narrow interpretation of managerial power. Although the discretion to withhold dividends to bolster the capital of the corporation was absolute and equitable, if the corporation used the dividends of non-cumulative preferred stockholders, these dividends were not lost to

his theory, arguing that an equitable duty existed, which controlled the managerial discretion when financial innovations (like the discretionary issue of non-par stocks) created holes in pre-existing contractual obligations of management.<sup>41</sup> In his 1926 Columbia Law Review article, he argued that equity guided managerial discretion beyond contract, in order to protect weaker shareholders from powerful ones, who might have control over management.<sup>42</sup> And finally, in his 1926 Harvard Law Review article, Berle furthered this argument by demonstrating that equity compensated for *de facto* imbalance of power between shareholders, arguing that the law would ensure that management treated all shareholders evenhandedly, guaranteeing that the interests of ownership were not undermined.<sup>43</sup>

When these articles are read with Berle's biographical context in mind, it becomes clear that his prime concern was controlling the self-interested and irresponsible actions of management, who controlled one of the most important political actors within American society: the corporation.<sup>44</sup> More importantly, Berle's more candid writings indicate that he wanted the corporation to help American society avoid the internal strife that Europe appeared doomed to suffer.<sup>45</sup> Accordingly, his objective was to help empower shareholders (which he saw as evermore representative of the middle and working classes) to make corporate managers firmly accountable to their control: in other words, the wider polity. He envisioned the distribution of corporate ownership through the middle and working classes as a mechanism to place the power of economic

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this class, but had to be recorded and returned to them before common shareholders could receive dividends. See Berle 1923, *supra*, note 21.

<sup>41</sup> In this article, pre-existing shareholders' rights were challenged by discretion to issue non-par stocks. This was significant, because such contractual arrangements had not have foreseen this innovation. Berle acknowledged that such unforeseen evolutions in corporate law created a crisis, since they potentially freed management to act without regard for the interests of shareholders. To remedy this failure of the contract, Berle asserted that the rights of shareholders created an obligation for management (like agents) to manage the corporation in shareholders' best interests, regardless of whether this obligation was explicitly contractual. Berle appeared confident that courts would recognize that shareholders could rely on equity to protect their rights. See ADOLF A. BERLE, JR., *PROBLEMS OF NON-PAR STOCKS*, 25 COLUM. L. REV. 43 (1925) (Hereinafter: Berle 1925).

<sup>42</sup> Berle explored how management allocated dividends (and losses) between share classes of the corporation. Once again, he employed the theory of the corporation as the private property of shareholders. He asserted even after management allocated initial preferred dividends in accordance with explicit contractual requirements, the remaining surplus, if it was to be allocated as dividends, was subject to an equitable distribution. This illustrated how principles of equity, beyond contract, provided a rationale for ordering how dividends were to be portioned amongst shareholders. This protected weaker shareholders from the influence of powerful ones. See ADOLF A. BERLE, JR., *PARTICIPATING PREFERRED STOCK*, 26 COLUM. L. REV. 303 (1926) (Hereinafter: Berle 1926).

<sup>43</sup> See ADOLF A. BERLE, JR., *NON-VOTING STOCK AND BANKERS CONTROL*, 39 HARV. L. REV. 673 (1926) (Hereinafter: Berle 1926.2).

<sup>44</sup> Entry from Berle's personal diary on August 25, 1932, in: Berle's Personal Writings, *supra*, note 15 at 19.

<sup>45</sup> Berle's Biographer, *supra*, note 8 at 66.

concentration under a form of democratic control through shareholder power. In fact, Berle had the bold ambition of becoming the prophet of the shareholding class, or as he so modestly put it, “the American Karl Marx”.<sup>46</sup>

### III. THE MODERN CORPORATION AND PRIVATE PROPERTY

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

In 1927, a Harvard connection helped Berle to land a sizable grant from the Laura Spelman Rockefeller Foundation to study recent trends in corporate development.<sup>47</sup> The grant was contingent upon him obtaining an academic appointment,<sup>48</sup> which he soon did at Columbia University.<sup>49</sup> The grant requirements also demanded that the project utilize the expertise of an associate economist.<sup>50</sup> By chance, his old bunkmate from officer training at Plattsburg Camp,<sup>51</sup> Gardiner C. Means, had just enrolled at Harvard as a candidate for a Ph.D. in economics.<sup>52</sup> Means’s academic interests dovetailed nicely with the project,<sup>53</sup> so Berle invited him to assist.<sup>54</sup> The end result was *The Modern Corporation and Private Property*.<sup>55</sup>

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<sup>46</sup> Berle exclaimed to his wife: “that his real ambition in life is to be the American Karl Marx – a social prophet”, see Berle’s Biographer, *supra*, note 8 at 62. Also see THOMAS K. MCCRAW, *BERLE AND MEANS*, 18 REV. AM. HIS. 578 (1990), 579 (**Hereinafter**: McCraw 1990)

<sup>47</sup> Edwin F. Gay actually devised the project. Gay was an economic historian who became the founding dean of the Harvard Business School. He was advising various foundations (including the Social Science Research Council, which sponsored the Laura Spelman Rockefeller Foundation) on what types of economic issues deserved funding. For his Rockefeller project, he wanted to blend the expertise of a lawyer and an economist to study the modern corporation. See HERBERT HEATON, *A SCHOLAR IN ACTION: EDWIN F GAY* (1952), 211.

<sup>48</sup> Entry from Berle’s personal diary on August 25, 1932, in: Berle’s Personal Writings, *supra*, note 15 at 21.

<sup>49</sup> Adolf Augustus Berle Jr., online: [http://c250.columbia.edu/c250\\_celebrates/remarkable\\_columbians/a\\_a\\_berle.html](http://c250.columbia.edu/c250_celebrates/remarkable_columbians/a_a_berle.html) (last visited: 08/07/10).

<sup>50</sup> ADOLF A. BERLE, JR. AND GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (2<sup>ND</sup> ED., 1968), xxxix (**hereinafter**: The Modern Corporation).

<sup>51</sup> Berle’s Biographer, *supra*, note 105 at 51. And also, see COLUMBIA UNIVERSITY AND JULIUS GOEBEL, *A HISTORY OF THE SCHOOL OF LAW, COLUMBIA UNIVERSITY. THE BICENTENNIAL HISTORY OF COLUMBIA UNIVERSITY* (1955), 299-305 and 316-317.

<sup>52</sup> Entry from Berle’s personal diary on August 25, 1932, in: Berle’s Personal Writings, *supra*, note 15 at 20.

<sup>53</sup> Berle’s Biographer, *supra*, note 8 at 51.

<sup>54</sup> Entry from Berle’s personal diary on August 25, 1932, in: Berle’s Personal Writings, *supra*, note 15 at 20.

<sup>55</sup> The Modern Corporation, *supra*, note 50.

Academically, Berle bore all the markings of a prodigy. While Louis Brandeis graduated from Harvard law with the highest marks ever recorded, Berle was its youngest graduate, matriculating at the age of 21.<sup>56</sup> Consequently, much was expected of Berle, who in turn embraced some grandiose ambitions. Besides ambitiously aspiring to the status of Karl Marx,<sup>57</sup> he intended *The Modern Corporation and Private Property* to become a classic, and purposefully crafted the book with this intention. He wanted this work to make him an opinion maker for the intellectual elites of America.<sup>58</sup>

His cunning instinct helped him to appreciate that although he was not in favor of anti-trust measures (believing that the large modern corporation, with a widely dispersed share base, ought to be the primary actor of the American economy), in order to appeal to the legal intelligentsia he would have to be careful to achieve the favor of American legal icons like Louis Brandeis and Felix Frankfurter, who were staunch critics of big business and strong advocates of anti-trust measures.<sup>59</sup> As planned, the book became famous as a warning of the potential threat of corporate managerial plutocracy over American society, demonstrating how modern corporations were consuming the American economy<sup>60</sup> and how unrestrained managers were controlling these modern corporations. By focusing on the latter and ignoring the former when making his recommendations, he could offer a sacrifice to powerful anti-trust advocates, and still focus his recommendations upon the distinct issue of the control of management. In short, he appeased the anti-trusters for the time being, while still progressing his alternative agenda of transforming the corporation into a mechanism which ensured the greater democratization of economic power throughout American society. In the end Berle succeeded in his ambition, for the book upon publication was celebrated as one of the most important books of its time.<sup>61</sup>

## B. *The Modern Corporation and Private Property*

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<sup>56</sup> Berle's Biographer, *supra*, note 8 at 13-16.

<sup>57</sup> Berle exclaimed to his wife: "that his real ambition in life is to be the American Karl Marx – a social prophet", see Berle's Biographer, *supra*, note 8 at 62. Also see McCraw 1990, *supra*, note 46 at 579.

<sup>58</sup> Berle's Biographer, *supra*, note 8 at 62.

<sup>59</sup> That said, Berle and Means did not advocate for dismantling large-scale corporate enterprise, but harnessing its potential to better serve society.

<sup>60</sup> For a later and far more advanced understanding of how corporations capture economies, see RONALD H. COASE, "THE PROBLEM OF SOCIAL COST", 3 J.L. & ECON 1 (1960).

<sup>61</sup> Berle's Biographer notes that the book review from New York *Herald Tribune* applauded the book as a "masterly achievement of research and contemplation" and wondered if it could be "the most important work bearing on American statecraft" since the Federalist Papers. Jerome Frank wrote, "This book will perhaps rank with Adam Smith's *Wealth of Nations* as the first detailed description in admirably clear terms of the existence of a new economic epoch." Ernest Gruening called it "epoch-making". Harry W. Laigler proclaimed it was "bound to make economic history". In 1932, Justice Brandeis cited the book calling it the work of "able, discerning scholars" in the *Liggett v. Lee* case. By the spring of 1933, *Time* magazine dubbed it "the economic Bible of the Roosevelt administration". See Berle's Biographer, *supra*, note 8 at 60-61.

Berle and Means pointed to the key features of the modern corporation's evolution, namely: an increase in corporate concentration of property<sup>62</sup> and a decrease in control over corporate management by owners,<sup>63</sup> which was a by-product of ever increasing stock ownership dispersion.<sup>64</sup> They noted that this led to an increased concentration of power for corporate managers<sup>65</sup> and elite financial groups.<sup>66</sup> The book cast the threat of corporate hegemony over freedom, suggesting that plutocracy could supersede state democracy as the dominant form of social organization. In a personal letter to Felix Frankfurter, Jerome Frank expresses skepticism about Berle and Mean's ominous proposition: "With the present drift of events, we may soon come to state capitalism (via the R.F.C. [Reconstruction Finance Corporation] or something like it) as an alternative to breakdown. If so, then their predictions may be wrong."<sup>67</sup> Frank's words were more prophetic and astute than he could have appreciated at the time.

Berle and Means centered on the need for shareholders to have meaningful control over their corporations. What Means's empirical research proved was that the opposite was occurring,<sup>68</sup> resulting in a fracture between ownership and control of property.<sup>69</sup> The authors warned that this emergent situation might cause market distortions,<sup>70</sup> especially if the gap between ownership and control continued to widen, amplifying the perversion of the classic theory of market function.<sup>71</sup> To explain their logic, if profit was to work as a virtuous incentive, the traditional logic demanded that only a "fair return" be dispersed to the shareholders (as the owners of the property without control) and that the remainder go

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<sup>62</sup> The Modern Corporation, *supra*, note 50 at vii-viii and 44-45; and also see ADOLF A. BERLE, *PROPERTY, PRODUCTION AND REVOLUTION*, 65 COLUM. L. REV. 1 (1965), 1.

<sup>63</sup> The Modern Corporation, *ibid.*, 119-140.

<sup>64</sup> The Modern Corporation, *ibid.*, 64-65.

<sup>65</sup> Berle and Means prophesize: "What will be the development in the field of 'control'? It is not easy to prophesize. ... Economically the problem is likely to change in form as corporations gradually increase in size and as stock distribution increases, to the point where the "control" is virtually in the hands of a self-perpetuating Board of Directors ...". See The Modern Corporation, *ibid.*, 217-218.

<sup>66</sup> The Modern Corporation, *ibid.*, 206. For an example of such control groups, see Berle 1926.2, *supra*, note 43.

<sup>67</sup> *Letter from Jerome Frank to Felix Frankfurter (December 29, 1932)*, in: Berle's Biographer, *supra*, note 8 at 68.

<sup>68</sup> The Modern Corporation, *supra*, note 50 at 128-131 and 245. But also an article that Means published a year before, with much of the core research findings, see GARDINER C. MEANS, *THE SEPARATION OF OWNERSHIP AND CONTROL IN AMERICAN INDUSTRY*, 46 QUARTERLY J. OF ECON. 68 (1931) (**Hereinafter: Means 1931**)

<sup>69</sup> The Modern Corporation, *ibid.*, 303-308.

<sup>70</sup> The Modern Corporation, *ibid.*, 302-308. Also generally see ADAM SMITH, *WEALTH OF NATIONS (GREAT MINDS SERIES)* (1991).

<sup>71</sup> The Modern Corporation, *ibid.*, 302.

to the management (who control the property), since profit would induce the most efficient decision-making and management made the decisions.<sup>72</sup> The authors concluded that:

The corporation would thus be operated financially in the interest of control, the stockholder becoming merely the recipient of the wages of capital ... [running] counter to the conclusion reached by applying the traditional logic of property to precisely the same situation.<sup>73</sup>

What Berle and Means probably mean by “the traditional logic of property” is the sort of understanding of property that Morris Cohen thought of as being a right over a possession,<sup>74</sup> which implicitly is assumed to grant a right to self-assertion,<sup>75</sup> or a claim to a sovereign power<sup>76</sup> over a possession, without the interference of government power.<sup>77</sup> To put it more concretely, in the context of the authors’ suggestion, it means that owners ought to receive the profits of the corporation, because they acquired ownership of the corporate venture, and are the rightful benefactors of all corporate economic surplus to the exclusion of all non-owners.

Berle and Means predicted that separation of ownership and control would create a new logic for property,<sup>78</sup> which would be inspired by the better appreciation of the “economic relationships” between economic actors.<sup>79</sup> They did not provide any hints to what these new “economic relationships” would be like. And yet, even though there is no evidence that Berle ever seriously entertained the more radical ideas of the Legal Realists regarding property, one’s imagination can easily attach Cohen’s critique of the long-established understanding of property rights<sup>80</sup> and his seemingly sensible, but explosively contentious redefinition of property rights as having “positive duties” to public interest included.<sup>81</sup> For instance, Berle’s understanding of the corporation as a democratizing actor within modern society could be viewed as traveling a parallel path to Cohen’s

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<sup>72</sup> The Modern Corporation, *ibid.*, 302.

<sup>73</sup> The Modern Corporation, *ibid.*, 302.

<sup>74</sup> MORRIS R. COHEN, *PROPERTY AND SOVEREIGNTY*, 13 CORNELL LQ 8 (1927), 12 (**Hereinafter**: Cohen 1927).

<sup>75</sup> Cohen 1927, *ibid.*, 18.

<sup>76</sup> Cohen 1927, *ibid.*, 29.

<sup>77</sup> Cohen 1927, *ibid.*, 11.

<sup>78</sup> The Modern Corporation, *supra*, note 50 at 302.

<sup>79</sup> The Modern Corporation, *ibid.*, 308.

<sup>80</sup> Cohen 1927, *supra*, note 74 at 15-21.

<sup>81</sup> Cohen 1927, *ibid.*, 21.

redefinition of property rights, since the interest of shareholders from Berle's point of view would be close to the ever-ambiguous "public interest".

### C. The Importance of *The Modern Corporation and Private Property* to the Berle-Dodd Debate

It is important to sum up before moving forward, so that the reader is mindful of the ground covered before continuing. In the 1920s, Berle regarded the trends toward managerialism as a dangerous mistake, which could destabilize American society. He feared that managerialism, without safeguards, could amplify the economic inequalities in America, and provoke Bolshevik elements in American society. As a result, Berle started to construct arguments based on property rights, which justified shareholder authority over corporate management. Underpinning Berle's efforts (and this is important for understanding Berle's arguments throughout the debate) was the evolution of the public corporation with its ever-widening ownership class, which continued to increase the potential of democratizing economic power within American society. For this reason, if corporate managers could be compelled to act for the sole benefit of shareholders, the corporation ought to be the primary actor of the American economy. This ties his early shareholder primacy arguments firmly to the perceived needs of the broader polity of American society.

Moving forward now, the importance of *The Modern Corporation and Private Property* to the Berle-Dodd debate is that the initial article of the debate<sup>82</sup> was a chapter from *The Modern Corporation and Private Property*. To repeat, because this is key, chapter seven of book two is an exact reproduction of Berle's initial essay of the Berle-Dodd debate – with one very important difference.<sup>83</sup> From the article Berle removed his candid admission that his arguments were constructed "with full realization of the possibility that private property may one day cease to be the basic concept in terms of which the courts handle problems of large scale enterprise".<sup>84</sup> In the missing text, he also argued that it was possible that "the entire system [had] to be revalued" and that "the corporate profit stream in reality no longer [was] private property", asserting that a new theory, which adequately explained the phenomenon of the modern corporation, would likely develop.<sup>85</sup> However, he qualified these views as a matter of sociological study, which regardless of their factual merit had not yet attained a standing as a "matter of law".<sup>86</sup> He suggested that finding a superior theory to explain the distortion created by modern corporations upon private property was "rather the reflexion [sic] of a movement which [was] likely to

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<sup>82</sup> Berle 1931, *supra*, note 39.

<sup>83</sup> To be completely accurate, in addition to the first 3 and the last paragraphs of Chapter 7 of Book 2, the first sentence and a half of the fourth paragraph is not present in Berle's *Corporate Powers as Power in Trust*.

<sup>84</sup> *The Modern Corporation*, *supra*, note 50 at 219-220.

<sup>85</sup> *The Modern Corporation*, *ibid.*, 219-220.

<sup>86</sup> *The Modern Corporation*, *ibid.*, 219-220.

take form in the future than the statement of a present ordering of affairs”.<sup>87</sup> Berle recommended that until a new corporate theory became a “matter of law”, lawyers and legal academics must do their best within the existing legal framework – that being to think “in terms of private property”.<sup>88</sup> And that is exactly what Berle did in the 1931 article with his bullish argument that: “all powers granted to a corporation ... are ... at all times exercisable only for the ratable benefits of all the shareholders as their interest appears”<sup>89</sup> without qualification.

The ramifications of this omission/admission are profound. It explains that Berle only intended for shareholder primacy to be an interim measure until a more adequate sociological clarification of the corporate property evolution was offered and accepted by the legal and business communities. To emphasize again: Berle was advocating the shareholder primacy position, which he acknowledged was less than adequate, until a satisfactory solution to the problems of corporate property could be established. Unfortunately for Berle, such a new understanding of property never emerged, nor sparked the sort of legal evolution Berle imagined, although his vision was fertile ground for the seeds of planners corporatism (also called state corporatism) to grow.<sup>90</sup>

An apparent contradiction in Berle’s book<sup>91</sup> is his strong advocacy of shareholder primacy, while celebrating planners corporatism as the solution to the corporate power problem. However, Berle’s arguments are consistent with each other. Berle only intended for the judicial protection of shareholder primacy to be an interim measure until a greater understanding of the evolution of the corporation and property was accepted. He concluded that the shareholder primacy position, which he fully acknowledged was less than adequate, would need to be advocated until a satisfactory solution to the corporate power problem could be established.<sup>92</sup> Berle thought that the last chapter, in which he

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<sup>87</sup> The Modern Corporation, *ibid.*, 219-220.

<sup>88</sup> The Modern Corporation, *ibid.*, 219-220.

<sup>89</sup> Berle 1931, *supra*, note 39 at 1049; and The Modern Corporation, *ibid.*, 220.

<sup>90</sup> Bratton and Wachter 2008, *supra*, note 5 at 122-123 (describing corporatism as a cooperative relationship between private groups and also between government and those groups that communicate in order to establish “public interest” on an issue, and then adopt, adapt and coordinate policies accordingly in order to achieve the agreed upon “public interest” within society). Also Bratton and Wachter note Ellis Hawley. See ELLIS W. HAWLEY, THE NEW DEAL AND THE PROBLEM OF MONOPOLY (1966), 36-43 (Hereinafter: Hawley 1966) (categorizing two types of corporatism: (1) “planners” corporatism that advocates for the government to take the lead role in this process, and (2) “business commonwealth” corporatism that advocates for industrialists to take the lead role).

<sup>91</sup> Berle offered Means the opportunity to co-author, in part so that Means could use the book as his dissertation toward his Ph.D, which he did. Ultimately, it was Berle’s project. He initiated and directed the project and was solely responsible for securing grant for its research. Possibly more insightful as to the power dynamic between the authors was that Berle only gave Means one-third of the royalties from the book sales. For information about the writing of the book, see Berle’s Biographer, *supra*, note 8 at 50-62; and also see *Entries from Berle’s personal diary on August 25, 1932 and June 27, 1947*, in: Berle’s Personal Writings, *supra*, note 15 at 18-28.

<sup>92</sup> The Modern Corporation, *supra*, note 3 at 219-220.

endorsed planners corporatism, was the most important because this chapter pointed toward what he believed to be the direction that corporate law was going to take in the future. Thus, the book is rightly interpreted to be both endorsing planners corporatism<sup>93</sup> and shareholder primacy. This insight provides critical insight into the nature of his shareholder primacy argument, and contextualizes it with the rest of the arguments from the book.

It is unfortunate that neither Berle's personal writings,<sup>94</sup> nor his biography,<sup>95</sup> nor any of his other publications acknowledge this connection between the article *Corporate Powers as Power in Trust* and *The Modern Corporation and Private Property*. As a result, no explanation exists for why he omitted this important insight from the 1931 article<sup>96</sup> which was published just before the book was released.<sup>97</sup> The missing text is critical to properly contextualize the Berle-Dodd debate. This insight clearly establishes that although Berle appeared to be entirely committed to his shareholder primacy argument in the 1931 article, he undoubtedly acknowledged that this argument represented no more than an interim solution.<sup>98</sup> To emphasize, although the argument in *Corporate Powers as Power in Trust* appeared unequivocal, the missing text, which would soon appear in the book, established that this was clearly not the case.

Accordingly, Berle appreciated that law and sociology in America had to catch up with the reality of the evolution of the modern corporation before planners corporatism could realistically be advocated in the corporate legal discourse. *The Modern Corporation and Private Property* must be read as primarily advocating shareholder primacy as a solution (not planners corporatism) because sociology had not worked out an understanding of the corporation which would facilitate the legal developments necessary to advocate corporatism with any degree of success. As a result, Berle's evolving position was not inconsistent as most scholars suggest,<sup>99</sup> when his arguments are fully contextualized with the historical record.

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<sup>93</sup> Bratton and Wachter 2008, *supra*, note 5 at 118-222.

<sup>94</sup> Berle's Personal Writings, *supra*, note 15.

<sup>95</sup> Berle's Biographer, *supra*, note 8.

<sup>96</sup> Berle 1931, *supra*, note 39.

<sup>97</sup> The Modern Corporation, *supra*, note 50.

<sup>98</sup> The Modern Corporation, *ibid.*, 219-220.

<sup>99</sup> For support, see Bratton and Wachter 2008, *supra*, note 5 at 101 (in particular footnote 5 on that page). For allusions to the contradictions in Berle's work and thus the danger of misrepresenting his position, see DAVID MILLON, *THEORY OF THE CORPORATION*, 1990 DUKE L. J. 201 (1990), 222 (**Hereinafter**: Millon 1990). And generally see C.A. HARTWELL WELLS, *THE CYCLES OF CORPORATE SOCIAL RESPONSIBILITY*, 51 U. KAN L. REV. 77 (2002) (**Hereinafter**: Wells 2002) (describing Berle's transitions of opinion from 1931 up to the 1960s).

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

#### IV. THE BERLE-DODD DEBATE

##### A. *Corporate Powers as Power in Trust*

While working on *The Modern Corporation and Private Property*, Berle continued to publish other pieces.<sup>100</sup> These works continued to argue for greater protection of shareholder rights. His writing inspired a range of reactions and although some agreed with Berle that new safeguards were needed to protect shareholders (especially to secure a higher rate of investment),<sup>101</sup> the majority argued that Berle's assessment was a reactionary overstatement of the law, which ran "counter to the historical evolution of the corporation".<sup>102</sup> Before the release of *The Modern Corporation and Private Property*, he

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<sup>100</sup> See ADOLF A. BERLE, JR., *CONVERTIBLE BONDS AND STOCK PURCHASE WARRANTS*, 36 YALE L. J. 649 (1927); ADOLF A. BERLE, JR., *PUBLICITY OF ACCOUNTS AND DIRECTORS' PURCHASES OF STOCK*, 25 MICH. L. REV. 827 (1927); ADOLF A. BERLE, JR., *SUBSIDIARY CORPORATIONS AND CREDIT MANIPULATION*, 41 HARV. L. REV. 874 (1928); ADOLF A. BERLE, JR., *SUBSIDIARY CORPORATIONS AND CREDIT MANIPULATION*, 41 HARV. L. REV. 874 (1928); ADOLF A. BERLE, JR., *COMPENSATION OF BANKERS AND PROMOTERS THROUGH STOCK PROFITS*, 42 HARV. L. REV. 748 (1929); ADOLF A. BERLE, JR., *PROMOTERS' STOCK IN SUBSIDIARY CORPORATIONS*, 29 COLUM. L. REV. 35 (1929); ADOLF A. BERLE, JR., *INVESTORS AND THE REVISED DELAWARE CORPORATION ACT*, 29 COLUM. L. REV. 563 (1929); ADOLF A. BERLE, JR., "CASES AND MATERIALS ON THE CORPORATION FINANCE" (1930); ADOLF A. BERLE, JR., *THE ORGANIZATION OF THE LAW OF CORPORATION FINANCE*, 9 TENN. L. REV. 125 (1931); ADOLF A. BERLE, JR., *CORPORATE DEVICES FOR DILUTING STOCK PARTICIPATIONS*, 31 COLUM. L. REV. 1239 (1931); and ADOLF A. BERLE, JR., *LIABILITY FOR STOCK MARKET MANIPULATION*, 31 COLUM. L. REV. 264 (1931).

<sup>101</sup> Karl McGinnis believed that the law was progressing toward greater protection of shareholders and that Berle's *Cases and Materials on the Corporation Finance* was an important contribution toward understanding the problem of shareholder protection. See KARL MCGINNIS, "BOOK REVIEW", 10 TEX. L. REV. 34 (1931), 122-123. Irving Levy observed that Berle's suggestions, in *Studies in the Law of Corporation Finance*, were heterodox, acknowledging the protest of corporate lawyers to Berle's advocacy of the equitable control of the management by shareholders. He explained that some practitioners believed that Berle's theory in action would be paramount to judicial interference with the ability of managers to exercise their professionally informed discretion over the corporation. That said, Levy sided with Berle because he believed that establishing safeguards over managerial discretion was prudent. See IRVING J. LEVY, *BOOK REVIEW*, 7 N.Y.U. L. Q. REV. 552 (1929).

<sup>102</sup> Joseph L. Kline, who was a Wall Street corporate lawyer, argued, "Any movement to increase the power of shareholders as such runs counter to the historical evolution of corporations. Mr. Berle's thesis is therefore essentially reactionary". See JOSEPH L. KLINE, *BOOK REVIEW*, 42 HARV. L. REV. 714 (1929), 717. Laylin K. James, in reviewing Berle's *Cases and Materials on the Corporation Finance*, attacked his arguments for the greater protection of shareholders as too zealous. See LAYLIN K. JAMES, *BOOK REVIEW*,

published his seminal article on the topic in the Harvard Law Review. *Corporate Powers as Power in Trust* should not have been a surprise to those familiar with his writing; it was obvious that Berle was building toward the introduction of a grand shareholder primacy theory. He probably expected more of the same criticism, however his most formidable critic would be unexpected. In the Harvard Law Review, E. Merrick Dodd accused Berle of being a dangerous conservative. This was too much for the self-styled American Karl Marx to bear, and he promptly penned a reply in the following issue.<sup>103</sup>

In the initial article, Berle had argued that since “all powers granted to a corporation ... [were] ... at all times exercisable only for the ratable benefits of all the shareholders as their interest appears”,<sup>104</sup> a legal foundation existed to develop and enforce greater fiduciary ties between management and shareholders. He explained that the existing rights and restrictions of corporate law were no more than “nominal” rules,<sup>105</sup> in the sense that they were only guidelines for how corporate governance ought to function. However, when these guidelines conflicted with the equitable rights of shareholders, equity prevailed.<sup>106</sup> As a result, managerial actions were bound by equity, no matter how absolute the power granted to managers might appear or how technically correct the exercise of such power was.<sup>107</sup> Although the argument was obviously anti-managerialist, he explained the nature of the equitable protections of shareholders in a manner that did not appear to be limiting managerial discretion, rather he suggested that such interpretation of the rules expanded managerial authority to go beyond the technical limitations in order to better protect the interests of shareholders.<sup>108</sup>

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26 ILL. L. REV. 712 (1932). Franklin S. Wood responded to Berle’s 1926 article *Non-Voting Stocks and “Bankers Control”*, arguing that Berle’s equitable remedies solution to the problem of managerial control was unjustifiable under sound principles of law and equity. See FRANKLIN S. WOOD, “THE STATUS OF MANAGEMENT STOCKHOLDERS”, 38 YALE L. J. 57 (1928). When reviewing Berle’s *Studies in the Law of Corporation Finance*, Robert T. Swaine disagreed with Berle’s position but did not question his statement of the law, writing: “But, however much one may dissent from Mr. Berle’s underlying philosophy, these essays must be recognized as an excellent and stimulating bit of advocacy. As a statement of the present state of the law they are of doubtful accuracy.” See ROBERT T. SWAINE, *BOOK REVIEW*, 38 YALE L. J. 1003 (1929), 1004. And Wilbur G. Katz argued that Berle overstated the law, he also rejected his shareholder primacy theory, arguing that Berle underemphasized the potential downside of his equitable solutions, condemning him for being too critical of management, and being too eager to create the impression that the complexities of many financial and inter-corporate transactions are all the result of “corporate skullduggery”. See WILBUR G. KATZ, *BOOK REVIEWS*, 40 YALE L. J. 1125 (1931), 1128.

<sup>103</sup> For the observation that Berle considered himself the American Karl Marx, see McCraw, *supra*, note 46 at 579. For his outrage of being accused of being a Tory, see Berle’s Biographer, *supra*, note 8 at 66.

<sup>104</sup> Berle 1931, *supra*, note 39 at 1049; and *The Modern Corporation*, *supra*, note 50 at 220.

<sup>105</sup> Berle 1931, *ibid.*, 1049; and *The Modern Corporation*, *ibid.*, 220.

<sup>106</sup> Berle 1931, *ibid.*, 1049; and *The Modern Corporation*, *ibid.*, 220.

<sup>107</sup> Berle 1931, *ibid.*, 1050; and *The Modern Corporation*, *ibid.*, 220.

<sup>108</sup> Berle 1931, *ibid.*, 1049-1050; and *The Modern Corporation*, *ibid.*, 220.

In the body of the 1931 article, Berle described five scenarios<sup>109</sup> in which management apparently had been granted a wide discretion over corporate conduct.<sup>110</sup> In each, no matter how absolute the discretion appeared, such power had to be exercised in accordance with equitable limitations.<sup>111</sup> The underlying theory which bound managerial discretion to equitable control in each of the five scenarios was the understanding of the corporation as being exclusively private property, which supported the argument that all powers granted to management were exclusively for the benefit of the shareholders as a whole.<sup>112</sup> However, Berle hesitated to assert that this understanding of the fiduciary duty of management could evolve into a branch of trust law, because such a duty must be less rigorous than other trust situations when applied – otherwise the burden placed upon corporate management could be too great to reasonably optimize market efficiency.<sup>113</sup>

The timing of the publication of *Corporate Powers as Power in Trust* is noteworthy, because it occurred just months before the publication of the *Modern Corporation and Private Property*.<sup>114</sup> It was much like Means's publication of *The Separation of Ownership and Control in American Industry*, which was published at about the same time and was designed to have much the same effect in the world of economics.<sup>115</sup> Given the academic community's anticipation of the upcoming book, the article provided Berle with an opportunity to emphasize his central argument prior to its release. This early exposure was important to Berle, because he wanted to ensure that other important points in the book did not overshadow his shareholder primacy argument. In other words, the early release of this argument can be interpreted as Berle's effort to prevent shareholder primacy from becoming obscured by the pandemonium the book was anticipated to create about the looming threat of corporate power.

## B. Dodd, the Anti-Managerialist

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<sup>109</sup> The 5 examples are: (1) power to issue stocks, (2) power to declare or withhold dividends, (3) power to acquire stocks in another corporation, (4) power to amend the corporate charter, and (5) power to merge with another enterprise. See Berle 1931, *ibid.*, 1050-72; and *The Modern Corporation*, *ibid.*, 221-240.

<sup>110</sup> Berle 1931, *ibid.*, 1050-72; and *The Modern Corporation*, *ibid.*, 1050-72.

<sup>111</sup> Berle 1931, *ibid.*, 1050; and *The Modern Corporation*, *ibid.*, 221.

<sup>112</sup> Berle 1931, *ibid.*, 1072-1073; and *The Modern Corporation*, *ibid.*, 241.

<sup>113</sup> Berle 1931, *ibid.*, 1074; and *The Modern Corporation*, *ibid.*, 242.

<sup>114</sup> This original publisher decided shortly after the original publication that they “could not handle the book properly” and arrangements were made to transfer the book to Macmillan and Company. It was General Motors (a client of Corporation Trust), which pressured the publishing house to drop the book. See Berle's Biographer, *supra*, note 8 at 67.

<sup>115</sup> Means 1931, *supra*, note 68.

Edwin Merrick Dodd was born in Providence, Rhode Island, in 1888, and was the son of a wool merchant.<sup>116</sup> He entered Harvard College in 1910.<sup>117</sup> His first teaching position in law was at Washington & Lee,<sup>118</sup> but the Great War interrupted his fledgling career, where he served as a member of the legal staff for the War Industries Board.<sup>119</sup> After the war, he practiced law for a short time, but soon realized that he preferred academia.<sup>120</sup> He taught at both the University of Nebraska and Chicago<sup>121</sup> before returning to Harvard Law School in 1928,<sup>122</sup> where he taught for more than twenty-three years.<sup>123</sup> During the Second World War he served once again with the War Production Board, but this time in a more judicial capacity as a Compliance Commissioner.<sup>124</sup> Dodd died in a tragic car accident with his wife in 1951.<sup>125</sup>

When one reflects on the body of Dodd's work, one can distinguish recurring anti-managerialist leanings – in particular: 1) the promotion of the fiduciary duty of corporate management, and 2) the protection of fairness and equity between classes of security holders.<sup>126</sup> Dodd consistently asserted that managers were in a position of trust and confidence, which lead him to urge courts to be more diligent in enforcing managerial obligations.<sup>127</sup> His works indicated that in a managerialist debate, he would argue the

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<sup>116</sup> ZECHARIAH CHAFEE, JR., *EDWIN MERRICK DODD*, 65 HARV. L. REV. 379 (1952), 379 (Hereinafter: Chafee 1952).

<sup>117</sup> Chafee 1952, *ibid.*, 379.

<sup>118</sup> Chafee 1952, *ibid.*, 380.

<sup>119</sup> Chafee 1952, *ibid.*, 380-381.

<sup>120</sup> Chafee 1952, *ibid.*, 380-381.

<sup>121</sup> Chafee 1952, *ibid.*, 380-381.

<sup>122</sup> RALPH J. BAKER, *EDWIN MERRICK DODD*, 65 HARV. L. REV. 389 (1952), 389 (Hereinafter: Baker 1952).

<sup>123</sup> ERWIN N. GRISWOLD, *EDWIN MERRICK DODD*, 65 HARV. L. REV. 379 (1952), 377 (Hereinafter: Griswold 1952).

<sup>124</sup> COVINGTON HARDEE, *EDWIN MERRICK DODD*, 65 HARV. L. REV. 379 (1952), 396.

<sup>125</sup> Griswold 1952, *supra*, note 123 at 377.

<sup>126</sup> Baker 1952, *supra*, note 122 at 389.

<sup>127</sup> A review of examples that support this claim from the body of Dodd's work follows. In a two-part series, Dodd explored the limits of management power to alter corporate charters. See E. MERRICK DODD, JR., *DISSENTING STOCKHOLDERS AND AMENDMENTS TO CORPORATE CHARTERS*, 75 U. PA. L. REV. 585 (1927); and E. MERRICK DODD, JR., *DISSENTING STOCKHOLDERS AND AMENDMENTS TO CORPORATE CHARTERS (CONTINUED)*, 75 U. PA. L. REV. 723 (1927). In another particularly relevant article, Dodd traced the radical change in the impact of the fiduciary principle from small-scale to large-scale capitalism. See E. MERRICK DODD, JR., *MODERN CORPORATION, PRIVATE PROPERTY, AND RECENT FEDERAL LEGISLATION*, 54 HARV. L. REV. 917 (1941). In another, Dodd argued that corporate management's ability to purchase and redeem its own company shares ought to be brought within the fiduciary obligation. See E. MERRICK DODD, JR., *PURCHASE AND REDEMPTION BY A CORPORATION OF ITS OWN SHARES: THE SUBSTANTIVE LAW*, 89 U. PA. L. REV. 697 (1941). Dodd again argued that corporate management ought to act in light of their fiduciary

anti-managerialist position and accordingly one would assume that he would agree, in general, with Berle's position. However, this was not the case, for although they may have shared much common ground, upon reading Berle's 1931 article (and possibly all of his legal articles up to 1931), Dodd deduced that Berle was too radical in his protection of shareholder rights, and that he was sacrificing the broader responsibility of managers to the community and possibly the potential that corporatism had to stabilize American capitalism at the time.<sup>128</sup>

In fact, Dodd was so disturbed by the implications of Berle's argument that he uncharacteristically employed a managerialist argument in order to attempt to undermine Berle's shareholder primacy theory. He determined that Berle's extreme stance was dangerous, making management no more than attorneys for shareholders (Dodd considered shareholders sophisticated financiers and promoters, not the middle and working classes that Berle envisioned) by limiting the scope of managerial accountability to maximizing profits; and when necessary, doing this at the expense of all other corporate constituents. Years later, Dodd admitted that the arguments he offered Berle in his reply were "rash" and riddled with "legal difficulties",<sup>129</sup> but regardless, Dodd felt the need to address this threat before Berle's misguided theory could gain greater traction and potentially change the course of corporate evolution.

### *C. For Whom Are Corporate Managers Trustees?*

In the 1932 article that branded Berle a conservative, Dodd argued that the duty of managers ought to be extended to other stakeholders. From Dodd's perspective, managers were granted many freedoms, whether through law or factual circumstance, to conduct business in a manner that would not necessarily maximize profits.<sup>130</sup> Dodd observed that this freedom appeared to have agitated Berle to place undue emphasis upon the fiduciary relationship between managers and shareholders.<sup>131</sup> Dodd's assumption regarding Berle's motivations was incorrect; even at face value, Berle was clearly attempting to prevent managers from exploiting the separation of ownership and control, not to maximize shareholder dividends.<sup>132</sup>

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obligation for the benefit of security holders in relation to their interest. See E. MERRICK DODD, JR., *FAIR AND EQUITABLE RECAPITALIZATIONS*, 55 HARV. L. REV. 780 (1942). In the following article, he showed great concern for the fiduciary principles, especially in relation to the obligation of majority shareholders to minority shareholders or to a particular class of shares. See E. MERRICK DODD, JR., *LIABILITY OF A HOLDING COMPANY FOR OBTAINING FOR ITSELF PROPERTY NEEDED BY A SUBSIDIARY – THE BLAUSTEIN CASE*, 58 HARV. L. REV. 125 (1944). For supporting commentary, see Baker 1952, *ibid.*, 390; and Chaffee, *supra*, note 116 at 382.

<sup>128</sup> Bratton and Wachter 2008, *supra*, note 5 at 124-128.

<sup>129</sup> E. MERRICK DODD, *BOOK REVIEWS*, 9 U. CHI. L. REV. 538 (1942), 546 (Hereinafter: Dodd 1942).

<sup>130</sup> E. MERRICK DODD, JR., *FOR WHOM ARE CORPORATE MANAGERS TRUSTEES?*, 45 HARV. L. REV. 1145 (1932), 1147 (Hereinafter: Dodd 1932).

<sup>131</sup> Dodd 1932, *ibid.*, 1147.

<sup>132</sup> The Modern Corporation, *supra*, note 50 at 302-308.

Dodd wanted to maintain the gap between ownership and control of the modern corporation so that private property rights would not restrict all management decisions. Dodd adopted an understanding of the underlying structure of the corporation, and agreed with Berle that managers owed a fiduciary duty to the shareholders, but not as individuals, only to shareholders as a group.<sup>133</sup> What Dodd meant by this was that it was not the actual interest of shareholders, but a constructed interest of “the shareholder”, to which management owed a duty. He argued that this conceptualization of shareholders required corporate managers to treat the corporation differently than merely an amalgamation of contractual and fiduciary obligations owed to actual and immediate shareholders. This created a space for management to find a balance between the optimal-immediate and perpetual performance of the organization by serving the best interest of the corporation as a whole.

Dodd asserted that his suggestion was not a dramatic shift of perception from Berle’s understanding of the firm, for the picture was altered “more in form than in substance”,<sup>134</sup> since the sole function of the corporation (being to make profit for its shareholders) remained unaltered.<sup>135</sup> But this was not altogether true, because although the sole function of the corporation was still profit making, Dodd’s perspective was jamming a wedge between ownership and control, aligning managerial discretion with the best interests of the corporation rather the shareholders. This opened a debate as to what was in the best interests of the corporation. Such ambiguity was what Berle was attempting to eradicate so as to limit managerial opportunism – at least in the interim. Dodd hoped that if this theoretical tweak were accepted, it would free management enough to take into consideration the interests of other stakeholders, even at the expense of maximizing profits.

Dodd was aware that he was placing power into the hands of management. He argued for placing faith in management rather than shareholders to guide the corporation, asserting that the fiduciary relationship, as Berle conceived it, would create a serious obstacle to achieving socially responsible managers.<sup>136</sup> He argued that one must look to the managers, not to the owners, for professionalized corporate conduct,<sup>137</sup> for it was “hardly thinkable” that absentee owners, who have little or no contact with their business other than collecting a dividend, would be filled “with a professional spirit of public service”.<sup>138</sup> Moreover, if corporate managers had a duty solely to shareholders, all other

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<sup>133</sup> Dodd 1932, *supra*, note 130 at 1146.

<sup>134</sup> Dodd 1932, *ibid.*, 1146.

<sup>135</sup> Dodd 1932, *ibid.*, 1146.

<sup>136</sup> Dodd 1932, *ibid.*, 1162.

<sup>137</sup> Dodd 1932, *ibid.*, 1153.

<sup>138</sup> Dodd 1932, *ibid.*, 1153.

stakeholders with a vested interest in the corporation (including employees, consumers and the community) would have to find protection from corporate power when their interests were contrary to maximizing profits for shareholders.<sup>139</sup> Therefore, to promote socially responsible behavior, corporate managers needed to be the guardians of all interests that the corporation affected, and this could only happen if corporate managers were freed to be able to employ the corporation's "funds in a manner appropriate to a person practicing a profession and imbued with a sense of social responsibility without thereby being guilty of a breach of trust".<sup>140</sup>

If freed from whatever constraints the fulfillment of a shareholder primacy agenda could impose, why would managers use this broader discretion for the betterment of the community when they could use it to enrich themselves instead? To address the issue of opportunism, Dodd acknowledged the problem and then stated that it was not the concern of his article to question: "whether the voluntary acceptance of social responsibility by corporate managers [was] workable, but whether experiences in that direction [ran] counter to fundamental principles of the law of business corporations".<sup>141</sup> However, he tacitly contradicted himself by appealing to the claims of high-minded managers, who espoused the virtue of public duty. He did this to establish that managers might be worthy of trust. But to the more skeptical contemporary ear, such claims sound hauntingly like the rhetoric of Kenneth Lay, who at one time was the poster boy for corporate social responsibility and "self-regulation", but whose promises were exposed as some of the grossest examples of corporate deception in American history.<sup>142</sup> This begs the question: why would one attempt to wrench managers out of fiduciary relationships without understanding the outcome? As William Bratton has pointed out, the advocates of greater corporate responsibility have followed Dodd down this slippery slope ever since, by asking observers to bet on the fact that if management had greater freedom from shareholder expectations, they would be more responsible to the community.<sup>143</sup>

In the end, Dodd merely employed optimism for the new generation of managers who claimed to be enlightened enough to use their discretion to assist other stakeholders, like employees, who needed protection from the inequities of their bargaining positions with

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<sup>139</sup> Dodd 1932, *ibid.*, 1162.

<sup>140</sup> Dodd 1932, *ibid.*, 1161.

<sup>141</sup> Dodd 1932, *ibid.*, 1162.

<sup>142</sup> For a broad perspective on this issue, see *CONFERENCE ON ENRON, WORLDCOM, AND THEIR AFTERMATH*, 27 VT. L. REV. 817 (2003); WILLIAM W. BRATTON, *ENRON AND THE DARK SIDE OF SHAREHOLDER VALUE*, 76 TUL. L. REV. 1275 (2002); JOHN C. COFFEE, JR., *WHAT CAUSED ENRON - A CAPSULE SOCIAL AND ECONOMIC HISTORY OF THE 1990S*, 89 CORNELL L. REV. 269 (2003); and DAVID MILLON, *WHO CAUSED THE ENRON DEBACLE*, 60 WASH. & LEE L. REV. 309 (2003).

<sup>143</sup> WILLIAM W. BRATTON, *WELFARE, DIALECTIC, AND MEDIATION IN CORPORATE LAW*, 2 BERKELEY BUS. L.J. 59 (2005), 73-74 (*hereinafter*: Bratton 2005); and WILLIAM W. BRATTON, *NEVER TRUST A CORPORATION*, 70 GEO. WASH. L. REV. 867 (2002) (arguing this point to Lawrence Mitchell in response to his book "Corporate Irresponsibility"). For an example of such Doddish assumptions, see LAWRENCE E. MITCHELL, "CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT" (2001) (*Hereinafter*: Mitchell 2001).

the corporation.<sup>144</sup> He romanticized about the potential to transform modern business from a “purely private matter” into a “public profession”, in which managers would undertake a role as stewards of society.<sup>145</sup> His arguments were inspiring, but also lacking substance, rendering them no more than corporate futurism.

It has been observed that Dodd was endorsing “business commonwealth” corporatism.<sup>146</sup> Like planners corporatism, this form focuses on collaborative relationships shared between different groups (including government) in order to establish what is in the public interest.<sup>147</sup> After public interest is established, then policies are adopted, adapted and coordinated among the different groups in order to achieve the agreed upon public interest within society.<sup>148</sup> The distinction between the two visions of corporatism is that while planners corporatism advocates that the government take the lead role in this process, business commonwealth corporatism argues for industrialists to take the lead, “relegating government to a backstop, supporting role”.<sup>149</sup>

However, when one considers Dodd’s broader publication record,<sup>150</sup> it becomes questionable whether the suggestion that Dodd was a business commonwealth corporatist can stand up to scrutiny. Admittedly, Dodd’s argument from the 1932 article suggests that he was using the business commonwealth corporatists (in particular, Owen D. Young and Gerald Swope) as examples of professionalized corporate managers who voluntarily accepted a responsibility for achieving public interest ends.<sup>151</sup> But when one puts the 1932 article to one side and reviews Dodd’s other writings before and after the 1932 article, it becomes clearer that Dodd was primarily an anti-managerialist. Therefore one can conclude that Dodd was merely open-minded to Young’s and Swope’s business commonwealth corporatism, adopting a wait-and-see approach to “whether experiences in that direction [ran] counter to fundamental principles of the law of business corporations”.<sup>152</sup>

It is further submitted that Dodd sided with business commonwealth corporatists, merely because he needed examples of potentially enlightened managers to counter what he believed to be Berle’s alarmingly extreme shareholder primacy position. In other words,

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<sup>144</sup> Dodd 1932, *supra*, note 130 at 1146, 1148, 1151-1153, and 1165-1167.

<sup>145</sup> Dodd 1932, *ibid.*, 1148.

<sup>146</sup> Bratton and Wachter 2008, *supra*, note 5 at 122.

<sup>147</sup> Bratton and Wachter 2008, *ibid.*, 123.

<sup>148</sup> Bratton and Wachter explanation of corporatism *see supra*, note 90.

<sup>149</sup> Bratton and Wachter explanation of corporatism *see ibid.*, 25.

<sup>150</sup> *Supra*, note 127 for review of Dodd’s writing.

<sup>151</sup> Bratton and Wachter 2008, *supra*, note 5 at 123-124.

<sup>152</sup> Dodd 1932, *supra*, note 130 at 1162.

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

In sum, Dodd's 1932 article ought to be regarded as a reaction to Berle's position. The argument in this article contradicted his own best judgment (as established by the archive of his work)<sup>153</sup>. This is why he later admitted that this argument was "rash" and riddled with "legal difficulties".<sup>154</sup> Thus it should be regarded more as a consequence of Berle's extremism and less as a sincere endorsement of business commonwealth corporatism. Dodd was merely petitioning those potentially lured by Berle's perceived extremism to keep an open-mind and not to close the door on the potential for enlightened managerial behavior. And yet Dodd was overzealous in making this point, crossing the line of suggesting the potential of other options by fully advocating managerialism in a rash and reactionary manner. Therefore though the case can be made that Dodd advocated "business commonwealth" corporatism, his level of enthusiasm actually skews a more accurate understanding of what Dodd was doing. To be more accurate one must emphasize that the contradictory nature of Dodd's other writings, before and after this article, point to the conclusion that he was not a business commonwealth corporatist.<sup>155</sup>

#### *D. For Whom Corporate Managers are Trustees: A Note*

One could imagine a number of ends to this story. For instance, Berle could have explained his position in a congenial manner, highlighting the similarities of his arguments with those of Dodd, and explaining their differences as not so dissimilar after all. But this never happened. Instead, as Berle's biographer notes, Berle was outraged by Dodd's accusation that he was a conservative. Imagine how agonizing it must have been for the sometimes pompous Berle to endure such an affront on the eve of the release of his crowning achievement (*The Modern Corporation and Private Property*), which was to be (by his design) his coming out party into the world of the left-leaning intellectual elites of America.<sup>156</sup> His biographer writes, "Dodd's real crime was making Berle seem like a Tory in the midst of an American revolution".<sup>157</sup> Berle had expected a managerialist attack from conservatives, who would rhetorically defend the *status quo ante* of managerial discretion, but he did not expect to be accused of being a conservative. Dodd was probably equally surprised that Berle's reply was left-leaning. This family feud of the left exposed Berle's argument as being less than ideal, based on

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<sup>153</sup> *Supra*, note 127 for review of Dodd's early writing.

<sup>154</sup> Dodd 1942, *supra*, note 129 at 546.

<sup>155</sup> *Supra*, note 127 for review of Dodd's writing.

<sup>156</sup> Berle's Biographer, *supra*, note 8 at 62.

<sup>157</sup> Berle's Biographer, *ibid.*, 66.

the weak assumption that the interests of absentee owners would make management more accountable, while also exposing Dodd's corporate responsibility argument as being naïvely trusting of corporate managers. The debate expose the fragility of both arguments.

To address Dodd's criticism, and more importantly, to defend his own reputation and exact a little revenge, Berle elaborated on his main thesis, that "all powers granted to a corporation ... are ... at all times exercisable only for the ratable benefits of all the shareholders as their interest appears".<sup>158</sup> He argued that the present law established that managers were required to manage the corporation in the interest of its shareholders, and that although many groups, notably labour, were gaining recognition as having claims against the corporation (which created legitimate cost to industry), the recognition of these costs (which reduced profits) did not alter the main objective of the corporate managers.<sup>159</sup> Berle continued to fire back at Dodd by arguing that the "real justification" for Dodd's opposition to his thesis stemmed from Dodd's underlying assumption that industrial managers of the day functioned more as government officials than as merchants,<sup>160</sup> which Berle tacitly (and spitefully) suggests was a foolhardy reason, because managers did not see themselves as such.<sup>161</sup>

Berle did not dispute Dodd's suggestion that the corporation needed to be accountable to the wider polity.<sup>162</sup> This concession probably shocked Dodd, because it was a slippery slope, which opened the door to the primacy of the public interest over property rights. This is an argument that a clever conservative liberal, like Dodd accused Berle of being, would never make. After making clear his colors, Berle then went on the attack, clarifying with slightly condescending undertones to Dodd that managers did wield immense (government-like) power over society, but did not regard themselves as stewards of society and did not assume social responsibilities. And to make matters worse, no mechanism existed to enforce the applications of Dodd's pseudo-theory of the corporation.<sup>163</sup> Furthermore, if the fiduciary obligation of managers to shareholders was ignored, then the management and *control*<sup>164</sup> would become "for all practical purposes

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<sup>158</sup> Berle 1931, *supra*, note 39 at 1049; and *The Modern Corporation*, *supra*, note 50 at 220.

<sup>159</sup> ADOLF A. BERLE, JR., *FOR WHOM CORPORATE MANAGERS ARE TRUSTEES: A NOTE*, 45 HARV. L. REV. 1365 (1932), 1365 (Hereinafter: Berle 1932).

<sup>160</sup> Berle 1932, *ibid.*, 1367.

<sup>161</sup> Berle 1932, *ibid.*, 1367.

<sup>162</sup> Berle 1932, *ibid.*, 1372.

<sup>163</sup> Berle 1932, *ibid.*, 1367.

<sup>164</sup> Berle explained that "Control" in this context refers to individuals or small groups of individuals who are able to mobilize or cast sufficient votes to elect a corporate board of directors. This is the sense in which the word is used in the financial communities. See Berle 1932, *ibid.*, 1366. He also contemplated "control" in his earlier works, for instance, see *The Modern Corporation*, *supra*, note 50 at 206; and Berle 1926.2, *supra*, note 43.

absolute” – resulting in greater corporate irresponsibility.<sup>165</sup> Therefore, until such time as Dodd (or any others who sympathized with the noble manager) was prepared to offer a “clear and reasonable enforcement scheme of responsibilities”, emphasis would have to be placed on the fact that the corporation’s sole purpose was to make profits for their shareholders, because there existed no other legal control of corporate power, however imperfect it may be.<sup>166</sup> Berle emphasized that shareholder primacy was the best option available to take “responsibility for control of national wealth and incomes” in a manner that properly protected the majority of the community.<sup>167</sup> Basically, he was chastising Dodd for being quixotic, suggesting it was time for him to get his head out of the clouds and see what managers were actually doing.

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

The administration of corporations – peculiarly, a few hundred large corporations – is now the crux of American industrial life. Upon the securities of these corporations had been erected the dominant part of the property system of the industrial east. A major function of these securities is to provide safety, security, or means of support for that part of the community which is unable to earn its living in the normal channels of work or trade. Under cover of that system, certain individuals may perhaps acquire a disproportionate share of wealth. But this is an incident to the system and not its major premise; statistically, it plays a relatively minor part. Historically, and as a matter of law, corporate managements have been required to run their affairs in the interests of their security holders.<sup>168</sup>

In closing, Berle reiterated that the law could not surrender the present fiduciary controls over management before a new order emerged, noting that “legal technique [did] not contemplate intervening periods of chaos”<sup>169</sup>, but would only respond to new outcomes or theories as they were established.<sup>170</sup> He foresaw that social theorists would guide the

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<sup>165</sup> Berle 1932, *supra*, note 159 at 1367.

<sup>166</sup> Berle 1932, *ibid.*, 1367.

<sup>167</sup> Berle 1932, *ibid.*, 1368.

<sup>168</sup> Berle 1932, *ibid.*, 1365.

<sup>169</sup> Berle 1932, *ibid.*, 1371.

<sup>170</sup> Berle 1932, *ibid.*, 1371.

establishment of a revised institutional design of American society, and that at this point the law could play a role stabilizing expectations and relations between stakeholders as they emerged.<sup>171</sup> But until such a time, lawyers were in a position where they needed legal tools to meet day-to-day situations. The fiduciary duty of management to shareholders was presently the best legal tool they had to control corporate behavior.<sup>172</sup> And as it stood, the shareholder primacy model worked as a method to ensure public interest, if envisaged in the correct manner.

Berle punctuated his reply to Dodd, declaring: “[I]t is one thing to say that the law must allow for such developments. It is quite another to grant uncontrolled power to corporate managers in the hope that they will produce that development.”<sup>173</sup> Berle’s bad-natured reactions aside, he focused his attack on what Dodd had actually attempted to accomplish in his article, namely weakening the fiduciary obligations of managers to shareholders before social theorists could rationalize the modern corporation in a manner that could be adopted by law. He did so because he thought that the application of Dodd’s argument would result in a *carte blanche* for corporate irresponsibility, and because Dodd did not appreciate what he was attempting to accomplish with shareholder primacy. The article amounted to a cold splash of water tossed across Dodd’s face, followed by Berle’s unspoken cry to “WAKE UP!”.

In sum, Berle argued clearly that shareholders’ fiduciary controls over management could not be abandoned by lawyers until a new order emerged, noting that “legal technique [did] not contemplate intervening periods of chaos”, but would only respond to new outcomes or theories as they were established.<sup>174</sup> Berle’s argument in the 1932 article mirrored the missing passages from the 1931 article (which were published in *The Modern Corporation and Private Property*). He argued that social science needed to better guide the legal understanding of the evolving corporate form, and that only after this was done could the law play a role in the emerging new order.<sup>175</sup> Berle emphasized that lawyers needed new legal tools to bring corporate behavior under greater control.<sup>176</sup> Shareholder primacy was the only tool available.

One question may be nagging the reader at this point, which is worth exploring: why did Berle not take the time to write a more thorough response to Dodd? If Berle had more to say about the future regulation of corporations and how the shareholder primacy argument was merely to be an interim solution in light of the opportunity opening for

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<sup>171</sup> Berle 1932, *ibid.*, 1371-1372.

<sup>172</sup> Berle 1932, *ibid.*, 1371-1372.

<sup>173</sup> Berle 1932, *ibid.*, 1372.

<sup>174</sup> Berle 1932, *ibid.*, 1371.

<sup>175</sup> Berle 1932, *ibid.*, 1371-1372.

<sup>176</sup> Berle 1932, *ibid.*, 1371-1372.

planners corporatism on the political horizon, why did he not present it in the Harvard Law Review? *The Modern Corporation and Private Property* was merely weeks away from release, and his 1932 article could have been a great support for the book's launch, which Berle so desperately wanted to be a success. And yet, Berle was very guarded in his response to Dodd. At first, I chalked it up to Berle's disgust with the situation, imagining him firing off a reply more as a knee-jerk emotional response than as a reasoned clarification of his position. I also figured that it tied in with his fear of alienating Brandeis-style anti-trust advocates. But William Bratton and Michael Wachter provide a more provocative alternative, which I had overlooked. They write:

We suspect he thought that the timing was wrong. The battle between his progressive vision of corporatism and business commonwealth corporatism was taking place behind closed doors. Berle wanted to ensure his vision of corporatism was the one that would be adopted by the Roosevelt Administration and presumably was jealous to protect his influence.<sup>177</sup>

Of course the timing was wrong! They note that Raymond Moley, a colleague at Columbia University, lured Berle away from full-time academia in 1932 by convincing him to join Roosevelt in his bid to win the presidency.<sup>178</sup> However, the authors are vague as to when this offer was made, writing only: it was "early in [Roosevelt's] 1932 presidential campaign".<sup>179</sup> The argument calls for more precision. If a connection is to be established between Berle's reply to Dodd and Berle's Roosevelt years, pinpointing months matters. So to be more exact, although some disagreement between Sam Rosenman (Governor Roosevelt's counsel at the time) and Moley existed as to when Moley joined Roosevelt's bid for the Presidency (Moley saying January 1932 and Rosenman saying March 1932<sup>180</sup>), Berle could not have joined the campaign prior to Moley. Berle also noted that his first memorandum to Roosevelt was in May of 1932.<sup>181</sup> Certainly, Berle was aware that he would be functioning in his new position as a political advisor for a presidential candidate in May. Dodd published his reply to Berle on May 8, 1932,<sup>182</sup> and Berle fired back his reply to Dodd after that date in the following edition.

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<sup>177</sup> Bratton and Wachter 2008, *supra*, note 5 at 128.

<sup>178</sup> Bratton and Wachter 2008, *ibid.*, 109. Also see Berle's Biographer, *supra*, note 8 at 71.

<sup>179</sup> Bratton and Wachter 2008, *ibid.*, 109.

<sup>180</sup> Berle's Biographer, *supra*, note 8 at 71 (as the biographer paraphrases Berle). Also generally see SAMUEL I. ROSENMAN, *WORKING WITH ROOSEVELT* (1952); SAMUEL B. HAND, *COUNSEL AND ADVISE: A POLITICAL BIOGRAPHY OF SAMUEL I. ROSENMAN* (1979); RAYMOND MOLEY, *AFTER SEVEN YEARS* (1939); and RAYMOND MOLEY, *THE FIRST NEW DEAL* (1968).

<sup>181</sup> A passage from Berle's 1956 article entitled *The Reshaping of the American Economy*, reprinted in: Berle's Personal Writings, *supra*, note 15 at 31. And also, see Berle's Biographer, *supra*, note 8 at 71 (dating Berle's first memo to late May).

<sup>182</sup> Dodd 1932, *supra*, note 130 at 1145.

The “New Individual” speech (presented about three months later), which was penned by Berle for Roosevelt, clearly established that corporatism was on Berle’s mind.

So what happened to his vision of the corporate liberal revolution? As argued, his early hopes for democratization of the economy were through shareholder primacy and the evolution of the corporate form. This was his corporate liberal revolution. However, this was only one manner to enforce the public interest in corporate governance. In 1932, the political landscape was shifting, and Berle believed that planners corporatism, which he endorsed in the last chapter of the *Modern Corporation and Private Property*, was possible if Roosevelt won the election and if Berle could convince him to see things his way. In sum, Berle wanted to ensure that corporate governance could be directed to take into consideration the wider polity, and he believed that he had an opportunity to make this happen.

However, Bratton and Wachter did not get it totally right. The battle behind closed doors was not between Berle’s corporatism and business commonwealth corporatism. The battle, at least in Roosevelt’s campaign team ranks (and that was where Berle was battling), was between: 1) his corporatism and the new individual and 2) Brandeis-style anti-trust economics and the old individual.<sup>183</sup> The champion of the latter was Felix Frankfurter and his acolytes, whom Berle called “the would-be Brandeis followers of today”, and yet who “lacked the great man’s admirable genius for being both radical and practical”.<sup>184</sup>

The relationship between Frankfurter and Berle needs to be explained so that the claim that they strongly disliked each other does not seem like an exaggeration, because in fact, “strongly disliked” may understate the spirit of their relationship. Frankfurter came to America from Austria at the age of 12 and spoke no English. A few years later, he graduated from Harvard Law School with grades only slightly less impressive than Brandeis. Frankfurter joined the faculty at Harvard when Berle was in his first year of law school.

Frankfurter’s biographer describes Frankfurter’s chief personality imperfection in the following passage:

Because his self-image was inflated, and because his psychological peace rested upon that self-image, Frankfurter could not accept serious, sustained opposition in fields he considered his domain of expertise; he reacted to his opponents with vindictive hostility.<sup>185</sup>

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<sup>183</sup> Berle’s Biographer, *supra*, note 8 at 89.

<sup>184</sup> Berle’s Biographer, *ibid.*, 104.

<sup>185</sup> H. N. HIRSCH, THE ENIGMA OF FELIX FRANKFURTER (1981), 5-6. And also for reprint, *see* Berle’s Biographer, *ibid.*, 14.

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

Later in life neither man cared to discuss the other, and there are only snippets of stories concerning their Harvard years. Yet, what emerges is an arrogant young Berle bent on cutting others down to size. The young Adolf relentlessly challenged Frankfurter in class, thereby making himself an unforgivable embarrassment to the professor. According to William O. Douglas, later a Columbia Law School and New Deal colleague, in the years following Berle's enrollment in Frankfurter's course, Berle began attending it for a second year in a row. Frankfurter was puzzled and asked Berle if he had taken the course the previous year. Berle replied affirmatively and Frankfurter asked, "Then why are you back?" "Oh", Berle responded, "I wanted to see if you had learned anything since last year." Another story had a vengeful Frankfurter blocking the young Berle from making the *Law Review*.<sup>186</sup>

From one perspective, Frankfurter's animosity was understandable. From another, it was not. It is difficult to image a pupil exhibiting such disrespect for a professor without inciting disciplinary action. However, for Frankfurter to personally retaliate against the immature Berle (remember Berle started law school three or four year earlier than most students, since he already had two Harvard degrees by the age of 19), thereby exhibiting transparent signs of vindictiveness to a poorly adjusted (yet arrogant) student might be seen as unprofessional.

Putting this relationship into relevant context, Roosevelt strategically divided his advisors so that no one camp within his ranks enjoyed the position of privileged insider,<sup>187</sup> thus creating a competitive decision-making process. This was an unnecessary mechanism in the case of Berle and Frankfurter, for any decision-making process that involved both men could be nothing less than competitive. While on the campaign trail, before Berle had written the "New Individual" speech, Roosevelt invited Frankfurter's opinion regarding policy development. Berle's biographer writes:

Felix Frankfurter's intrusion into the campaign [was] intolerable. Aside from his old personal animus to the Harvard law professor, Berle saw in Frankfurter an ideological adversary – a Brandesian "atomist" who opposed the brain trust consensus on large economic units for industrial planning.<sup>188</sup>

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<sup>186</sup> Berle's Biographer, *ibid.*, 14.

<sup>187</sup> Berle's Biographer, *ibid.*, 88.

<sup>188</sup> Berle's Biographer, *ibid.*, 76.

Berle warned Roosevelt that he should not make Frankfurter's "New Freedom" speech, which was similar to what Brandeis had drafted for Woodrow Wilson.<sup>189</sup> Berle thought that Brandeis-style individualism was what Coolidge's and Hoover's Administrations used as a euphemism for inaction.<sup>190</sup> He argued, "Whatever the economic system does permit, it is not individualism."<sup>191</sup> He then advised Roosevelt:

It is necessary to do for [the American] system what Bismarck did for the German system in 1880, as [a] result of conditions not unlike these . . . . Otherwise only one of two results can occur. Either [the] handful of people who run the economic system now will get together making an economic government which far outweighs in importance the federal government; or in their struggles they will tear the system to pieces. Neither alternative is sound national policy.<sup>192</sup>

Berle pressed Roosevelt to make a "pronouncement" arguing, as Berle's biographer puts, for it "public collective planning".<sup>193</sup> Berle suggested to Roosevelt that this pronouncement "would probably make at once [Roosevelt's] place in history and [have] political significance vastly beyond the significance of [his] campaign".<sup>194</sup> Five weeks later Roosevelt gave the "New Individualism" speech, which Berle named in order to contrast Frankfurter's old freedom mantra and to make the statement that he had countermanded Frankfurter's attempts to make individualism a core principle of the campaign.<sup>195</sup>

So, in reply to Bratton and Wachter, I agree that the timing was wrong, and that Berle was engulfed in a policy battle related to his corporatist ambitions. But the battle was not between his corporatism and business commonwealth corporatism, it was between his vision and Frankfurter's vision. As far as the business commonwealth corporatism model, there is no evidence that Frankfurter, or others in the democratic camp, directly advocated it. Furthermore, Berle did want, as Bratton and Wachter put it, "to ensure his vision of corporatism was the one that would be adopted by the Roosevelt Administration".<sup>196</sup> He "was jealous to protect his influence",<sup>197</sup> but not from his few

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<sup>189</sup> Berle's Biographer, *ibid.*, 77.

<sup>190</sup> Berle's Biographer, *ibid.*, 77.

<sup>191</sup> Berle's Biographer, *ibid.*, 77.

<sup>192</sup> Berle's Biographer, *ibid.*, 78.

<sup>193</sup> Berle's Biographer, *ibid.*, 78.

<sup>194</sup> Berle's Biographer, *ibid.*, 78.

<sup>195</sup> Berle's Biographer, *ibid.*, 78.

<sup>196</sup> Bratton and Wachter 2008, *supra*, note 5 at 128.

<sup>197</sup> Bratton and Wachter 2008, *ibid.*, 128.

members of the brain-trust are the time (Moley, Rexford Tugwell and James Warburg) rather from his old nemesis – Felix Frankfurter.

Berle would have probably known from the outset of his time with Roosevelt that Frankfurter had been informally advising Roosevelt from the time that he was the Governor of New York State,<sup>198</sup> and that at some point Frankfurter would be called in to assume a similar role during the presidential campaign. Furthermore, Frankfurter was Brandeis's protégé, and the ideological connection between Frankfurter and Brandeis was well known.<sup>199</sup> So Berle, being an ex-student of Frankfurter and a young lawyer for a year at Brandeis's law firm, would have known that a battle was coming. He would have also known the position that Frankfurter would be espousing to Roosevelt. Here Berle had an advantage, because he knew Frankfurter's plan of action, but Frankfurter was blind to Berle's. Berle's biographer sets the scene in the following passage:

Both men were anxious to succeed and there developed between them a strong animus that would ripen into the bitterest and most ideological of New Deal rivalries ... the issue between them being whether the antitrust laws should be used to break up big corporations and restore the competition [Frankfurter] or whether big corporations were the products of natural economic forces and should be controlled through federal regulation [Berle].<sup>200</sup>

Berle would have appreciated that he had an ace up his sleeve, being that his planners corporatism pitch to Roosevelt was unknown to Frankfurter. It is easy to imagine Berle wanting to write a much different reply to Dodd, outlining planners corporatism, but Berle had not won the ideological struggle with Frankfurter by the time that Berle fired back his reply to Dodd.<sup>201</sup> Berle must have felt that it was too risky to reveal his position in the Harvard Law Review (Frankfurter's backyard). Berle could have foreseen the "vindictive" Frankfurter not only being aware of, but also enjoying, Dodd's reply to Berle on the eve of the much-anticipated release of *The Modern Corporation and Private Property*. Berle must have figured that publishing a full disclosure to Frankfurter of how he would advise Roosevelt in the coming months would not be worth the possibility of Frankfurter winning the opinion of Roosevelt on this issue at such a critically sensitive moment in American history. Having a hand in the future course of American society, at

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<sup>198</sup> MAX ISENBERGH, *CLAIMS OF HISTORY? OR WHAT THE MARKET WILL BEAR?*, 45:2 VA. Q. REV. 345 (1969), 347. And also see MAX ISENBERGH, *FRANKFURTER AS POLICYMAKER*, 85 YALE L. J. 280 (1975).

<sup>199</sup> Generally see NELSON L. DAWSON, LOUIS D. BRANDEIS, FELIX FRANKFURTER, AND THE NEW DEAL (1980). And also, see BRUCE ALLEN MURPHY, *THE BRANDEIS/FRANKFURTER CONNECTION THE SECRET POLITICAL ACTIVITIES OF TWO SUPREME COURT JUSTICES* (1982).

<sup>200</sup> Berle's Biographer, *supra*, note 8 at 14.

<sup>201</sup> Berle would have been writing his reply to Dodd in May 1932 and Roosevelt had not agreed to Berle's "New Individualism" speech until about five weeks before the speech was delivered by Roosevelt at the Commonwealth Club in San Francisco on September 23, 1932. See Berle's Biographer, *ibid.*, 78.

a time when it was on the verge of economic collapse, raised the stakes so high that Berle had to play his cards close to his chest.

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

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

I was rash enough to suggest that our law of business corporations ... might develop a broader view which would make the proposition that corporate managers are, to some extent, trustees for labor and for the consumer more than meaningless rhetoric. The legal difficulties which were involved were clear enough, as Mr. A.A. Berle was quick to point out.<sup>202</sup>

On the other hand, Berle never made such a concession.<sup>203</sup> Even when confronted by contemporaries for his apparent shift in opinion without sufficient explanation,<sup>204</sup> he denied he ever made concessions – claiming that others misunderstood his writing.<sup>205</sup> Hopefully, my revisiting of the Berle-Dodd debate has clarified Berle’s position, rectifying the long-held misunderstanding of his shareholder primacy argument.

#### V. CONCLUSION

Since Dodd’s reply to Berle, some have feared that investor pressures are negative for corporate governance and society.<sup>206</sup> These fears are now intensifying as commentators

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<sup>202</sup> Dodd 1942, *supra*, note 129 at 546.

<sup>203</sup> Although it is claimed may that he did, such claims assume that the position he endorsed in the *The 20<sup>th</sup> Century Capitalist Revolution* was contrary to his shareholder primacy argument. In fact, considering he regarded shareholder primacy as merely an interim and inadequate measure, there is no inconsistency between his arguments. For his supposed concession, see ADOLF A. BERLE, JR., “THE 20<sup>TH</sup> CENTURY CAPITALIST REVOLUTION” (1954), 137.

<sup>204</sup> For instance, John Lintner mockingly commented: “Berle ... has had his vision somewhere on the road to Damascus, and now regards the concentrated authority of the nucleus of corporate management as being not merely inevitable but positively beneficent in important ways. It has probably enhanced the rate of industrial progress, and has stimulated pioneering and fundamental research which such corporations alone can do.” See John Lintner, *The Financing of Corporations*, in: EDWARD S. MASON, ED., “THE CORPORATION IN MODERN SOCIETY” (1966), 170 (**Hereinafter**: Mason 1966). While Eugene Rostow also commented: “In 1954, Professor Berle accepted Professor Dodd’s initial position, apparently because he concludes that the directors of endocratic corporations, as keepers of the public conscience, can now be safely trusted to exercise their vast power in the public interest, without the safeguard of either stockholder or effective public supervision.” See Eugene V. Rostow, *To Who and For What Ends Is Corporate Management Responsible?*, in: Mason 1966, *ibid.*, 62.

<sup>205</sup> Berle denies his concessions by claiming that he was misunderstood. See Adolf A. Berle, Jr., *Forward*, in: Mason 1966, *ibid.*, xii.

<sup>206</sup> For a general survey of the history of corporate social responsibility, see Wells 2002, *supra*, note 99. For more recent examples of concerns about shareholder empowerment, see Mitchell 2001, *supra*, note 143;

watch investor empowerment evolve into a new and powerful layer of global governance.<sup>207</sup> This governance of society by segments of the financial industry has been called the “rise of finance”.<sup>208</sup>

A central feature of this rise of finance is an increased government dependency upon private investment. Some fear this will lead to disaster. These concerns generally mirror Dodd’s concerns of shareholder primacy. Dodd feared that investors would only use their power to engage in self-interest and avarice. Others dismiss such fears as paranoia. A good case to assess both sides of the arguments is Moody’s recent reassessment of Greece’s creditworthiness.<sup>209</sup> Its downgrading of Greece’s credit status could have crippled the country’s capacity to raise the capital necessary to provide public services. This would have resulted in social unrest and threatened to destabilize the European Union. Moody’s reassessment made clear the power of the financial sector over the fate of economically troubled countries. Luckily for Greece, the European Union stepped in and brokered a deal with the International Monetary Fund to bail Greece out.

This example demonstrates the leverage global financial players (like credit rating agencies and investors) have over public interest. At the same time, it is important to appreciate that Moody’s was commenting only upon Greece’s creditworthiness. If Greece is not credit worthy, this is not Moody’s fault. Further, the Credit Crisis demonstrated what happens when credit rating agencies under-estimate risk. Therefore, Moody’s was merely being professional, non-political and responsible. In the same light, investors were not trying to punish Greece for mismanaging its economy; they were merely safeguarding their investment portfolios by rationally responding to negative investing information.

Then again, it is fair to say that, for the most part, the evermore-powerful financial industry does turn a blind eye to how their investment choices affect society-at-large. Players within this industry presume that they are not responsible for the consequences of political mismanagement. Furthermore, the way decisions are made within the financial sector reinforces this general presumption. For instance, innovations in capital

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WILLIAM LAZONICK AND MARY O’SULLIVAN, *MAXIMIZING SHAREHOLDER VALUE: A NEW IDEOLOGY FOR CORPORATE GOVERNANCE*, IN: WILLIAM LAZONICK AND MARY O’SULLIVAN, EDs., *CORPORATE GOVERNANCE AND SUSTAINABLE PROSPERITY* (2002); SIMON DEAKIN, *SQUARING THE CIRCLE - SHAREHOLDER VALUE AND CORPORATE SOCIAL RESPONSIBILITY IN THE U.K.*, 70 *GEO. WASH. L. REV.* 976 (2002); STEPHEN M. BAINBRIDGE, *DIRECTOR PRIMACY AND SHAREHOLDER DISEMPOWERMENT*, 119 *HARV. L. REV.* 1735 (2006); and MARTIN GELTER, *THE DARK SIDE OF SHAREHOLDER INFLUENCE: MANAGERIAL AUTONOMY AND STAKEHOLDER ORIENTATION IN COMPARATIVE CORPORATE GOVERNANCE*, 50 *HARV. INT’L L. J.* (2009).

<sup>207</sup> Deakin 2008, *supra*, note 7, 679; Lawrence E. Mitchell, *THE MORALS OF THE MARKETPLACE: A CAUTIONARY ESSAY FOR OUR TIME*, 20 *STAN J LAW & POL* 171 (2009); and STEPHEN CLARKSON AND STEPAN WOOD, *A PERILOUS IMBALANCE: THE GLOBALIZATION OF CANADIAN LAW AND GOVERNANCE* (2010), 227.

<sup>208</sup> Deakin 2008, *ibid.*

<sup>209</sup> A special report on debt. Judging the judges: the travails of the rating agencies, *THE ECONOMIST* (JUN 24TH 2010), ONLINE: [HTTP://WWW.ECONOMIST.COM/NODE/16397146](http://www.economist.com/node/16397146).

asset pricing models, online trading resources and algorithmic strategies help investors to make decisions based upon specialized economic details that are highly honed to balance the risk-return ratios on investments. Such specialized information presents investment options as though they were in a vacuum - divorced from their social consequences. As a result, the form and substance of financial decision-making make it easy for investors to detach from considering the social implications of their investment choices.

Even deeper concerns exist about investor empowerment. Destructive patterns of overt disregard for social consequences have been observed. For example, institutional investors “rent seek” at the expense of the long-term value of a corporation and/or society.<sup>210</sup> If these concerns are valid and if such behavior can be established as a commonplace occurrence, then a sensible conclusion is that investors have too much discretion and thus the rise of finance as a governance tool must be reversed. But even if the political will existed, such a reversal might spark massive global market disruptions and even further failures at a time when the global economy is less than fully stable. So, what to do?

This article suggests re-visiting some early thoughts on shareholders to find answers for managing today’s investor related problems. Berle of the 1920’s and 30’s believed that increasing dispersion of share ownership throughout society was eventually going to help eliminate the democratic deficit within the American economy. Dodd misinterpreted Berle’s shareholder primacy as a threat to greater corporate responsibility, believing that shareholders represented sophisticated private interests that were rarely aligned with public interest. Fast-forwarding to the 1960’s, Manne re-invigorated the shareholder primacy position, recasting shareholders as experienced investors. He saw shareholders in much the same light as Dodd, but where Manne saw praiseworthiness, Dodd saw grounds for suspicion. In other words, Manne was just the sort of conservative that Dodd mistakenly accused Berle of being. Each of these three academics has a radically different understanding of what potential rests with granting shareholders greater power within corporate governance. Berle thought that it could democratize the management of the economy; Manne thought that it could make corporate function more efficient; and Dodd thought that it could only create corporate social irresponsibility.

All of these potential visions for investors are still possible because there are few market and legal pressures placed upon shareholders that limit their freedom to be socially responsible, or socially thoughtless, or overtly destructive. The reason why there are few market restrictions is that innovations in investment strategies (like hedging and shorting) allow investors to profit from both positive and negative market performance. The reason why there are few legal restrictions is mainly because of two connected mindsets. The first is an entrenched predetermination about freedom, individualism and property ownership.<sup>211</sup> The second is a lack of appreciation for the ways corporate property

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<sup>210</sup> For empirical evidence of the rent-seeking behavior of institutional investors, *see* STEEN THOMSEN, *THE HIDDEN MEANING OF CODES: CORPORATE GOVERNANCE AND INVESTOR RENT SEEKING*, 7 *EURO. BUS. ORGANIZATION L. REV.* 845 (2006).

<sup>211</sup> For Legal Realist commentary on this, *see* ROBERT HALE, *COERCION AND DISTRIBUTION IN A SUPPOSEDLY NON-COERCIVE STATE*, 38 *POL. SCI. Q.* 470 (1923); MORRIS R. COHEN, *PROPERTY AND SOVEREIGNTY*, 13

profoundly change what it means to be an owner. Ultimately, this leads to today's situation in which investors are being granted ever-greater power over society, and yet they are not attracting much greater obligations to the property they own, and to the societies they shape.

The privatization of public services,<sup>212</sup> the use of meta-regulation,<sup>213</sup> and empowerment of global capital<sup>214</sup> are three examples of how governments have placed the day-to-day regulation of public interest in the hands of private actors, like corporations and investors. These private actors readily accept these government gifts when they are granted ... and rightly so. Business actors want the potential profits locked in managing segments of the public sector. They also want the flexibility and competitive edge gained by "rowing" while governments "steer".<sup>215</sup> At the same time, investors want to capitalize on the freedom to search the globe for promising investment opportunities.

But these private actors may soon learn that there is no such thing as a free lunch. Private actors and governments are blurring the line between government responsibility and private freedoms. This blurring of traditional roles is shifting some of the underlying assumption about how society "ought" to be governed. Letting markets regulate society was supposed to fix the problems of political organization by removing government from governance.<sup>216</sup> However, when the power of the market is unleashed, it can create as much vice as virtue.<sup>217</sup> Thus, the shift to the market may have solved some problems of political organization, but as the Credit Crisis demonstrated, it has also created new problems of market organization.

The problems associated with social organization, whether political or market based, will never go away. The shift to the market has resulted in two things. One is a transfer of

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CORNELL LQ 8 (1927), MORRIS COHEN, *THE BASIS OF CONTRACT*, 46 HARV. L. REV. 553 (1933); ROBERT HALE, *BARGAINING, DURESS, AND ECONOMIC LIBERTY*, 43 COLUM. L. REV. 603 (1943); and ROBERT L. HALE, "FREEDOM THROUGH LAW: PUBLIC CONTROL OF PRIVATE GOVERNING POWER" (1952). For a critique of the concept of freedom and individualism and its negative effects upon corporate governance, see Mitchell 2001, *supra*, note 143.

<sup>212</sup> ALFRED C. AMAN, JR., *LAW, MARKETS AND DEMOCRACY: A ROLE FOR LAW IN THE NEO-LIBERAL STATE*, 51 N.Y.L. SCH. L. REV. 801 (2007).

<sup>213</sup> JOHN BRAITHWAITE, *REGULATORY CAPITALISM, HOW IT WORKS, IDEAS FOR MAKING IT WORK BETTER* (2008), 1-29.

<sup>214</sup> JULIA BLACK AND ROUCH, *THE DEVELOPMENT OF GLOBAL MARKETS AS RULE-MAKERS: ENGAGEMENT AND LEGITIMACY*, 2 LAW & FINANCIAL MARKETS REV. 218 (2008).

<sup>215</sup> JOHN BRAITHWAITE, *REGULATORY CAPITALISM, HOW IT WORKS, IDEAS FOR MAKING IT WORK BETTER* (2008), 1-29.

<sup>216</sup> See F. A. HAYEK, *THE ROAD TO SERFDOM* (1944); F. A. HAYEK, *THE USE OF KNOWLEDGE IN SOCIETY*, 35: AM. ECON. REV. 519 (1945); F. A. HAYEK, *THE CONSTITUTION OF LIBERTY* (1960); and MILTON FRIEDMAN *CAPITALISM AND FREEDOM* (1962).

<sup>217</sup> JOHN BRAITHWAITE, *MARKETS IN VICE, MARKETS IN VIRTUE* (2005).

power from the state to private actors. The other is confusion over whether public or private actors are responsible for areas in which there have been these transfers of power. As governments scramble to get away from welfare state obligations, investors and business actors gamble that they will be able to profit from these traditional areas of public interest without attracting greater social responsibilities. However, a sober look at what is occurring today leads one to believe that this gamble is a bad bet for private interests in the long term. Fundamental changes in the public-private distinction are occurring, as private actors are being lured into a precarious situation.

What is this precarious situation? It is the circumstances in which private actors may find themselves if there is a swing in public opinion. To explain, Karl Polanyi argued that there is a “double movement” within society in which people eventually refuse to tolerate the market overwhelming other social needs.<sup>218</sup> Simon Deakin has emphasized the opposite side of the double movement. He explains that when social needs overwhelm the needs of the market, then there is a backlash from business interests.<sup>219</sup> If this “double movement” exists, then there will be a constant tension between favoring the needs of markets and the needs of society. According to Deakin, the pendulum is now swinging toward the needs of markets,<sup>220</sup> but if Polanyi is correct, this shift will not be permanent.

As these swings occur, New Institutional Economics suggests that institutions and organizations will not remain the same, but will evolve in correspondence with these swings.<sup>221</sup> Thus, when pendulum swings back, it never arrives at the point where it once was. In other words, if Polanyi’s “double movement” is right again (as it was in 1944), and the primacy of the political over the economic is once again restored, there will be no welfare state welcoming the swing back, nor will there be a classic twentieth century public/private divide to protect the interest of capital. What is unnerving about this precarious situation is that the permutations of how it could be mismanaged dramatically dwarf the potential productive ways it could be managed.

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

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<sup>218</sup> For a detailed commentary on the double movement, see Fred Block, Introduction, in: KARL POLANYI, *THE GREAT TRANSFORMATION* (2<sup>ND</sup> ED., 2001) at xxiii-xxvii.

<sup>219</sup> Deakin 2008, *supra*, note 7, 679.

<sup>220</sup> For instance, see Deakin 2008, *ibid.*, 67-68.

<sup>221</sup> DOUGLASS NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE* (1990), Ch. 11.