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LAW, THE AMERICAN CORPORATION, AND SOCIETY

FENNER L. STEWART, JR.

A DISSERTATION SUBMITTED TO THE FACULTY OF GRADUATE STUDIES
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
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TORONTO, ONTARIO

DECEMBER 2013

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**LAW, THE AMERICAN CORPORATION, AND
SOCIETY**

by **Fenner L. Stewart, Jr.**

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ABSTRACT

This book explores how American legal scholarship treats the corporation by providing a history of American corporate legal theory, a history of corporate (social) responsibility from the perspective of the Berle–Dodd debate, an analysis of how legal scholars understand corporate lawmaking in America, and an initial inquiry into how the prevailing opinions about the corporation are realized in the context of a critical assessment of whether or not this resulting corporate governance holds the potential to compliment the efforts of new governance regulators.

This book consists of four essays about American corporate governance. Three essays trace how three particular presumptions about the corporation came to become part of the dominant narrative about the corporation within the American academic context. The first presumption is that the American contractarian theory of the corporation most accurately frames an understanding of the corporation. This presumption underpins much of Delaware’s corporate law. Second is the notion that shareholder value maximization provides the necessary precondition for effective corporate governance. The modern incarnation of this presumption was inadvertently inspired by the early 20th Century work of Adolf A. Berle. Third is the idea that there is market competition for incorporations between states, and this competition creates a “race to the top.” Such presumptions help shape the dominant narrative about the American corporation. In the final chapter, the elements of these presumptions, and the narratives they weave, are reconsidered within the context of new governance, which encourages private actors, like corporations, to play larger roles within the administrative functions of governments. It is explained how new governance thought presumes that corporations are becoming more imbued with a sense of public spiritedness. This presumption is closely examined and then ultimately rejected as dangerously optimistic considering the narratives that dominate corporate legal thinking—at least in the American context.

Each of the four chapters has been published in U.S. law reviews, creating a portfolio of essays regarding the American corporation and its place in society.

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CHAPTER 1: INTRODUCTION

I. PRELIMINARY NOTE TO DISSERTATION: KNOWLEDGE-POWER, NARRATIVE, AND THE CORPORATION

The introduction to this dissertation starts by offering a perspective upon the role of narrative and its impact on corporate law. The chapters of this book focus upon some of the grand legal narratives and theories of the American corporation. Chapter 2, in particular, discusses how these grand narratives/theories are indeterminate, shifting over time. It is suggested that they bend to accommodate the political preferences of the moment, helping to legitimate the manner in which market activities are organized. In others words, although corporate legal narratives may appear authoritative, it is suggested that, most times, such legal narratives do not dictate social activities, but merely rationalize the endorsement of one political preference over another ex post facto. That does not diminish the significance of such study though, since tracing the history of such shifts in corporate narratives provides one with a useful roadmap to the history of the rationalization of economic power within the American context.

Much of this thinking is aligned with a somewhat recent symposium on corporate narrative entitled *Business Law and Narrative Symposium*.¹ This

¹ This Symposium was held at Michigan State University College of Law on September 10, 2009. For more on the Symposium, see Michigan State University College of Law, News Release, “Michigan State Law Review to Host Business Law

symposium generally suggested that corporate academic scholarship does not play a significant role in how the corporation is viewed and functions in American society.² For instance, the introducers to the *Business Law and Narrative Symposium* suggest that corporate legal scholars are deluding themselves if they think they are writing “the signification of the corporation,” which basically means that such scholars do not play a major role in manufacturing of how Americans view the corporation.³ This may be true, but there is also a danger in discounting the academic contribution too deeply for reasons that will be explored in the following comment on the interrelationships between narrative, knowledge, and power.

In one of the articles from this symposium, Larry Backer provides a model of knowledge-power, which elucidates how corporate knowledge is produced.⁴ However, this model, although highly insightful, fails to draw a clear distinction between Nietzsche’s notion of the operation of knowledge and power and Foucault’s notion of knowledge-power.⁵ The result is that Backer overemphasizes the

and Narrative Symposium” (10 Sep 2009) online: <http://www.law.msu.edu/news/2009/releases/business-narrative.html>.

² See e.g. Mae Kuykendall & David Westbrook, “Introduction: Unsettling Questions, Disquieting Stories” (2009) 2009 Mich St L Rev 817 at 827.

³ *Ibid* at 827.

⁴ See generally, Larry Cata Backer, “The Drama of Corporate Law: Narrator Between Citizen, State, and Corporation” (2009) 2009 Mich St L Rev 1111.

⁵ See generally Frederick Nietzsche, *On The Genealogy of Morality*, revised student ed, Keith Ansell-Pearson ed, translated by Carol Diethe (Cambridge: Cambridge University Press, 2008) [Nietzsche, *On The Genealogy*]; Friedrich

importance of the narrator, if he is adopting a Foucaudian perspective.⁶ While Nietzsche, like Backer, would have primarily focused on the privileged producers of knowledge, assuming they are the controllers of knowledge,⁷ Foucault would not do so. Foucault would focus on knowledge, assuming that knowledge is the controller of those who produce knowledge.⁸ This will be explained, but first, Backer's reasoning will be traced.

Again, to be fair, Backer's description of the social construction of corporate knowledge is otherwise excellent. He emphasizes that to understand this social production of corporate legal knowledge and its significance, one must understand the history of how particular knowledge became privileged and the process by which this occurred, including the way that this information was conveyed to others and how

Nietzsche, *Beyond Good and Evil*, translated by RJ Hollingdale (New York: Penguin Books, 1990) [Nietzsche, *Beyond Good and Evil*]; Michel Foucault, *Power/Knowledge: Selected Interviews and Other Writings, 1972-1977*, Colin Gordon ed, translated by Colin Gordon et al (New York: Pantheon Books, 1980) [Foucault, *Power/Knowledge*]; Michel Foucault, *Discipline and Punish: The Birth of the Prison*, Vintage Books 2d ed, translated by Alan Sheridan (New York: Vintage Books, 1995) [Foucault, *Discipline and Punish*]; Michel Foucault, *Politics, Philosophy, Culture: Interviews and Other Writings, 1977-1984*, Lawrence D Kritzman ed, translated by Alan Sheridan (New York: Routledge, 1988) [Foucault, *Politics, Philosophy, Culture*]; Michel Foucault, *Power*, James D Faubion ed, translated by Robert Hurley et al (New York: New Press, 2000) [Foucault, *Power*].

⁶ See Backer, *supra* note 4.

⁷ See generally Nietzsche, *On The Genealogy*, *supra* note 5.

⁸ See generally Foucault, *Discipline and Punish*, *supra* note 5; Foucault, *Politics, Philosophy, Culture*, *supra* note 5; Foucault, *Power*, *supra* note 5.

others internalized this privileged knowledge.⁹ Backer continues that law, as a doctrinal force, “serves as a critical component” for normalizing corporate knowledge.¹⁰ Backer explains:

Power over the management of the knowledge-reality on which law is founded (and which founds law) is a central aspect of social control. But it is also the central element in the allocation of social power, prestige, and the ordering of human hierarchies. And thus one moves from knowledge-reality (at the heart of narrative) to the ordering element of the narrator—that is, to power-knowledge. And thus we come to an understanding of ourselves [as corporate legal academics], of our function within the academy.¹¹

In the above quotation, Backer cites Foucault for the notion of power-knowledge, but as he continues, a tension develops between his use of power-knowledge and Foucault’s notion.¹² Backer casts legal experts as the controllers of their narratives, as if they exist as agents somewhat independent of the knowledge that shapes their understandings.¹³ From this perspective, the narrator can be the master of the narrative/knowledge that he or she creates, and thus is the master of power-knowledge.¹⁴ Backer comes close to acknowledging the power of narrative/knowledge over the narrator, but falls short of the Foucauldian notion:

⁹ Backer, *supra* note 4 at 1115.

¹⁰ See *ibid* at 1116-17.

¹¹ *Ibid* at 1116-17.

¹² *Ibid* at 1117.

¹³ See *Ibid* at 1118–20, 1165.

¹⁴ See *Ibid* at 1118.

Yet narrative also serves to situate the narrator at that core, and indeed, to define that core in ways that perpetuate the narrator control of both story and its disciplinary consequences. Like Nietzsche's notions of the power-knowledge framework of religious narrative, the narrator serves as a critical element of narration.¹⁵

It is at this point that Backer conflates Nietzsche's notion of the operation of knowledge and power with that of Foucault's knowledge-power. For Foucault, the individual actor/narrator is much less significant, because he or she is faced with the untamable tyranny of knowledge, which all narrators feed in subjugation, arguably without the potential for emancipation. In other words, although Foucault, both in his writing and way of life, was constantly challenging the oppressive nature of the imposition of the normal upon the individual, his theory of knowledge-power suggests the paradox of such self-critical challenging, exposing the presumption of free will as problematic.¹⁶

To understand this final point, a short history of the development of Foucault's notion is justified, starting with a quick review of Nietzsche's position. In *On the Genealogy of Morality*, Nietzsche identified the understanding of "the good"

¹⁵ *Ibid* at 1124.

¹⁶ For more on Foucault's theory, see Foucault, *Discipline and Punish*, *supra* note 5 at 27, 184-85; Michel Foucault, *Language, Counter-Memory, Practice: Selected Essays and Interviews*, Donald F Bouchard, ed, (Ithaca, NY: Cornell University Press, 1977) at 207 [Foucault, *Language, Counter-Memory, Practice*]; Foucault, *Politics, Philosophy, Culture*, *supra* note 5 at 43; see also Alan Sheridan, *Michel Foucault: The Will to Truth* (New York: Tavistock, 1980) at 131 (quoting Foucault's *Théories et Institutions Pénales (Penal Theories and Institutions)*). For more on his lifestyle, see David Macey, *The Lives of Michel Foucault* (New York: Vintage Books, 1995).

that contemporary thinkers of his time regarded to be truth.¹⁷ Nietzsche then conducted a historical examination of how individuals at different points in time and from different social traditions held different conceptions of “the good.”¹⁸ Thus, his comparative historical analysis relativized contrasting conceptions of “the good.”¹⁹ This exercise exposed how truths were mere culturally conditioned preferences.²⁰ Nietzsche concluded that blind adherence to a concept of “the good” was socially manufactured and could serve as a coercive tool for subjugation.²¹ Nietzsche’s contribution was to point out that individuals often simply internalize a predetermined normative order, which imposes arbitrary social preferences and amounts to a form of self-imprisonment.²²

¹⁷ Nietzsche, *On The Genealogy*, *supra* note 5 at 10-34.

¹⁸ Friedrich Nietzsche, “Human, All Too Human”, Volume I, Section 45, in Nietzsche, *On The Genealogy*, *supra* note 5 at 123-24; see also Nietzsche, *On The Genealogy*, *supra* note 5 at 10-34.

¹⁹ *Ibid.*

²⁰ *Ibid* at 11.

²¹ *Ibid* at 11-12.

²² Nietzsche, *Beyond Good and Evil*, *supra* note 5 at 47-49; see also Maudemarie Clark & David Dudrick, “Nietzsche on the Will: An Analysis of BGE 19” in Ken Gemes & Simon May eds, *Nietzsche on Freedom and Autonomy* (Oxford: Oxford University Press, 2009) 247 at 263.

Until Nietzsche, such critical theorists, such as Karl Marx,²³ critiqued consciousness, arguing that the particular beliefs did not reflect reality, creating a “false consciousness.”²⁴ However, they were willing to introduce an alternative version of reality, which they believed was not a “false consciousness.”²⁵ This is where Nietzsche was radical and different. He refused to manufacture an ideal to replace or improve on “the good” that he criticized, because he believed any social

²³ Emmet Kennedy, a leading American history of France and French, wrote: “Marx inherited the word ‘ideology’ not from Hegel, who used the word once in reference to the French Ideologists and therefore cannot be, strictly speaking, credited with an explicit theory of ideology, but only from the cumulative usages current in the 1830s and 1840s and specifically from Destutt de Tracy.” Emmet Kennedy, “‘Ideology’ from Destutt de Tracy to Marx” (1979) 40 *J Hist Ideas* 353 at 366.

²⁴ Marx and Engels linked ideology to “false consciousness.” False consciousness is a term sometimes attributed to Marx, but it was actually coined by Engels in the following passage from a letter he wrote to Franz Mehring: “Ideology is a process...[of] false consciousness. The real motives impelling him remain unknown to him, otherwise it would not be an ideological process at all. Hence he imagines false or apparent motives...[and] works with mere thought...which he accepts without examination...for a more remote process independent of thought...” Letter from Friedrich Engels to Franz Mehring, (14 July 1893) in Karl Marx & Friedrich Engels, *Selected Correspondence, 1846-1895*, translated by Dona Torr (Westport, Conn: Greenwood Press, 1975) 510 at 511.

²⁵ In *The German Ideology’s* Preface, Marx and Engels, in their mocking declaration, observed that men have constantly created false self-concepts, “products of their brains,” which have imprisoned and oppressed them. They wrote: “Let us teach men, says one, how to exchange these imaginations for thoughts which correspond to the essence of man; says another, how to take up a critical attitude to them; says the third, how to knock them out of their heads; and existing reality will collapse.” Karl Marx & Friedrich Engels, *The German Ideology*, 3d ed (Moscow: Progress Publishers, 1976) at 29.

construction of “the good” would subjugate others to his own biased perspective.²⁶ As Nietzsche wrote, “But what am I saying? Enough! Enough! At this point just one thing is proper, silence: otherwise I shall be misappropriating something that belongs to another, younger man...”²⁷

Weber studied the operation of power, domination, and legitimacy.²⁸ In one sense, Weber explored the relationship between power and subjugation more systematically than Nietzsche did.²⁹ Weber detailed the processes in which the

²⁶ Nietzsche, *On The Genealogy*, *supra* note 5 at 66-67.

²⁷ *Ibid* at 67.

²⁸ Weber defines power as “the probability that one actor within a social relationship will be in a position to carry out his own will despite resistance, regardless of the basis on which this probability rests. Max Weber, *Economy and Society: An Outline of Interpretive Sociology*, Guenther Roth & Claus Wittich, eds, (New York: Bedminster Press, 1968) vol 1 at 53. Domination is defined as “the probability that a command with a given specific content will be obeyed by a given group of persons.” *Ibid*. Weber viewed legitimacy as an essential element of domination. *Ibid* at 212-15.

²⁹ Nietzsche’s thoughts on power and subjugation can be summed up in the ending line of *The Will to Power*, in which he wrote: “This world is the will to power—and nothing besides! And you yourselves are also this will to power—and nothing besides!” Friedrich Nietzsche, *The Will to Power*, Walter Kaufmann, ed, translated by Walter Kaufmann & RJ Hollingdale (New York: Vintage Books, 1967) at 550 [Nietzsche, *The Will to Power*]. Weber believed that power and domination were intimately tied together, and as such there would always be a ruling class. He wrote: “Any thought...of removing the rule of men over men through the most sophisticated forms of ‘democracy’ is utopian.” W Mommsen, *Max Weber and German Politics, 1890–1920*, translated by Michael S Steinberg (Chicago: University of Chicago Press, 1984) at 394 (quoting Weber).

individual internalized the legitimate order being imposed.³⁰ He drew a distinction between power and domination. Power was the ability of an individual to act in accordance with his or her will, regardless of what resistance he or she might face.³¹ On the other hand, domination was the ability to transform that will into a command, which others would obey.³²

Weber's notion of the process of rationalization of action is complex, and the secondary literature has broadly explored its implications.³³ For present purposes, it is sufficient to say that he argued that there exists the interplay of four types of rationality: purposive (rational), value (moral), affectual (emotive), and traditional (habitual).³⁴ These rationalities persuade the subjugated to submit.³⁵ Weber argued

³⁰ Weber, *supra* note 28 at vol 1 at 31-36, 313-15, 323, vol 3 at 954. For more on Weber's position on this matter, see David M Trubek, "Max Weber on Law and the Rise of Capitalism" (1972) 1972 Wis L Rev 720 at 725-27.

³¹ Weber, *supra* note 28 at vol 1 at 53.

³² *Ibid.*

³³ See generally Jürgen Habermas, "Law and Morality" (The Tanner Lectures on Human Values, delivered at Harvard University, 1-2 October 1986), translated by Kenneth Baynes, online: <<http://tannerlectures.utah.edu/lectures/documents/habermas88.pdf>>; Guenther Roth & Wolfgang Schluchter, *Max Weber's Vision of History: Ethics and Methods* (Berkeley: University of California Press, 1979); Wolfgang Schluchter, *The Rise of Western Rationalism: Max Weber's Developmental History*, translated by Guenther Roth (Berkeley: University of California Press 1981).

³⁴ Weber, *supra* note 28 at vol 1 at 24-26.

³⁵ Specifically, Weber argued that rational grounds are one of the grounds on which legitimacy may be based. *Ibid* at 215.

that legitimacy was tied closely to the notion of rationality.³⁶ Legitimacy was a tool used to secure voluntary compliance of others, i.e., to secure domination.³⁷ Thus, Weber thought that privileged groups exercised their power by using rationalities that legitimated their commands and secured domination over the weaker.³⁸ As Weber wrote:

Every highly privileged group develops a myth of its...superiority. Under the conditions of stable distribution of power that myth is accepted by the negatively privileged strata.³⁹

In other words, the poor and the weak subjected themselves to domination because of a subjective knowledge about reality, which coerces them into believing that acting in the interests of the highly privileged group is in fact acting in their own self-interest.⁴⁰ The powerless internalize the rationalities, or reasons, for their subjugation to power.⁴¹

Foucault used the thought of each of these authors to inform his own understanding of the operation of knowledge and power in society. From Nietzsche,

³⁶ For Weber, the idea of legitimate order was based on the idea that “social action...may be guided by the belief in the existence of a legitimate order.” *Ibid* at 31.

³⁷ Weber believed that rulers used domination in such a way that it appeared “as if the ruled had made the content of the command the maxim of their conduct for its very own sake.” Weber, *supra* note 28 at vol 3 at 946.

³⁸ See *ibid* at 954.

³⁹ See *ibid* at 953.

⁴⁰ See Weber, *supra* note 28 at vol 1 at 212, vol 3 at 952-54.

⁴¹ See Weber, *supra* note 28 at vol 1 at 212-13, vol 3 at 952-54.

and Marx and Engel's limited "false consciousness,"⁴² he took the understanding that there is only historically and socially contingent constructions of reality.⁴³ From Weber, he developed the understanding that rationalities are primary for legitimating domination within society.⁴⁴ Foucault then opined that power is not something people wield, but is something that knowledge wields.⁴⁵ Knowledge is power when rationalities legitimated particular actions within a society.⁴⁶ Such rationalities encourage members to embrace acting in particular ways (normal) and to avoid acting in other ways (abnormal).⁴⁷ Such rationalities also impose the normal upon not only the weak, but also the strong. Knowledge dominates, not people.

⁴² See *supra* note 24 and accompanying text.

⁴³ The genealogy approach that Foucault used in *Discipline and Punish: The Birth of the Person* was used to bring to mind Nietzsche's genealogy of morals. See Foucault, *Power/Knowledge*, *supra* note 5 at 53 ("If I wanted to be pretentious, I would use the 'genealogy of the morals' as the general title of what I am doing."); Foucault, *Discipline and Punish*, *supra* note 5 at 29; see also generally Michael Mahon, *Foucault's Nietzschean Genealogy: Truth, Power, and the Subject* (Albany: State University of New York Press, 1992).

⁴⁴ For an excellent analysis of this, see Colin Gordon, "Governmental Rationality: An Introduction" in Graham Burchell, Colin Gordon & Peter Miller, eds, *The Foucault Effect: Studies in Governmentality* (Chicago: University of Chicago Press, 1991) 1.

⁴⁵ See Foucault, *Language, Counter-Memory, Practice*, *supra* note 16 at 207; Foucault, *Politics, Philosophy, Culture*, *supra* note 5 at 43; Foucault, *Discipline and Punish*, *supra* note 5 at 27, 184-85.

⁴⁶ See Sheridan, *supra* note 16 at 131 (quoting Foucault's *Théories et Institutions Pénales (Penal Theories and Institutions)*).

⁴⁷ See Foucault, *Discipline and Punish*, *supra* note 5 at 184.

The social construction of reality suggests that society exists by defining, institutionalizing and imposing the normal.⁴⁸ There must be such distinctions, which define what is normal, for order to exist, and thus, there must be the normal and the abnormal.⁴⁹ From another vantage point, deviance is the challenging of order, and must be discouraged to protect order.⁵⁰ Therefore power, or what Weber might consider domination, exists as long as there are distinctions that define order.⁵¹

Foucault engaged in a historical study of epistemology, which focuses upon the operation of the verification theory of knowledge.⁵² This verification theory operated throughout history to exclude the deviant from the normal.⁵³ Foucault

⁴⁸ See Peter L Berger & Tomas Luckmann, *The Social Construction of Reality: A Treatise in the Sociology of Knowledge* Garden City, NY: Doubleday, 1966) at 54-58, 62, 72-73.

⁴⁹ See *ibid* at 54-55, 72.

⁵⁰ See *ibid* at 168-69.

⁵¹ See *ibid* at 55, 61-62, 168-69.

⁵² See generally Foucault, *Discipline and Punish*, *supra* note 5; see also Joseph Rouse, "Power/Knowledge" in Gary Gutting, ed, *The Cambridge Companion To Foucault* (Cambridge: Cambridge University Press, 2005) 95.

⁵³ During the Enlightenment, there were thinkers who imagined finding a method to view society that could draw a distinction between socially constructed values and *true* knowledge. It was from such pursuits that the quest to find the Archimedean point was reinvigorated. The Archimedean point is the presumed observation point from where an observer can remove him/herself from subjective bias and see objectively the subject of inquiry. This quest for objectivity became the foundation for the school of thought in the social sciences called, positivism, within which its students attempt to discover authentic knowledge through methodologies which mirror the methods of the natural sciences in order to verify social observations. See e.g. Auguste Comte, *A General View of Positivism*, translated by JH Bridges

argued that this process is central to the connection between knowledge and power.⁵⁴ This process of legitimating the normal excludes people who do not conform to the legitimated normative standards.⁵⁵ This is similar to Nietzsche's understanding of "the good" and how those that did not conform to this understanding of "the good" could be subject to sanction.⁵⁶

Foucault's historical narratives illustrate this principle in operation, documenting how those who failed to conform to normative standards were disqualified, excluded, rehabilitated, punished, or some combination of each.⁵⁷ The marginalization of these populations provides evidence of how power (excluding, punishing, and/or reforming) was the condition and effect of knowledge (normalizing), and how normalizing was the condition and effect of excluding, punishing, and/or reforming.⁵⁸ In other words, he demonstrated how systems of knowledge and power were mutually reinforcing, how they needed each other. One

(London: Trübner & Co, 1844); Francis Bacon, "The Great Instauration of Lord Bacon" in Francis Bacon, *The Works of Francis Bacon, Lord Chancellor of England*, vol 3 (London: Longman, 1859) at 329, 347.

⁵⁴ See Colin Gordon, "Introduction" in Foucault, *Power*, *supra* note 5 at xi, xviii-xix.

⁵⁵ See Foucault, *Discipline and Punish*, *supra* note 5 at 184.

⁵⁶ See *supra* notes 17-22 and accompanying text.

⁵⁷ See Foucault, *Discipline and Punish*, *supra* note 5 at 182-83.

⁵⁸ See *ibid* at 182-84.

shaped the other. One sustained the other. Both coevolved. And, both co-dependently shaped the behavior of individuals and, thus, society.⁵⁹

Foucault's study of epistemology deconstructed the processes of knowledge and power, revealing how manufactured assumptions construct identities of individuals and societies.⁶⁰ Again, at the center of this process is the distinction between what is normal and deviant.⁶¹ In other words, to think in Weber's terms, rationalities legitimate domination.⁶² However, for Foucault, domination is not something that resided primarily with the individual, although the individual is certain the vessel through which knowledge has social impact.⁶³ Rather, power/domination resides primarily in the system of thought itself.⁶⁴ In other words, a social order needs rules, which are legitimated as normal, and thus require a catalogue of normal and not normal (like the mad, the sick, and the criminal) against which the social order can define itself.

⁵⁹ See *ibid* at 27.

⁶⁰ See *supra* notes 57-58 and accompanying text; see also e.g. Michel Foucault, *The Archaeology of Knowledge & The Discourse on Language*, translated by Alan Sheridan (New York: Vintage Books, 1982).

⁶¹ See e.g. Foucault, *Discipline and Punish*, *supra* note 5; see also Rouse, *supra* note 52.

⁶² See *supra* notes 35-41 and accompanying text.

⁶³ See Foucault, *Politics, Philosophy, Culture*, *supra* note 5 at 102-07; Foucault, *Power/Knowledge*, *supra* note 5 at 327, 331, 34, 342-43.

⁶⁴ See *ibid*.

Returning to Backer, from Foucault's perspective, a focus upon the privileged producers of knowledge might blind an observer to the subtleties of a particular genealogy of knowledge. Thus, the presumption that narrators control the production of corporate thought leads to a presumption that the production of knowledge has occurred in a particular way. This might prove to be problematic. As Backer astutely suggested, we must identify privileged knowledge, the process by which this knowledge became privileged, the way that it was conveyed, and how others internalized it⁶⁵ — but he should have stop at this point.

Ultimately, an overemphasis upon the narrators may lead to less than useful presumptions about the nature of knowledge production. The power of the Foucauldian insight is that it can trace how knowledge was produced and how this lead to a particular exercise of power, contributing to an understanding of the present, but it cannot predict how knowledge-power will manifest, and which actors will play leading roles in such future manifestations.

At times, this book tacitly assumes that corporate legal scholarship does in fact play a role in the process of defining the corporation and how corporate governance plays out in everyday situations. Admittedly, such assertions are not defended. No attempt is made to establish how, or if, such academic knowledge migrates from the obscurity of the ivory tower to inform and shape the dominant business narratives. Such cause and effect is left open to the contestation of others.

⁶⁵ Backer, *supra* note 4 at 1115.

Thus, in part, this book leans upon the uncertainty of how a particular narrative comes to shape the dominant knowledge, relying on the notion that the source of an idea will not be determinative as to what impact the idea may have upon the world view of a particular society, since whether an idea influences the dominate narrative may have less to do with the source of the idea and more to do with how that idea captures the pre-existing spirit of the moment.

II. THESIS AND OBJECTIVES

From the outset, it is important to take a moment to reflect upon the commonality between each of the four essays about American corporate governance. Three essays trace how three particular presumptions about the corporation came to become part of the dominant narrative about the corporation within the American academic context. The first presumption is that the American contractarian theory of the corporation most accurately frames an understanding of the corporation.⁶⁶ This presumption underpins much of Delaware's corporate law. Second is the notion that shareholder value maximization provides the necessary precondition for effective corporate governance.⁶⁷ The modern incarnation of this presumption was

⁶⁶ For instance, Delaware law prefers to regard the inability of an oppressed minority shareholder in a closely held corporation to exit as the product of bad bargaining, not inequity, and, therefore, refuses to offer an equitable remedy. Another example is how weak shareholder rights in publicly traded corporations are justified by the consensual nature of purchasing shares and the ability to exit.

⁶⁷ See e.g. Jordan A Schwarz, *Liberal: Adolf A. Berle and the Vision of an American Era* (New York, London, UK: Free Press, Collier Macmillan, 1987) at 60-

inadvertently inspired by the early 20th Century work of Adolf A. Berle.⁶⁸ Third is the idea that there is market competition for incorporations between states, and this competition creates a “race to the top.”⁶⁹ Such presumptions help shape the dominant narrative about the American corporation. In the final chapter, the elements of these presumptions, and the narratives they weave, are reconsidered within the context of new governance, which encourages private actors, like corporations, to play larger roles within the administrative functions of governments.⁷⁰ It is explained how new governance thought presumes that corporations are becoming more imbued with a sense of public spiritedness. This presumption is closely examined and then ultimately rejected as dangerously optimistic considering the narratives that dominate corporate legal thinking—at least in the American context. Each of the four chapters

66; see also Henry G Manne, “Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A. Berle” (1964) 64 Colum L Rev 1427 [Manne, “Some Theoretical Aspects”]; Henry G Manne, “The ‘Higher Criticism’ of the Modern Corporation” (1962) 62 Colum L Rev 399 [Manne, “The ‘Higher Criticism’”].

⁶⁸ See e.g. Schwarz, *supra* note 67 at 60-66; see also Manne, “Some Theoretical Aspects”, *supra* note 67; Manne, “The ‘Higher Criticism’”, *supra* note 67.

⁶⁹ See generally Ralph K Winter, Jr, “State Law, Shareholder Protection, and the Theory of the Corporation” (1977) 6 J Legal Stud 251.

⁷⁰ See e.g. John Braithwaite, *Regulatory Capitalism: How it Works, Ideas for Making it Work Better* (Cheltenham, UK: Edward Elgar Publishing, 2008); Colin Scott, “Regulation in the Age of Governance: The Rise of the Post-Regulatory State” in Jacint Jordana & David Levi-Faur, eds, *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (Cheltenham, UK: Edward Elgar, 2005) 145; Julia Black, “Decentering Regulation: Understanding the Role of Regulation and Self Regulation in a ‘Post-Regulatory’ World” (2001) 54 Current Probs 103.

has been published in U.S. law reviews,⁷¹ creating a portfolio of essays regarding the American corporation and its place in society.

III. A ROADMAP OF THE BOOK'S CHAPTERS

Again, this book visits four specific examples of how America has legally treated the corporation: a history of American corporate legal theory, a history of corporate (social) responsibility from the perspective of the Berle–Dodd debate,⁷² an analysis of how legal scholars understand corporate lawmaking in America, and an initial inquiry into how the prevailing opinions about the corporation are realized in corporate governance and whether or not this resulting corporate governance holds the potential to compliment the efforts of new governance regulators.

Chapter 2 is entitled “Indeterminacy and Balance: A Path to a Wholesome Corporate Law.” It explores three theories of the corporation: the concession, entity,

⁷¹ Fenner L Stewart, Jr, “The Economizing Corporation and its Place in the Wilderness of New Governance” (Osgoode Hall L Sch Comp Res in L & Pol Econ Res Paper Series, Paper No 31/2012, 2012) [forthcoming in *Ind J Global Legal Stud*, Spring/Summer 2014]; Fenner L Stewart, Jr, “Indeterminacy and Balance: A Path to a Wholesome Corporate Law” (2012) 9 *Rutgers Bus L Rev* 81; Fenner L Stewart, Jr, “Berle’s Conception of Shareholder Primacy: A Forgotten Perspective For Reconsideration During the Rise of Finance” (2011) 34 *Seattle UL Rev* 1457; Fenner L Stewart, Jr, “The Place of Corporate Lawmaking in American Society” (2010) 23 *Loyola Con L Rev* 147.

⁷² See AA Berle, Jr, “Corporate Powers as Powers in Trust” (1931) 44 *Harv L Rev* 1049 [Berle, “Corporate Powers”]; E Merrick Dodd, Jr, “For Whom Are Corporate Managers Trustees?” (1932) 45 *Harv L Rev* 1145; AA Berle, Jr, “For Whom Corporate Managers Are Trustees: A Note” (1932) 45 *Harv L Rev* 1365 [Berle, “A Note”].

and contractarian theories. Each of these theories is essential to an understanding of the corporation.⁷³ Each is essential in the sense that every corporation is created through an incorporation process (concession theory), which creates its status as a legal person (entity theory), and provides the complex social and legal contexts for corporate governance (contractarian theory). They are also inherently indeterminate in the sense that it is the normative presumptions that attach to each of these theories (for instance, contracts are consensual and efficient⁷⁴), which determines which policy outcomes the theory will endorse. A potentiality arises here that most advocates of the prevailing contractarian theory do not acknowledge. Although the contractarian theory's position in American corporate legal thought is solidified,⁷⁵ the normative presumptions that attach to it, namely that contracts are necessarily consensual and efficient, are not as concrete. If these normative presumptions shift, this could trigger a shift within contractarian thinking, resulting in the promotion of different policy outcomes than is presently advocated.

⁷³ See e.g. Thomas W Joo, "Theories and Models of Corporate Governance" in H Kent Baker & Ronald Anderson, eds, *Corporate Governance: A Synthesis of Theory, Research, and Practice* (Hoboken, NJ: John Wiley & Sons, 2010) 157; John Dewey, "The Historic Background of Corporate Legal Personality" (1926) 35 Yale LJ 655.

⁷⁴ Joo, *supra* note 73 at 170 (arguing that "incorporating efficient-market assumptions, contractarianism makes two claims: that governance is consensual and that it is efficient").

⁷⁵ See Ian Ayres, "Making a Difference: The Contractual Contributions of Easterbrook and Fischel" (1992) 59 U Chicago L Rev 1391.

Chapter 2 asserts that all of these essential theories of the corporation ought to be considered. Taking seriously all of these factors will encourage legal discourse on corporate governance, which will reveal the underlying normative preferences that give rise to favoring one policy outcome over another. If this level of engagement were to occur, there would be more opportunities for candid debates centering upon that which is at stake within corporate governance.

In particular, Chapter 2 traces through the histories of the concession, entity, and contractarian theories to the present. It explains how the concession and entity theories today are dismissed as largely irrelevant and how the prevailing contractarian theory enjoys more or less full reign over steering corporate legal thinking. The chapter predicts that, in the near future, there is a greater likelihood of a policy shift within the contractarian model than any shift away from it. That said, Chapter 2 concludes with the recommendation that it endorsed at the outset: Scholars need to be self-critical of their roles in the manufacturing of corporate knowledge and, in part, be leery of accepting *a priori* knowledge as fact. This critical approach should lead to a more wholesome corporate law, whatever that law might look like.

Chapter 3 is entitled “Berle’s Conception of Shareholder Primacy: A Forgotten Perspective for Reconsideration during the Rise of Finance.” It traces how the shareholder primacy theory developed from the rise of the modern corporation through to present day. Adolf A Berle Jr developed this theory in the 1920s and 1930s based on his belief that managerial opportunism was running rampant on Wall Street

in the 1920s, threatening the whole of the American economy.⁷⁶ He believed that the only tool that the law had to police this dangerous opportunism was to ensure that managers had only one master: shareholders.⁷⁷ Chapter 3 explores his theory through the Berle–Dodd debate, which is regarded as the seminal American corporate social responsibility debate within legal scholarship.⁷⁸

Until Charles O’Kelly’s important promotion of the work of Berle with his annual Adolf A. Berle, Jr. Symposium on Corporations, Law and Society at the University of Seattle,⁷⁹ commentators footnoting Berle’s contribution to corporate legal literature were becoming forgetful of Berle’s position, suggesting in passing references that Berle was the forefather of the modern shareholder primacy movement,⁸⁰ without mention of the fact that Berle would be opposed to its present incarnation.

⁷⁶ Adolf A Berle, *Navigating the Rapids 1918–1971: From the Papers of Adolf A. Berle*, Beatrice Bishop Berle & Travis Beal Jacobs, eds (New York: Harcourt Brace Jovanovich, 1973) at 19 [Berle, *Navigating the Rapids*].

⁷⁷ Berle, “Corporate Powers”, *supra* note 72 at 1049.

⁷⁸ CA Harwell Wells, “The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century” (2002) 51 U Kan L Rev 77 at 81-99.

⁷⁹ For more on the symposium, see Seattle University School of Law, “The Adolf A. Berle, Jr. Center on Corporations, Law & Society”, online: <<http://www.law.seattleu.edu/x1865.xml>>.

⁸⁰ See e.g. Lawrence E Mitchell, *Corporate Irresponsibility: America’s Newest Export* (New Haven: Yale University Press, 2001).

Chapter 3 explains Berle’s relationship to today’s shareholder primacy argument within its historical context, including with it a further explanation of how Henry Manne “flipped”⁸¹ his arguments.⁸² Berle used shareholder primacy to endorse corporate power directly serving the wider polity, while Manne reframed Berle’s shareholder primacy in order to limit the ability of corporate power to directly serve the wider polity. Manne detached Berle’s underlying normative preference from the shareholder primacy argument and attached his own, retooling it for his own purposes.

As with the essentialist theories explained in Chapter 2, until the shareholder primacy argument is combined with additional normative claims, the policy outcome that it legitimatizes is indeterminate. Berle constructed “the shareholder” as representing the general public, and thus presumed that the shareholder would lend its proxy to initiatives supporting the interests of the polity. Manne constructed “the shareholder” as representing the residual claim of the corporation, and thus presumed

⁸¹ A flip occurs when legal language is used to endorse a particular reform (like Berle advocating shareholder primacy to open the corporation to public-interest concerns) and then that same language is used to endorse the opposed reform (like Manne advocating shareholder primacy to close the corporation to public-interest concerns). For more on how arguments can be flipped, see Duncan Kennedy, *A Critique of Adjudication: Fin de siècle* (Cambridge: Harvard University Press, 1997); see also Kerry Rittich, “Functionalism and Formalism: Their Latest Incarnations in Contemporary Development and Governance Debates” (2005) 55 UTLJ 853 at 857.

⁸² See generally Henry G Manne, “Mergers and the Market for Corporate Control” (1965) 73 J Pol Econ 110 [Manne, “Corporate Control”]; Manne, “Some Theoretical Aspects”, *supra* note 67; Manne, “The ‘Higher Criticism’”, *supra* note 67.

that it would lend its proxy to sustainable maximization of the corporation's residual. As such, Berle's use of shareholder primacy was to direct managers to focus on a more Keynesian and political management of the economy, while Manne's was to direct managers to narrow their focus squarely upon economic efficiency of their organizations.

Therefore, while Berle is considered the grandfather of modern shareholder primacy theory, up to very recently the literature on this topic often glossed over this shift in the modern shareholder primacy argument from Berle's conception to Manne's conception. Thus, the article focuses on Berle, but also on the indeterminate nature of shareholder primacy. The interest of shareholders as a collective can never be truly determined, however "the shareholder," as an empty signifier, can be filled with a variety of contrasting meanings, thereby becoming a point of contention.⁸³ As with the prevailing contractarian theory of the corporation, a revolution in corporate function could occur without undermining the dominance of shareholder primacy thinking today, thereby representing a potentiality if the appropriate circumstances were to arise.

Chapter 3 ends with a discussion of the rise of finance. It suggests that investors are now less connected to the social consequences of their investment choices and that this blindness negatively influences society. Those in the world of

⁸³ Karl Mannheim, *Essays on the Sociology of Knowledge*, Paul Kecskemeti, ed (London, UK: Routledge & Kegan Paul, 1952) at 197-98.

investing and finance think in terms of decoupling value from risk and are disconnected from the social consequences such financialized choices have in the real world.

As a result, the chapter concludes that Berle would not favor today's incarnation of shareholder primacy. It ends with suggesting that a strong look should be taken at the pros and cons of the rise of finance and the role of shareholder primacy within it. It further suggests that there exists a potentiality in Berle's application of the shareholder primacy, demonstrating how managers can be encouraged to serve a more enlightened and socially conscious construction of the shareholder.

Chapter 4 is entitled "The Place of Corporate Lawmaking in American Society." It takes a critical look at the market for attracting incorporations, known as the charter market, and Delaware's place within it. Specifically, the article looks at how legal thinking has been captured by the idea that competition, not politics, drives corporate legal development and how this framing of legal development influences how corporate governance mechanisms are conceived as being non-politically constitutionalized.

After a brief history of incorporation in America, Chapter 4 introduces the Cary–Winter debate⁸⁴ that arose concerning how to deal with the charter market. On

⁸⁴ William L Cary, "Federalism and Corporate Law: Reflections Upon Delaware" (1974) 83 Yale LJ 663; Winter, *supra* note 69.

the one hand, William Cary claimed that charter competition was producing a race-to-the-bottom in the manufacturing of corporate law. He believed that states were watering down corporate law in order to attract state revenue from incorporation fees and franchise tax.⁸⁵ On the other hand, Ralph Winter claimed that this competition actually created a race-to-the-top, because corporate managers would choose the state that had the most beneficial default rules that promote debt and equity capitalization, and as such, state competition was fostering rules that would make the corporation an efficient economizing device.⁸⁶

These two positions would shape the debate from the 1970s to the present. While Cary supporters favor anti-managerialism, federal governmental intervention, and centralized planning,⁸⁷ Winter supporters call for managerialism, unlimited state competition, and decentralized markets.⁸⁸ Over the years, legal scholars used event studies to support Winter's position, while Cary supporters fired back, claiming that

⁸⁵ See Cary, *supra* note 84 at 663-64.

⁸⁶ See Winter, *supra* note 69.

⁸⁷ See e.g. Lucian Arye Bebchuk, "The Case for Increasing Shareholder Power" (2005) 118 Harv L Rev 833; Lucian Arye Bebchuk & Assaf Hamdani, "Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters" (2002) 112 Yale LJ 553; Lucian Arye Bebchuk & Allen Ferrell, "Federalism and Corporate Law: The Race to Protect Managers from Takeovers" (1999) 99 Colum L Rev 1168.

⁸⁸ See e.g. Roberta Romano, *The Genius of American Corporate Law* (Washington, DC: AEI Press, 1993); Stephen M Bainbridge, "The Creeping Federalization of Corporate Law" (2003) 26 Regulation 26 [Bainbridge, "Creeping Federalization"].

the event studies that were used were not sophisticated enough, and simply could not account for the complexities of the American charter market.⁸⁹

The Enron scandal was a circumstance that provided an opening to Cary supporters, and their race-to-the-bottom argument garnered greater attention. The federal government seemed to agree, resulting in the passing of Sarbanes–Oxley Act.⁹⁰ After observing such federal intervention, Mark Roe turned the state competition debate on its head by arguing that Delaware, the de facto national corporate law, was never in competition with other states for incorporations.⁹¹ Thus, Delaware enjoys no competitors unless it triggers circumstances in which a reactionary public demands that the federal government intervenes – as had occurred with the Enron scandal and to a lesser degree with the Credit Crisis. Using Roe’s insight, Chapter 4 then continues to explain how Delaware is in fact a private caucus of managers and, to a lesser extent, shareholders who set corporate policy for themselves with the awareness that if they go too far, the federal government will step in.

⁸⁹ See e.g. Melvin A Eisenberg, “The Structure of Corporation Law” (1989) 89 Colum L Rev 1461 at 1508.

⁹⁰ *The Sarbanes–Oxley Act of 2002*, Pub L No 107-204, 116 Stat 745, (codified at 15 USC § 7201 et seq).

⁹¹ Mark J Roe, “Delaware’s Politics” (2005) 118 Harv L Rev 2491 at 2494-45, 2498; Mark J Roe, “Delaware’s Competition” (2003) 117 Harv L Rev 588 at 592-93.

In the end, the result is similar – Delaware favors managerialism within American corporate governance. Stephen Bainbridge’s director primacy theory is used as the reflecting Delaware policy.⁹² Bainbridge argues that the rise of independent directors has led boards to stop merely serving as rubber stamps for CEOs.⁹³ Chapter 4 explores how Bainbridge argues there is no need to empower shareholders further, as directors ensure corporate governance takes the shareholder maximization norm into consideration. His opponents, in particular Lucian Bebchuk, demand a greater shareholder voice in Delaware lawmaking. Bebchuk commits to advocating for more federal intervention, threatening Delaware’s primacy in the hopes that it will concede to his policy demands.⁹⁴

A potentiality in this situation is that even though Bebchuk welcomes/threatens federalization of corporate law in his writing,⁹⁵ and Bainbridge fiercely attacks federal intervention,⁹⁶ neither appears willing to acknowledge the

⁹² Brett H McDonnell, “Professor Bainbridge and the Arrowian Moment: A Review of *The New Corporate Governance in Theory and Practice*” (2009) 34 Del J Corp L 139 at 150-153.

⁹³ Stephen M Bainbridge, *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at 1-2 [Bainbridge, *New Corporate Governance*].

⁹⁴ Bebchuk, *supra* note 87 at 874.

⁹⁵ *Ibid.*

⁹⁶ Bainbridge, “Creeping Federalization”, *supra* note 88.

significance of Roe’s insight, which exposes the frailty of Delaware’s privilege to a degree that neither is comfortable with acknowledging.

Chapter 5 is entitled “The Corporation, New Governance, and The Power of Narrative.” It takes a critical look at the idea of publicization and how it plays out within new governance. Publicization is a vague, but popular, notion that the delegation of public power to for-profit agents—what John Braithwaite calls the “privatization of the public”⁹⁷—will lead to such agents exercising this power as idealized public servants—what Braithwaite calls the “publicization of the private.”⁹⁸ This chapter argues that publicization of the private is a dangerous metaphor which offers a romanticized picture of functionally efficient decentered actors⁹⁹ acting with the integrity of public servants. It is suggested that publicization of the private is an empty promise, which will lead the faithful to be less critical of privatization. Accordingly, Chapter 5 suggests that new governance initiatives may be leading to the privatization of the public—without the publicization of the private.

⁹⁷ Braithwaite, *supra* note 70 at 8.

⁹⁸ Braithwaite, *supra* note 70 at 8.

⁹⁹ See e.g. Julia Black, “Critical Reflections on Regulation” (2002) 27 *Austl J Leg Phil* 1; see also Friedrich A Hayek, “The Use of Knowledge in Society” (1945) 35 *Am Econ Rev* 519.

New governance is an umbrella term for theories of governance that marry the best of both the public and private orderings.¹⁰⁰ It celebrates a “blurring” of public and private functions.¹⁰¹ It is a noble venture that attempts to construct a governance alternative, which encourages economic growth,¹⁰² while balancing it with the need to generate sustainable and balanced policy options that protect human dignity and ensure a habitable natural environment for future generations. Part 2 of Chapter 5 introduces readers to some of the literatures that inform the current development of the new governance literature.

The hopefulness of the new governance literature, with its suggestion that society is on a course toward the “reassertion of the public interest” within governance¹⁰³ is contrasted with the normative presumption of mainstream corporate law. In Part 3 of Chapter 5, many of the central notions, which anchor how corporate legal experts understand the corporation and the law that regulates it, are reviewed.

¹⁰⁰ See generally David Trubek & Louise Trubek, “The World Turned Upside Down: Reflections on New Governance and the Transformation of Law” (2010) 2010 Wis L Rev 719; William H Simon, “New Governance Anxieties: A Deweyan Response” (2010) 2010 Wis L Rev 727; Lisa T Alexander, “Reflections on Success and Failure in New Governance and the Role of the Lawyer” (2010) 2010 Wis L Rev 738.

¹⁰¹ See generally Jason M Solomon, “New Governance, Preemptive Self-Regulation, and the Blurring of Boundaries in Regulatory Theory and Practice” (2010) 2010 Wis L Rev 591.

¹⁰² Braithwaite, *Regulatory Capitalism*, *supra* note 70 at vii-x.

¹⁰³ See generally David Levi-Faur, “Regulatory Capitalism and the Reassertion of the Public Interest” (2009) 27 Pol’y & Soc’y 181.

This provides a snapshot of the mindset that dominates American corporate legal culture and the commonsense position in the business world. This section offers a concise summary of much of what can be gleaned about American corporate legal culture from Chapters 2, 3, and 4. The main message of this section is that regulators would face serious resistance if they attempted to publicize corporate governance, and that any presumption to the contrary needs more sober reevaluation.

Part 4 of Chapter 5 explores the idea of technocratic narratives, its dominance within public and private governance, and its tendency to discourage publicization. To understand the nature of technocratic narratives, Chapter 5 draws a distinction between humanistic narratives and technocratic narratives. It defines humanistic narratives as storylines that package information in a manner that mirrors life experience. Technocratic narratives consist of the spectrum of scientific language, but most predominately economic ones, employed in order to attempt to resolve governance issues in a more abstract manner.

Technical experts, who guide much of governance today, embrace technocratic narratives, while ignoring humanistic narratives. The use of technocratic narratives may appear depoliticized, but Chapter 5 argues that it limits choices within the “regulatory calculus” to those that embrace “efficiency, expertise, and cost-containment.”¹⁰⁴ It plays out so that humanistic narratives are regarded as unsuitable, and are thus marginalized within decision-making. By divorcing governance

¹⁰⁴ Rittich, *supra* note 81 at 867.

decisions from humanistic narratives, social conflicts can be abstractified, practically concealing the connection between particular choices and their violent consequences.

This section challenges the notion of publicization from a different perspective: if it is assumed that there will be the “percolation”¹⁰⁵ of values from public governance to private governance, what if there needs to be a publicization of the public as well? This discussion of technocratic narratives suggests that this is quite likely the case.

Chapter 5 ends with the suggestion that the blurring of public and private in governance today will probably not lead to the publicization of corporations in some spontaneous way, and that the notion of publicization may not be capable of leading to the noble ends to which new governance aspires. And if this is the case, then new governance, and its call for a further blurring of public and private functions, may merit a critical re-evaluation.

Chapter 6 then concludes with some reflections on the book and some insights into the potential for further study of the relationships between corporate governance and society.

¹⁰⁵ John Braithwaite, “Strategic Socialism, Strategic Privatization and Crises” (2013) [unpublished, archived at <http://ssrn.com/abstract=2249544>] at 4.

CHAPTER 2: INDETERMINACY AND BALANCE: A PATH TO A WHOLESOME CORPORATE LAW

I. INTRODUCTION

Corporations are central players in the mediation of tensions between markets and society.¹ Thus, it stands to reason that we as corporate legal scholars ought to invite a robust debate that encourages broad discussions about the role of the corporation in society in order to help in finding and re-finding the “appropriate”² balance. To achieve this end, we must be constantly challenging and reassessing our assumptions about how the law ought to mediate corporate conflicts.³ Put differently,

¹ Andreas Georg Scherer, Guido Palazzo & Dorothee Baumann, “Global Rules and Private Actors - Towards a New Role of the Transnational Corporation in Global Governance” (2006) 16 *Bus Ethics Q* 505; Neva Goodwin, “The Social Impacts of Multinational Corporations: An Outline of the Issues with a Focus on Workers” in Alfred D Chandler, Jr & Bruce Mazlish, eds, *Leviathans: Multinational Corporations and the New Global History* (Cambridge: Cambridge University Press, 2005) 135; Dennis A Rondinelli, “Transnational Corporations: International Citizens or New Sovereigns?” (2002) 107 *Bus & Soc’y Rev* 391.

² This term (and others) is in quotations because this chapter sets aside the questions of whether evaluations such as “better” are possible in this context. In other words, this chapter is mindful, and wary, of drawing distinctions between good/legitimate forms of governance and bad/illegitimate ones, leaving such attempts at “objective” measure to others.

³ William W Bratton, Jr, “The ‘Nexus of Contracts’ Corporation: A Critical Appraisal” (1988) 74 *Cornell L Rev* 407 at 464-65 [Bratton, “Nexus of Contracts”].

we need to be aware of how the processes of socialization impact our norms, preferences, and politics as academics.⁴

Today, the corporation is generally held to be a nexus-of-contracts.⁵ It is also assumed that the contracts that bind corporate constituents are both consensual and efficient.⁶ Such efficiencies occur because legal requirements upon corporate governance have been relaxed, and relaxed legal requirements allow market forces to inspire corporate constituents to use their ingenuity to negotiate contracts in their own best interest.⁷ What follows from this is that corporate law ought to be permissive in nature, rejecting mandatory legal rules as generally suboptimal.⁸

⁴ Peter L Berger & Thomas Luckmann, *The Social Construction of Reality: A Treatise in the Sociology of Knowledge* (Garden City, NY: Doubleday, 1966) at 74, 177.

⁵ Bratton, “Nexus of Contracts”, *supra* note 3 at 458 (arguing that “the nexus of contracts concept places the corporation on a foundation of contractual consent”). For an example of a “real adherent,” see Stephen M Bainbridge, *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at 30-31 (Bainbridge’s application of “The Hypothetical Bargain Methodology”) [Bainbridge, *New Corporate Governance*].

⁶ Thomas W Joo, “Theories and Models of Corporate Governance” in H Kent Baker & Ronald Anderson, eds, *Corporate Governance: A Synthesis of Theory, Research, and Practice* (Hoboken, NJ: John Wiley & Sons, 2010) 157 at 170 (arguing that “incorporating efficient-market assumptions, contractarianism makes two claims: that governance is consensual and that it is efficient”) [Joo, “Theories and Models”].

⁷ Thomas W Joo, “Contract, Property, and the Role of Metaphor in Corporations Law” (2002) 35 UC Davis L Rev 779 (arguing that the contractarian vision of contract is a laissez-faire one, which justifies the assumption that “economic relationships are the product of individual free will and rational deliberation, and the law respects them for this reason”) [Joo, “Contract, Property”]. For an excellent

Recent corporate and financial scandals appear to challenge the prudence of these assumptions,⁹ yet they prevail over corporate legal thinking.¹⁰ To be fair, they may still be the best option available, and conceding this, this chapter ought not to be construed as an attack on these prevailing presumptions. Rather, this chapter merely suggests that more self-reflexive debates about the “right” way to mediate corporate conflicts will improve the ways we think about and discuss the corporation and thus, it is assumed, will improve our understanding of corporate governance. In other words, if we accept the tenuous nature of the choices we make, we can be more open-minded to a broader spectrum of considerations. With a more open-minded understanding, we ought to make “better” choices about how corporate governance ought to be regulated.¹¹ Such a critical mindset is important, as our assumptions

example of an adherent to this theory, see Bainbridge, *New Corporate Governance*, *supra* note 5 at 30-31 (Bainbridge’s application of “The Hypothetical Bargain Methodology”).

⁸ Joo, “Theories and Models”, *supra* note 6 at 171.

⁹ For examples and analysis, see Nancy B Rapoport, Jeffery D Van Niel & Bala G Dharan, eds, *Enron and Other Corporate Fiascos: The Corporate Scandal Reader*, 2d ed (New York: Foundation Press, 2009). However, also consider the wider literature on the Credit Crisis of 2008. See Simon Johnson & James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown* (New York: Pantheon Books, 2010); Andrew Ross Sorkin, *Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System—and Themselves* (New York: Viking, 2009).

¹⁰ Joo, “Theories and Models”, *supra* note 6 at 170.

¹¹ *Ibid.*

frame how corporate governance is conceptualized, influencing the way that participants within corporate governance calculate and respond to problems.¹²

Specifically, to improve the processes of understanding how to mediate corporate conflicts,¹³ this chapter recommends focusing upon the indeterminacy of corporate legal theories. In doing so, corporate legal thinking “habitualizes” being critical and mindful of such indeterminacies,¹⁴ resulting in greater pluralism, since no corporate legal theory would become “heavily privileged” over any other, allowing each to make contributions within legal thinking.¹⁵ When such a balance between theories exists, a robust debate can occur where no ideas are raised to the status of “truth” while other theories are off the table before the debate begins.¹⁶ This would lead to fewer consensuses,¹⁷ but more complexity than presently exists within

¹² For the interplay of corporate legal discourse, theory, doctrine, and policy, see Ron Harris, “The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business” (2006) 63 Wash & Lee L Rev 1421. For challenges to Harris’s position, see Lawrence E Mitchell, “The Relevance of Corporate Theory to Corporate and Economic Development: Comment on The Transplantation of the Legal Discourse on Corporate Personality Theories” (2006) 63 Wash & Lee L Rev 1489 [Mitchell, “The Relevance of Corporate”].

¹³ Bratton, “Nexus of Contracts”, *supra* note 3 at 464-65.

¹⁴ Berger & Luckmann, *supra* note 4 at 74, 177.

¹⁵ Bratton, “Nexus of Contracts”, *supra* note 3 at 464-65.

¹⁶ *Ibid.*

¹⁷ *Ibid* at 465.

corporate legal discourse, helping to immunize the law from the sort of oversimplifications that might offer “ease of comprehension” at the risk of “positive error.”¹⁸ This chapter argues that adding such complexity and balance to corporate legal discourse would be “wholesome” for corporate law.¹⁹

To be clear, this chapter does not reject the argument that relaxed legal requirements lead to optimal corporate governance results over time.²⁰ Rather, it argues that the assumptions that underpin this argument are too fragile to assert that relaxed legal requirements will produce the assumed outcome in all circumstances.²¹ Thus, such fragile *a priori* knowledge²² of the corporation must be recursively subject to careful scrutiny in today’s fast-changing society. If this is true, then no single theory or model ought to be treated as authoritative.

¹⁸ Joo, “Theories and Models”, *supra* note 6 at 170.

¹⁹ Bratton, “Nexus of Contracts”, *supra* note 3 at 465.

²⁰ Frank H Easterbrook & Daniel R Fischel, *The Economic Structure of Corporate Law* (Cambridge: Harvard University Press, 1991) at 35 [Easterbrook & Fischel, *The Economic Structure*].

²¹ For arguments supporting this anti-essentialist notion of corporate law, see William W Bratton, “Welfare, Dialectic, and Mediation in Corporate Law” (2005) 2 Berkeley Bus LJ 59 at 70 [Bratton, “Welfare”]; Bratton, “Nexus of Contracts”, *supra* note 3.

²² *A priori* knowledge is “knowledge that rests on *a priori* justification. *A priori* justification is a type of epistemic justification that is, in some sense, independent of experience.” Bruce Russell, “A Priori Justification and Knowledge” in Edward N Zalta, ed, *The Stanford Encyclopedia of Philosophy* (2011), online: <<http://plato.stanford.edu/entries/apriori/>>.

If an idea “works,” then that is the best we can hope for, and if circumstances change and what worked stops working, then we had better figure out how to adapt so that theory reflects practice as quickly as possible.²³ As Fred Block suggests, “market societies”²⁴ are patchworks of regulations which do not necessarily fit together easily, generating social systems that have an “always under construction” nature.²⁵ Within this context, it is suggested that embracing the indeterminacy of corporate theory will necessarily generate a more responsive and critical discourse that, over time, will improve corporate function within an ever-changing global marketplace.

²³ William James wrote of pragmatism: “Rationalism sticks to logic. . . . Empiricism sticks to the external senses. Pragmatism is willing to take anything, to follow either logic or the senses and to count the humblest and most personal experiences. She will count mystical experiences if they have practical consequences. . . . Her only test of probable truth is what works best in the way of leading us, what fits every part of life best and combines with the collectivity of experience’s demands, nothing being omitted.” William James, *Pragmatism: A Series of Lectures by William James, 1906–1907* (Rockville, Md: Arc Manor, 2008) at 40.

²⁴ Fred Block uses the term “market society,” which he attributes to Karl Polanyi. Block describes “market society” as Polanyi’s conception of a society that is constituted by two opposing movements: “the laissez-fair movement to expand the scope of markets, and the protective countermovement that emerges to resist . . . the impossible pressures of a self-regulating market system.” Fred Block, “Introduction” in Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, 2d ed (Boston: Beacon Press, 2001) xviii at xxviii.

²⁵ Canadian Broadcasting Corporation, “Markets and Society: The Life and Thought of Karl Polanyi, Part 5: The Legacy” (webcast) (Posted 8 August 2006, 9:53 pm) (interviewing Fred Block), online: Canadian Broadcasting Corporation <<http://www.insidethecbc.com/ideas-series-markets-and-society-available-for-download/>>.

Part 2 of this chapter introduces three essentialist theories of the corporation: the concession theory, the entity theory, and the aggregate contractarian theory. These three theories have always been relevant variables when considering the modern corporation.²⁶ Put differently, since the rise of the modern publicly traded corporation,²⁷ the corporation has always been a group of aggregate constituents²⁸ connected through contract,²⁹ while at the same time being an entity with personhood that only exists because of a concession made by the state.³⁰ It is argued that each of these three theories is indeterminate.³¹ Indeterminate, in this context, means that these

²⁶ David Millon, “Theories of the Corporation” (1990) 1990 Duke LJ 201 at 204, 242-51; see also Joo, “Theories and Models”, *supra* note 6.

²⁷ For an historical account of the rise of the modern corporation at the end of the 19th century, see Fenner Stewart, Jr, “The Place of Corporate Lawmaking in American Society” (2010) 23 Loyola Con L Rev 147 at 151-55 [Stewart, “The Place of Corporate Lawmaking”].

²⁸ *Santa Clara County v Southern Pacific Railroad Co*, 118 US 394 (1886) [*Santa Clara*]; see also Joo, “Theories and Models”, *supra* note 6 at 159.

²⁹ Armen Alchian & Harold Demsetz, “Production, Information Costs, and Economic Organization” (1972) 62 Am Econ Rev 777 at 783-84.

³⁰ For more on the historical roots of the concession theory, see William W Bratton, Jr, “The New Economic Theory of the Firm: Critical Perspectives from History” (1989) 41 Stan L Rev 1471 at 1502-05 [Bratton, “New Economic Theory”].

³¹ John Dewey, “The Historic Background of Corporate Legal Personality” (1926) 35 Yale LJ 655 at 669 [Dewey, “Corporate Legal Personality”].

essentialist theories do not support or reject any position with corporate governance until combined with additional normative claims.³²

Parts 3 and 4 trace this history of indeterminacy, pulling together a synthesis of these three essentialist theories of the corporation throughout the twentieth century to present. They offer insight into how each essentialist theory has been used to rationalize contrasting policy positions. In other words, they focus on how each of the essentialist theories have been used to embed a prescription as to how to regulate the corporation, and then later, how that same theory was used to advocate for a policy prescription that undermines the original.³³ Thus, they present historical examples of this indeterminacy in action. Specifically, this chapter explains how this has occurred in the use of both the concession and entity theories. Part 4 ends by predicting how the prevailing aggregate contractarian theory has already past its high-water mark, pointing to how alternative and contrasting versions of it may emerge. This history of legal thought draws attention to the patterns of how we manufacture knowledge about the corporation and corporate law over time.³⁴

³² *Ibid.*

³³ See text accompanying notes 55-56, 64-67 & 69-71.

³⁴ For the interplay of corporate legal discourse, theory, doctrine and policy, see Harris, *supra* note 12. For challenges to Harris's position, see Mitchell, "The Relevance of Corporate", *supra* note 12. See also Berger & Luckmann, *supra* note 4 at 74, 177.

In conclusion, the chapter reasserts that embracing the indeterminacy of corporate theory will generate the sort of robust debate that we as corporate legal scholars ought to have. In the end, the chapter leaves the reader with a simple proposal for conceptualizing the corporation: be self-critical of one's role in the manufacturing of corporate legal knowledge and, in part, be leery of accepting *a priori* knowledge as fact.

II. THREE ESSENTIALIST THEORIES OF THE CORPORATION AND THEIR INDETERMINATE NATURE

The thoughts of John Dewey explain how the essentialist theories of the corporation³⁵ are indeterminate. This part explains his position and then evaluates its implications, before disagreeing with his recommendations on what ought to be done about this indeterminacy. Then this part delves into an explanation of the three essentialist theories of the corporation: the concession theory, the entity theory, and the aggregate contractarian theory. Finally, it foreshadows the historical narrative explored in Parts 3 and 4 by briefly explaining how each of these essentialist theories

³⁵ For the purpose of this chapter, essentialist theories of the corporation are models of the corporation that assert it has a set of characteristics that all corporations must possess. There will be three considered: the concession theory, the entity theory, and the aggregate contractarian theory. These theories purport to be determinative for particular normative positions. However, if Dewey's anti-essentialist theory of corporate law is correct, then this is not the case. See Dewey, "Corporate Legal Personality", *supra* note 31 at 669.

can be used to endorse contradictory policy prescriptions by altering the additional normative suppositions attached to the essentialist theory in question.

It may not be accurate to call Dewey a realist, but he was most definitely an antiformalist, who was very sympathetic to the realist movement against formalism that was occurring in a number of disciplines, including law,³⁶ in the early part of the twentieth century.³⁷ He was acutely aware that social modeling and formal reasoning easily became safe havens for undisclosed normative agendas separate from the reasoning itself.³⁸

In 1926, Dewey published one of the most important articles that the *Yale Law Review* ever printed on corporate theory.³⁹ In the article, Dewey expressed concern over how a number of notions about the “inherent and essential attributes” of the corporation had been “shov[ed] . . . under the legal idea” of the corporation, leading

³⁶ See generally Oliver Wendell Holmes, *The Path of the Law* (New Orleans: Quid Pro, 2011); William W Fisher III, Morton J Horwitz & Thomas A Reed, *American Legal Realism* (New York: Oxford University Press, 1993) at 4; Felix S Cohen, “Transcendental Nonsense and the Functional Approach” (1935) 35 Colum L Rev 809 at 816; Morris R Cohen, “Property and Sovereignty” (1927) 13 Cornell LQ 8 at 12; Robert L Hale, “Coercion and Distribution in a Supposedly Non-Coercive State” (1923) 38 Pol Sci Q 470.

³⁷ Morton White, *Social Thought in America: The Revolt Against Formalism* (New York: Oxford University Press, 1976).

³⁸ John Dewey, *Experience and Nature* (New York: Dover Publications, 1958) at 422-27 [Dewey, *Experience and Nature*].

³⁹ Dewey, “Corporate Legal Personality”, *supra* note 31.

to “a confused intermixture.”⁴⁰ In fact, he insisted that “there [was] no clear-cut line, logical or practical, through the different theories” and that “[e]ach theory [had] been used to serve the same ends, and each [had] been used to serve opposing ends.”⁴¹ He argued that since these essentialist theories were indeterminate, legal thinkers must learn to assess critically whether legal assumptions attached to these theories reflected functional reality of the corporation.⁴²

By identifying such legal assumptions and pragmatically assessing their merit, Dewey asserted that the law could better address corporate legal problems.⁴³ Put differently, Dewey’s solution was not to take essentialist theories too seriously until “the concrete facts and relations involved [had] been faced and stated on their own account”⁴⁴ in order to forge direct connections between legal reasoning and the facts.⁴⁵ The weakness of Dewey’s suggestion is that by discounting essentialist theories when mediating corporate legal conflicts, a normative void can emerge, which might tempt the less pragmatically minded to fill the void, potentially

⁴⁰ *Ibid.*

⁴¹ *Ibid* at 669.

⁴² *Ibid* at 657-58.

⁴³ *Ibid* at 673.

⁴⁴ *Ibid* at 673.

⁴⁵ *Ibid.*

compromising the problem solving Dewey had envisioned for corporate legal thought.⁴⁶

This chapter agrees with Dewey's observations about the potentially negative impact of essentialist theories of the corporation, but it disagrees with his solution. Rather than largely disregarding essentialist theories as Dewey recommended,⁴⁷ this chapter advocates focusing primarily upon the indeterminacy of these essentialist theories.⁴⁸ Such methodology defends against the meritless privileging of any one theory over any other, tearing down monopolies of thought, and creating more balance between competing ideas and interests. Corporate legal debates would then become less shielded from the complexity of governance and more prepared to reject the sort of oversimplifications of corporate function that increase the risk of "positive error"⁴⁹ within corporate governance.

This chapter next considers each of these essentialist theories: the concession theory, the entity theory, and the aggregate contractarian theory. The concession

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ Bratton, "Nexus of Contracts", *supra* note 3 at 464-65.

⁴⁹ *Ibid* at 465.

theory asserts that corporations are merely creatures of statute.⁵⁰ The classic articulation of the concession theory was proffered by William Blackstone in his *Commentaries on the Laws of England*.⁵¹ He argued that for a corporation to exist, the monarch's consent was "absolutely necessary."⁵² Today, this observation is still technically correct: government authority must grant permission for the incorporation of a business. However, since the dawn of the twentieth century, corporate law has made the approval of this granting process guaranteed as long as the rules of incorporation are not violated.⁵³ In other words, instead of the legislature creating each corporation through legislation, corporations could be created merely through compliance with a general enabling statute. Incorporation now occurs automatically as long as the appropriate information and fees are submitted in accordance with regulatory requirements.⁵⁴

⁵⁰ *Trustees of Dartmouth College v Woodward*, 17 US (4 Wheat) 518 at 636 (1819) [*Woodward*]. For more on the historical roots of the concession theory, see Bratton, "New Economic Theory", *supra* note 30 at 1502-05.

⁵¹ William Blackstone, *Commentaries*, vol 1 (Chicago: University of Chicago Press, 1979) at 460.

⁵² *Ibid.*

⁵³ For legislative treatment of this issue, see, for example, Del Code Ann tit 8, § 101 (West 2011) (requiring only the filing of a certificate of incorporation with the Division of Corporations in the Department of State); *Model Bus Corp Act* §§ 2.01, 2.03 (2002); NY Const of 1846 art VIII, § 1.

⁵⁴ Of course, this is an oversimplification of the job that lawyers must undertake to organize the governance structure of a corporation in a manner that best suits their

That said, such legislative reforms do not diminish the basic claim that the corporation is a creature of statute. This is a characteristic that all corporations possess. It is an essential consideration. It is also indeterminate until additional normative claims are introduced. For instance, when the additional normative claim is introduced that incorporations are granted in order to help ensure society's economic welfare,⁵⁵ the concession theory suggests that whether or not a corporation meets this standard will dictate if the state will intervene. However, when the additional normative claim is introduced that "the state provides the corporate form... solely as a means of facilitating private ordering amongst people,"⁵⁶ then the concession theory suggests something much different. In sum, incorporation is essential to the corporation, but what follows from this acknowledgement is indeterminate.

client's needs. See Charles RT O'Kelley & Robert B Thompson, *Corporations and Other Business Associations*, 6th ed (New York: Aspen Publishers, 2010) at 8-19.

⁵⁵ *Citizens United v FEC*, 130 S Ct 876 at 971 (2010) (Stevens J, dissenting) (arguing that "[u]nlike other interest groups, business corporations have been 'effectively delegated responsibility for ensuring society's economic welfare'; they inescapably structure the life of every citizen").

⁵⁶ Stephen Bainbridge, "Citizens United v. FEC: Stevens' Pernicious Version of the Concession Theory" (1 January 2010), online: <http://www.professorbainbridge.com/professorbainbridgecom/2010/01/citizens-united-v-fec-stevens-pernicious-version-of-the-concession-theory.html> [Bainbridge, "Citizens United"].

The entity theory asserts that the corporation is something that exists beyond its aggregate parts.⁵⁷ The clearest case of this is how the law treats the corporation. Examples of this include: judicial enforcement of limited liability,⁵⁸ judicial reluctance to pierce the corporate veil,⁵⁹ the general refusal of courts to burden corporations with pre-incorporation contractual obligations made by its promoters,⁶⁰ and the capacity of the corporation to enter into contracts,⁶¹ hire workers,⁶² and acquire property.⁶³ In each of these legal examples, the law treats the corporation as

⁵⁷ George F Canfield, “The Scope and Limits of the Corporate Entity Theory” (1917) 17 Colum L Rev 128.

⁵⁸ Consider the emergence of limited liability companies. See O’Kelley & Thompson, *supra* note 54 at 535-38; see also *Elf Atochem North America, Inc v Jaffari*, 727 A 2d 286 (Del Sup Ct 1999).

⁵⁹ See O’Kelley & Thompson, *supra* note 54 at 608-11. In contractual situations, see *Consumer’s Co-op v Olsen*, 419 NW 2d 211 (Wis Sup Ct 1988); *K C Roofing Center v On Top Roofing, Inc* 807 SW 2d 545 (Miss Sup Ct 1991). In torts situations, see *Western Rock Co v Davis* 432 SW 555 (Tex Sup Ct 1968); *Baatz v Arrow Bar*, 452 NW 2d 138 (SD Sup Ct 1990).

⁶⁰ See O’Kelley & Thompson, *supra* note 54 at 658-59; see also *RKO-Stanley Warner Theatres, Inc v Granziano*, 355 A 2d 830 (Pa Sup Ct 1976).

⁶¹ Morton J Horwitz, “Santa Clara Revisited: The Developments of Corporate Theory” (1985) 88 W Va L Rev 173 at 221 (quoting Gerard Carl Henderson, *The Position of Foreign Corporations in American Constitutional Law* (Cambridge: Harvard University Press, 1918) at 166 [Horwitz, “Santa Clara”]).

⁶² *Prudential Insurance Co of America v Cheek*, 259 US 530 at 536 (1922) (holding that corporations have a right “to enter into relations of employment with individuals” subject to the law creating the corporation).

⁶³ *Jones v NY Guaranty & Indemnity Co*, 101 US 622 (1879).

though it was separate from, and something other than, the sum of its aggregate parts. This is a characteristic that all corporations possess; it is an essential consideration. And like the concession theory, it is also indeterminate until additional normative claims are introduced. For instance, the entity theory could regard the corporation as the private property of shareholders,⁶⁴ justifying a shareholder primacy perspective,⁶⁵ or it could be defined as a social corpus that is separate from its shareholders,⁶⁶ justifying a stakeholder perspective.⁶⁷

Finally, the aggregate contractarian theory argues that the corporation is the sum of the contractual obligations that each of its constituents (labor, management, shareholders, creditors, the community-at-large, etcetera) owe to each of its other constituents.⁶⁸ Again, all corporations possess this characteristic. Again, it is an essential consideration. And again, it is also indeterminate until additional normative

⁶⁴ AA Berle, Jr, “For Whom Corporate Managers are Trustees: A Note” (1932) 45 Harv L Rev 1365 [Berle, “A Note”]; AA Berle, Jr, “Corporate Powers as Powers in Trust” (1931) 44 Harv L Rev 1049 [Berle, “Corporate Powers”].

⁶⁵ *Ibid.*

⁶⁶ E Merrick Dodd, Jr, “For Whom Are Corporate Managers Trustees?” (1932) 45 Harv L Rev 1145 at 1153 [Dodd, “Corporate Managers”].

⁶⁷ *Ibid.*

⁶⁸ *Ibid.*; see also Michael C Jensen & Clifford W Smith, Jr, “Stockholder, Manager, and Creditor Interests: Applications of Agency Theory” in Michael C Jensen, ed, *A Theory of the Firm: Governance, Residual Claims, and Organizational Forms* (Cambridge: Harvard University Press, 2000) 136 at 136.

claims are introduced. For instance, the aggregate contractarian theory could stand as a barrier to state intervention, based on the assumption that contracting is consensual and efficient,⁶⁹ or it could transcend the notions of market/state and public/private⁷⁰ based on the assumption that contracting is a complex, multi-polar governance practice, which animates and transcends “the contract.”⁷¹ This revitalization of relational contract theory invites one to take seriously “the larger context and framework within which someone enter[s] into and assume[s] a particular contracting position.”⁷²

These three theories represent dimensions of the corporation that ought to be taken into consideration when mediating corporate conflicts, because they are essential to understanding the contemporary corporation. Furthermore, all of these theories are indeterminate, meaning that they could be used as a platform to take either side of any corporate governance debate. Accordingly, each of the theories

⁶⁹ Joo, “Contract, Property”, *supra* note 7 at 800 (arguing that the contractarian vision of contract is a laissez-faire one, which justifies the assumption that “economic relationships are the product of individual free will and rational deliberation, and the law respects them for this reason”); see also Bainbridge, *New Corporate Governance*, *supra* note 5 at 30-31 (Bainbridge’s application of “The Hypothetical Bargain Methodology”).

⁷⁰ Peer Zumbansen, “Rethinking the Nature of the Firm: The Corporation as a Governance Object” (2012) 32 *Seattle UL Rev* 1469 at 1496.

⁷¹ *Ibid* at 1490.

⁷² *Ibid* at 1493.

could support or reject any central issue within corporate governance.⁷³ In other words, these essentialist theories do not bias one normative claim over another. For instance, aggregate contractarian theory does not inherently support the claim that the corporation is private, that default rules are superior to mandatory rules, that efficiency is more important than fairness, that the law should focus on process and leave substance to corporate governance, and that reputational enforcement is better for all concerned than state enforcement.

That said, certain normative preferences tend to attach to each theory at different times in history.⁷⁴ For instance, Morton Horwitz rejected Dewey's indeterminacy argument, in part, when he used a critical legal history analysis to explain how the entity theory became associated with the private nature of the corporation. He asserted that conservative interests used the entity theory in a determinate way in order to reject governmental intervention.⁷⁵ Thus, Horwitz claimed that the entity theory was a private theory of the corporation.

⁷³ For a more exhaustive list of debates within corporate governance and how they play out in the American legal context, see Bratton, "New Economic Theory", *supra* note 30.

⁷⁴ Morton J Horwitz, *The Transformation of American Law: The Crisis of Legal Orthodoxy, 1780–1960* (New York: Oxford University Press, 1992) at 68 [Horwitz, *Transformation of American Law*]; Horwitz, "Santa Clara", *supra* note 61 at 204-06.

⁷⁵ Horwitz, *Transformation of American Law*, *supra* note 74 at 68; Horwitz, "Santa Clara", *supra* note 61 at 204-06.

David Millon qualified Horwitz's argument by illustrating that the entity theory was later used to support the public nature of the corporation.⁷⁶ By highlighting the indeterminacy of the entity theory, Millon did not however diminish Horwitz's argument that "the rise of a natural entity theory of the corporation was a major factor in legitimating big business,"⁷⁷ because, although theories may be inherently indeterminate, they become less indeterminate when studied within their historical contexts. Put differently, indeterminate theory can be used in a determinate manner when additional normative claims are imported. Horwitz asserted, "[W]hen abstract concepts are used in specific historical contexts, they do acquire more limited meanings and more specific argumentative functions. In particular contexts, the choice of one theory over another may not be random or accidental because history and usage have limited their deepest meanings and applications."⁷⁸

In sum, the concession, entity and aggregate contractual theories are all essential to an understanding of what the corporation is. Each of these theories is indeterminate and can be used to justify or reject any position within corporate governance. To build an argument for or against any position, additional normative claims need to be imported. These claims are not inherently connected to the

⁷⁶ Millon, *supra* note 26 at 204, 242-51; Dewey, "Corporate Legal Personality", *supra* note 31 at 669.

⁷⁷ Horwitz, *Transformation of American Law*, *supra* note 74 at 68.

⁷⁸ *Ibid.*

essentialist theory. Finally, examining these theories within their specific historical contexts helps to expose how additional normative claims are imported to these essentialist theories in order to create safe havens for undisclosed normative agendas separate from the theories themselves.

III. THE CONCESSION AND ENTITY THEORIES - A BRIEF HISTORY

A. The Concession Theory

The concession theory was quite compelling in the early part of the nineteenth century when corporations were created exclusively through the legislative process.⁷⁹

The legislation in question would prescribe the corporate powers and purpose,⁸⁰

⁷⁹ *Woodward, supra* note 50 at 636 (“A corporation is an artificial being...*existing only in contemplation of law.*” [emphasis added]); *Cassatt v Mitchell Coal & Coke Co*, 150 F 32 at 44 (3d Cir 1907) (“[A corporation] is a creature of the state.”); Adolf A Berle, Jr, “Constitutional Limitations on Corporate Activity—Protection of Personal Rights from Invasion Through Economic Power” (1952) 100 U Pa L Rev 933 at 935, n 3 [Berle, “Constitutional Limits”]; Adolf A Berle, Jr, “The Theory of Enterprise Entity” (1947) 47 Colum L Rev 343 at 343 [Berle, “Enterprise Entity”].

⁸⁰ *Woodward, supra* note 50 at 636 (“Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created.”); see also *Bank of Augusta v Earle*, 38 US (13 Pet) 519 at 584 (1839); *Bank of US v Dandridge*, 25 US (12 Wheat) 64 at 68 (1827); *Head & Amory v Providence Insurance Co*, 6 US (2 Cranch) 127 at 162 (1804).

which would, in principle, be designed for the satisfaction of the public interest.⁸¹ Corporations had no right to act outside of these legislated boundaries, and they bore only some resemblance in function to the modern corporation.⁸²

As early as 1819, the shift away from the concession theory can be observed within American case law.⁸³ In *Trustees of Dartmouth College v. Woodward*, the United States Supreme Court rejected the argument that corporations were created by the unilateral legislative act of the state and endorsed the argument that a corporate charter was a bilateral contract between the state and the incorporator.⁸⁴ Put differently, instead of accepting Blackstone's more traditional view of a unilateral sovereign authority over incorporation,⁸⁵ this process was regarded as a contractual relationship.⁸⁶ The state granted the power and privilege to operate as a corporation, and the incorporator promised to engage in the objectives for which corporation was

⁸¹ See *Woodward*, *supra* note 50 at 637 (“The objects for which a corporation is created...are deemed beneficial to the country; and this benefit constitutes the consideration, and in most cases, the sole consideration of the grant.”).

⁸² See Paul Lagasse, ed, *The Columbia Encyclopedia*, 6th ed (New York: Columbia University Press, 2000) at 688.

⁸³ See *Woodward*, *supra* note 50 at 518.

⁸⁴ *Ibid.*

⁸⁵ See *supra* notes 51-52 and accompanying text.

⁸⁶ *Woodward*, *supra* note 50 at 658-59.

created.⁸⁷ Thus, the court held that the power of the state to either revoke incorporation or modify the terms of the corporate charter was quite limited.⁸⁸

The case that marked the demise of the concession theory, as well as the death of the public corporation within American legal thinking and practice, was *Santa Clara County v. Southern Pacific Railroad Company*, in which the Supreme Court held that corporations are entitled to the Fourteenth Amendment's equal protection of the law on the same footing as individuals.⁸⁹ Up until Morton J. Horowitz wrote his classic article on the case,⁹⁰ it was conventionally understood that the *Santa Clara* Court granted the corporation Fourteenth Amendment rights because Justice Field, writing for the majority, adopted the entity theory.⁹¹ Horowitz considered the theoretical deliberations at the time, and then argued that it was more likely that Justice Field was following an early prototype of the aggregate theory of the corporation, which asserted that it could be treated much like a partnership.⁹² This point of technical clarity is not as important as Horowitz's argument about the

⁸⁷ *Ibid.*

⁸⁸ *Ibid.*

⁸⁹ *Santa Clara*, *supra* note 28; see also Horowitz, "Santa Clara", *supra* note 61.

⁹⁰ *Ibid.*

⁹¹ *Ibid* at 174, 178.

⁹² *Ibid* at 182, 204.

significance of the case. His argument proceeded to contextualize *Santa Clara* within the larger shift in corporate legal theory and practice to shield economic activities from government interference at that time.⁹³

Later, David Millon wrote that the development of corporate theory and doctrine was a more complicated matter than Horwitz's critical narrative suggested; in particular Millon suggested that the theory at the time was employed not only to advocate for a private conception of the corporation, as Horwitz's critique might suggest, but also a public one.⁹⁴ That said, Millon himself also asserted that this case was a watershed moment in the shift toward protection of corporate power from state interventions.⁹⁵

There were a series of corporate law reforms immediately after *Santa Clara*, which contributed to this turn to private theories of the corporation. Starting in 1888, states began to allow business people to acquire incorporation through an

⁹³ *Ibid* at 204-06.

⁹⁴ Millon, *supra* note 26 at 204, 242-51.

⁹⁵ *Ibid* at 213.

administrative process, rather than a legislative one.⁹⁶ This made incorporation more or less automatic.⁹⁷ The *ultra vires* doctrine⁹⁸ was also largely dismantled.⁹⁹

By the start of the 20th Century, states legislated the right for corporations to possess all of the freedoms of a natural businessperson.¹⁰⁰ Other corporate law reforms that were enacted at this time granted the corporation the capacity to buy and sell shares of other corporations.¹⁰¹ The corporate form could now become a holding company with many new powers and potentials.¹⁰² These new corporate holding companies created the ability to construct complex and opaque ownership structures.

⁹⁶ See David Sciulli, *Corporations vs. The Court: Private Power, Public Interests* (Boulder, Colo: L. Rienner, 1999) at 89-91; William G Roy, *Socializing Capital: The Rise of the Large Industrial Corporation in America* (Princeton: Princeton University Press, 1997) at 152-53.

⁹⁷ O’Kelley & Thompson, *supra* note 54 at 162-63; see also *supra* note 53.

⁹⁸ In this context, the *ultra vires* doctrine forbids a corporation from acting beyond the scope of powers granted to it. Henry Winthrop Ballantine, “Proposed Revision of Ultra-Vires Doctrine” (1927) 13 ABA J 323.

⁹⁹ Millon, *supra* note 26.

¹⁰⁰ Horwitz, “Santa Clara”, *supra* note 61 at 186-88.

¹⁰¹ Joel Seligman, “A Brief History of Delaware’s General Corporation Law of 1899” (1976) 1 Del J Corp L 249 at 265.

¹⁰² For more on the rise of holding companies, see Fred Freedland, “History of Holding Company Legislation in New York State: Some Doubts as to the ‘New Jersey First’ Tradition” (1955) 24 Fordham L Rev 369.

Each of these chipped away at the idea that the corporation was merely a creature of government concession, which resulted in the denial of its public dimension.

Upon reflection, it is unfortunate that American legal scholarship largely rejects the concession theory today, because it is one of the essentialist theories that ought to be taken seriously in order to obtain a comprehensive appreciation of the modern corporation. The prevailing attitude toward the concession theory is reflected in the following passage from Stephen Bainbridge:

It has been over half-a-century since corporate legal theory, of any political or economic stripe, took the concession theory seriously. In particular, concession theory is plainly inconsistent with the contractarian model of the firm, which treats corporate law as nothing more than a set of standard form contract terms provided by the state to facilitate private ordering. The state provides the corporate form not so the corporation can ensure social welfare, but solely as a means of facilitating private ordering amongst people.¹⁰³

It is significant to note that Bainbridge's statement demonstrates much of what is problematic about corporate law from Dewey's perspective. If Dewey is right, then it follows that the "contractarian model" [aggregate contractarian theory] and the concession theory can be "used to serve the same ends," or "to serve opposing ends;"¹⁰⁴ thus, they can be consistent or inconsistent with each other. In other words, both essentialist theories are indeterminate. So how can they be "plainly inconsistent?" In actuality, Bainbridge proves that they can be consistent in the last

¹⁰³ Bainbridge, "Citizens United", *supra* note 56.

¹⁰⁴ Dewey, "Corporate Legal Personality", *supra* note 31 at 669.

sentence of the passage: “The state provides the corporate form not so the corporation can ensure social welfare, but solely as a means of facilitating private ordering amongst people.”¹⁰⁵ Bainbridge is employing a variation of the concession theory here that states: at the point of incorporation the state does not impose an obligation upon the corporation to ensure social welfare, but merely offers a means to facilitate private ordering without a social welfare obligation. This is a version of the concession theory, one he takes seriously, and it is consistent with his version of the aggregate contractarian theory.

B. The Entity Theory

It is important to note from the outset that there can be a distinction drawn between the corporation as an artificial entity and the corporation as an entity, whose nature emerges from social action.¹⁰⁶ For the purpose of this chapter, the artificial

¹⁰⁵ Bainbridge, “Citizens United”, supra note 56.

¹⁰⁶ Millon, *supra* note 26 at 211. The entity theory of the firm invites sociologists to understand this complex human interaction. Max Weber discussed the meaning of social action in the following passage: “By ‘action’ in this definition is meant the human behavior when and to the extent that the agent or agents see it as subjectively *meaningful*...The meaning to which we refer may be either (a) the meaning actually intended either by an individual agent on a particular historical occasion or by a number of agents on an approximate average in a given set of cases, or (b) the meaning attributed to the agent or agents, as types, in a pure type constructed in the abstract. In neither case is the ‘meaning’ to be thought of as somehow objectively ‘correct’ or ‘true’ by some metaphysical criterion. This is the difference between the empirical sciences of action, such as sociology and history, and any kind of *prior* discipline, such as jurisprudence, logic, ethics, or aesthetics whose aim is to extract from their subject-matter ‘correct’ or ‘valid’ meaning.” Max Weber, “The Nature of

entity theory is considered to be a version of the concession theory, based on the reasoning that the artificial entity theory concentrates on the concession and the consequences of that concession.¹⁰⁷ This version claims that the corporation is created by incorporation, and thus it is an artificial construction of the state. By contrast, the natural entity theory [hereinafter just “entity theory”] suggests that the corporation is a “‘natural’ phenomenon” that is something more than merely an artificial creation of the state.¹⁰⁸

Millon explains that prior to the twentieth century the corporation was considered to be an artificial entity and it was not until the beginning of the twentieth century that the entity theory started to gain popularity.¹⁰⁹ In the American context, the entity theory was first used as a vehicle to make the normative claim that “the corporation [was] the creation of private initiative rather than state power.”¹¹⁰ As Millon explains:

The triumph of the new theory therefore signaled a willingness to dispense with the use of corporate law as a regulatory tool designed to address the special social and economic problems that Americans saw

Social Action” in WG Runciman, ed, *Weber: Selections in Translation* (Cambridge: Cambridge University Press, 1978) 7 at 7.

¹⁰⁷ Millon, *supra* note 26 at 211; Joo, “Theories and Models”, *supra* note 6 at 158.

¹⁰⁸ *Ibid* at 161.

¹⁰⁹ Millon, *supra* note 26 at 211.

¹¹⁰ *Ibid*.

as stemming from the rise of the business corporation. Theory instead tended to assimilate corporate persons to the status of natural persons, eliminating the many special limitations on corporate freedom of action that the states had imposed in the past. With this change in theory came a new willingness to treat corporate activity as fundamentally private in nature, differing in no important ways from ordinary individual commercial activities and therefore free from special legal regulations designed to protect public welfare.¹¹¹

Millon's explanation is an example of Horwitz's "history and usage" analysis,¹¹² which acknowledges that the "deep[er] meanings and applications" of an essentialist theory may be limited by the social context in which it is used.¹¹³ Although this version of the entity theory was used to block state intervention in corporate affairs,¹¹⁴ much like how the aggregate contractarian theory is used today,¹¹⁵ in time, a new version emerged that changed this usage. This new version of the entity theory was

¹¹¹ *Ibid* at 213.

¹¹² See *supra* note 78 and accompanying text. For more commentary on Horwitz's "history and usage" analysis, see Joo, "Theories and Models", *supra* note 6 at 171.

¹¹³ Horwitz, *Transformation of American Law*, *supra* note 74 at 68.

¹¹⁴ Millon, *supra* note 26 at 213.

¹¹⁵ Joo, "Theories and Models", *supra* note 6 at 164-70. Some might protest this point arguing that the aggregate contractarian model has already been exposed as indeterminate. See Margaret M Blair & Lynn A Stout, "A Team Production Theory of Corporate Law" (1999) 85 Va L Rev 247. That said, although this is evitable, it is still primarily being used at this time as a tool to block state intervention, like the entity theory was used at the turn of the twentieth century.

used to attempt to tie corporate managers to a social responsibility agenda, as the works of scholars such as Adolf A. Berle¹¹⁶ and E. Merrick Dodd¹¹⁷ demonstrate.

It is important to note that European scholars have had a much richer intellectual history of contemplating the corporate form as a natural entity.¹¹⁸ Generally, these European scholars advanced entity theories, which asserted that there was something essentially natural about how individuals congregated in order to accomplish tasks and that the power and complexity that emanated from such organization ought to be studied at a social rather than an individual level.¹¹⁹ Such theories took very seriously the effects of the social dimensions of group activity. Today, for instance, Marjatta Maula is taking the German theory of the corporation as a social system¹²⁰ in a promising direction, offering an accessible theory of “the

¹¹⁶ Berle, “A Note”, *supra* note 64; Berle, “Corporate Powers”, *supra* note 64.

¹¹⁷ Dodd, “Corporate Managers”, *supra* note 66.

¹¹⁸ For instance, Otto Gierke drew upon the medieval understanding of the corporation (*universitas*) as the collection of people that formed a “mystical body.” See Otto Gierke, *Political Theories of the Middle Age* (Cambridge: Cambridge University Press, 1913) at 10, 22, online: <<http://www.archive.org/stream/politicaltheorie00gieruoft#page/n7/mode/2up>>.

¹¹⁹ Most notably, Gunther Teubner built on Niklas Luhmann’s theories, constructing a theory of the corporation as an autopoietic social system. Gunther Teubner, “Enterprise Corporatism: New Industrial Policy and the ‘Essence’ of the Legal Person” (1988) 36 *Am J Comp L* 130. For more on the corporation as an autopoietic social system, see Dirk Baecker, “The Form of the Firm” (2006) 13 *Organization* 109.

¹²⁰ *Ibid.*

model of living organizations, which explains the processes of learning and renewal . . . that are based on continuous co-evolution and self-production of an organization.”¹²¹

American corporate legal scholars never attempted to grapple as deeply with these more social implications of the entity theory. This could be because, as Thomas Joo suggests, “[t]he general emphasis on groups as entities may have been too reminiscent of socialism and communism and too alien to American individualism” to be seriously contemplated. Thus, although the potential options for understanding the corporation as an entity were and are numerous,¹²² American scholars narrowly conceived the corporate entity, the general scope of which can be appreciated from a reading of the Berle–Dodd debate of the 1930s.¹²³

¹²¹ Marjatta Maula, *Organizations as Learning Systems: “Living Composition” as an Enabling Infrastructure* (Boston: Elsevier, 2006) at 3.

¹²² See e.g. Gierke, *supra* note 118; Baecker, *supra* note 119; Teubner, *supra* note 119.

¹²³ E Merrick Dodd, Jr, “Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?” (1935) 2 U Chicago L Rev 194 [Dodd, “Effective Enforcement”]; Berle, “A Note”, *supra* note 64; Dodd, “Corporate Managers”, *supra* note 66; Berle, “Corporate Powers”, *supra* note 64. For more on the history of the Berle–Dodd debate, see Fenner Stewart, Jr, “Berle’s Conception of Shareholder Primacy: A Forgotten Perspective For Reconsideration During the Rise of Finance” (2011) 34 Seattle UL Rev 1457 [Stewart, “Berle’s Conception”]; William W Bratton & Michael L Wachter, “Shareholder Primacy’s Corporatist Origins: Adolf Berle and The Modern Corporation” (2008) 34 J Corp L 99.

The dawn of the twentieth century marked the rise of large corporations, professional management, and passive investors.¹²⁴ This shift to professional management created new opportunities for the exploitation of shareholders,¹²⁵ who were not only growing in number, but were also increasingly less sophisticated.¹²⁶ This created a fear in some that the social bonds, whether fiduciary or contractual in nature, between those who nominally owned and those who in fact controlled were too weak to adequately prevent managerial opportunism. The champion of these concerns was Adolf A. Berle, who, starting in 1923, developed legal arguments to the effect that the contractual and fiduciary bonds owed by corporate managers to shareholders needed to be taken more seriously.¹²⁷ Accordingly, his shareholder

¹²⁴ See Roy, *supra* note 96 (large corporations and the corporate revolution); Bratton, “New Economic Theory”, *supra* note 30 at 1487-89 (management corporations); Michael Lounsbury & Ellen T Crumley, “New Practice Creation: An Institutional Perspective on Innovation” (2007) 28 *Org Stud* 993 at 997 (passive investments).

¹²⁵ Adolf A Berle & Gardiner C Means, *The Modern Corporation and Private Property*, 2d ed (New York: Harcourt, Brace & World 1968).

¹²⁶ *Ibid.*

¹²⁷ For more on the development of Berle’s theory, see Adolf A Berle, *Navigating the Rapids 1918–1971: From the Papers of Adolf A. Berle*, Beatrice Bishop Berle & Travis Beal Jacobs, eds (New York: Harcourt Brace Jovanovich, 1973) at 19 (entry from Berle’s personal diary on 25 August 1932) [Berle, *Navigating the Rapids*]; AA Berle, Jr, “Non-Voting Stock and ‘Bankers’ Control” (1926) 39 *Harv L Rev* 673 [Berle, “Non-Voting Stock”]; AA Berle, Jr, “Participating Preferred Stock” (1926) 26 *Colum L Rev* 303 [Berle, “Preferred Stock”]; AA Berle, Jr, “Problems of Non-Par Stocks” (1925) 25 *Colum L Rev* 43 [Berle, “Non-Par Stocks”]; AA Berle, Jr, “Non-

primacy argument declared that stock ownership was a new type of private property, which divorced ownership from control and, thus, demanded heightened fiduciary duties to complement the contractual obligations placed upon corporate managers.¹²⁸ Yet, these obligations were not between the managers and the owners; rather, the obligations were between the managers and the property, which had “a corporal existence distinct from that of its owners.”¹²⁹

Underpinning Berle’s efforts was the ever-widening diversity of share ownership, which he thought continued to increase the potential for democratizing corporate power.¹³⁰ For this reason, Berle theorized that if the law compelled corporate managers to act for the sole benefit of shareholders, then the corporation would eventually be aligned with the broader polity of American society.¹³¹ This was the foundational motivation for Berle’s shareholder primacy argument.¹³²

Cumulative Preferred Stock” (1923) 23 Colum L Rev 358 [Berle, “Non-Cumulative Preferred Stock”].

¹²⁸ Berle, “Corporate Powers”, *supra* note 64.

¹²⁹ Bainbridge, *New Corporate Governance*, *supra* note 5 at 27. These rights have sometimes been characterized as being owed to the shareholders as a class, thus excluding the particular rights that individual shareholders might have had. Berle, *Navigating the Rapids*, *supra* note 127.

¹³⁰ Stewart, “Berle’s Conception”, *supra* note 123 at 1460-63.

¹³¹ *Ibid.*

¹³² For more on the development of Berle’s theory, see sources cited *supra* note 127.

It is important to note that in 1932 Berle published *The Modern Corporation and Private Property* with Gardiner C. Means.¹³³ This book, in part, has a much different message than his shareholder primacy argument.¹³⁴ Berle understood that shareholder primacy was not the only path to making corporate power respect public interest concerns.¹³⁵ He believed that another path was that of greater government intervention in corporate affairs, which he endorsed in the last chapter of the book.¹³⁶ However, he also appreciated that greater government intervention was only possible if the political landscape shifted. And by the early 1930s, Berle began to appreciate that such a shift might occur if Roosevelt won the election in 1933.¹³⁷

The first article of the Berle–Dodd debate is a replication of a chapter from *The Modern Corporation and Private Property*, with one key omission: Berle’s shareholder primacy argument was 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.”¹³⁸ He also admitted in this omitted

¹³³ Berle & Means, *supra* note 125.

¹³⁴ *Ibid* at 302-08.

¹³⁵ Stewart, “Berle’s Conception”, *supra* note 123 at 1473.

¹³⁶ Berle & Means, *supra* note 125.

¹³⁷ Stewart, “Berle’s Conception”, *supra* note 123 at 1485-90.

¹³⁸ Berle & Means, *supra* note 125 at 219.

text 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 of the modern corporation would likely develop.¹³⁹ But he qualified these views as a matter of sociological study, which had not yet attained a standing as a “matter of law.”¹⁴⁰

Accordingly, 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.”¹⁴¹ Berle did just that in his 1931 article, arguing “all powers granted to a corporation . . . are . . . at all times exercisable only for the ratable benefits of all the shareholders as their interest appears”¹⁴² without qualification. Knowing that the concession theory would not be accepted in the 1920s, and still wanting to tie corporate power to the concerns of the boarder polity, he believed that the only corporate theory that could adequately serve as a tool to regulate the firm—at that time—was the corporation as private property.¹⁴³ Berle saw this as his only solution.¹⁴⁴

¹³⁹ *Ibid.*

¹⁴⁰ *Ibid.*

¹⁴¹ *Ibid* at 219-20.

¹⁴² *Ibid* at 220; Berle, “Corporate Powers”, *supra* note 64 at 1049.

¹⁴³ Berle & Means, *supra* note 125; Berle, “A Note”, *supra* note 64 at 1367; Berle, “Corporate Powers”, *supra* note 64.

Berle did not directly explain the entity as private property, but the theory is simple enough. The law regulates the corporation as property. This property is owned by shareholders. Shareholders have the authority to elect directors because of their ownership interest in the corporation. When shareholders elect directors, they also delegate the authority to run the corporation to the directors. Directors then in turn delegate part of this authority to executive management to oversee the day-to-day affairs of the corporation. Thus, directors and management had an obligation to shareholders as a class and not merely to the group of shareholders that consolidated control.¹⁴⁵ This created fiduciary and contractual obligations to protect minority shareholder interests in all circumstances.¹⁴⁶ In other words, the law imposed obligations upon directors and management to treat all shareholders evenhandedly, guaranteeing that the interests of ownership were not undermined.¹⁴⁷

E. Merrick Dodd thought Berle's shareholder primacy argument was dangerous, because such shareholders only cared about profits and not about the broader issues of corporate social responsibility.¹⁴⁸ Dodd endorsed a more radical

¹⁴⁴ *Ibid.*

¹⁴⁵ Berle, "Non-Voting Stock" *supra* note 127.

¹⁴⁶ See *supra* note 128 and accompanying text.

¹⁴⁷ *Ibid.*

¹⁴⁸ Dodd, "Corporate Managers", *supra* note 66 at 1146-48.

entity theory of the firm that hinted at the idea that the corporation was more than private property, and thus when managers served the best interests of the corporation, they would be serving more than merely the interests of property holders.¹⁴⁹ Dodd was, in fact, suggesting that the corporation was separate from its aggregate parts, a social entity which tied managers to serve the interests of a broader spectrum of corporate constituents.¹⁵⁰ He never clearly articulated what the corporation was as an entity, and yet he pushed forward, advocating for managers to be freer than Berle thought they should be.¹⁵¹ Dodd thought this would protect better employees, creditors and the community-at-large;¹⁵² this “theory,” which promotes a broader discretion for managers over corporate function, has been called managerialism.¹⁵³

Although Berle was sympathetic to the ends of Dodd’s managerialism, he thought that Dodd’s agenda was dangerously optimistic, because his theory was theoretically impoverished.¹⁵⁴ Berle argued that this form of managerialism would free directors and executive officers from the constraints of their fiduciary duties to

¹⁴⁹ *Ibid* at 1146.

¹⁵⁰ *Ibid* at 1149.

¹⁵¹ *Ibid*.

¹⁵² *Ibid* at 1153-56.

¹⁵³ For one of the best descriptions of the evolution of managerialism in the American context, see Bratton, “New Economic Theory”, *supra* note 30.

¹⁵⁴ Berle, “A Note”, *supra* note 64 at 1372.

shareholders, basically granting them broad discretion over corporate power in the vain hope they would be responsible.¹⁵⁵ This freedom to engage opportunism was precisely what Berle was attempting to avoid, and he was thus skeptical and leery of Dodd's corporate social responsibility agenda.¹⁵⁶

Berle's and Dodd's entity theories of the corporation largely framed discourse until the start of the 1970s. For instance, in 1970 Milton Friedman took up a version of Berle's private property entity theory of the corporation,¹⁵⁷ writing:

In a free enterprise, private property system, a corporate executive is an employee of the owners of the business. He has [a] direct responsibility to his employers. That responsibility is to conduct business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society.¹⁵⁸

It is interesting to note that Friedman constructed the interests of shareholders as those of profiteers with minimal regard for corporate social responsibility, while Berle constructed the interests of shareholders as those of the broader polity with great regard for corporate social responsibility.

¹⁵⁵ *Ibid.*

¹⁵⁶ *Ibid.*

¹⁵⁷ Although Milton Friedman could not be considered ideologically aligned with Berle, he did endorse Berle's fiduciary model in 1970.

¹⁵⁸ Milton Friedman, "The Social Responsibility of Business is to Increase its Profits", *The New York Times* (Magazine) (13 September 1970) [Friedman, "Social Responsibility of Business"]. For more on the interpretation of Friedman's position, see Bainbridge, *New Corporate Governance*, *supra* note 5 at 26-27.

A counter example to Friedman’s entity theory was that of his mid-twentieth century contemporary John Galbraith. Galbraith argued that management of the economy was to be carried out as a public–private partnership between large corporate entities and government; implicit in this argument is a Dodd-ish managerialism that suggested that managers were not accountable to shareholders but to the corporation, which in turn was accountable to broader public interest concerns.¹⁵⁹ It is also important to note, for general context, that this sort of heroic managerialism captured the public imagination at the time. It was deeply enamored with the vision of corporate managers as stewards of society. Like with Dodd’s theory, there was little concern for theoretical assumptions that underpinned this enthusiasm, regarding the corporation as a “social institution” without further contemplation for what sort of entity this might be.¹⁶⁰

Upon reflection, what is clear about the use of the entity theory during the mid-twentieth century was that it could be, and was, employed by both advocates for free markets, like Friedman,¹⁶¹ and by advocates for government control, like

¹⁵⁹ John Kenneth Galbraith, *The New Industrial State* (Princeton: Princeton University Press, 2007).

¹⁶⁰ For one of the best explanations of this, see Harwell Wells, “‘Corporation Law is Dead’: Heroic Managerialism, The Cold War, and the Puzzle of Corporation Law at the Height of the American Century” [forthcoming in 2013].

¹⁶¹ Friedman, “Social Responsibility of Business”, *supra* note 158.

Galbraith.¹⁶² This observation conforms to Dewey's¹⁶³ and Millon's¹⁶⁴ arguments, which contended that these essentialist theories are indeterminate, and also Horwitz's¹⁶⁵ historical narrative that argued that this indeterminacy has been narrowed at different points in history, because of its political usage by prevailing interests. Thus, although the entity theory was used to advocate the private nature of the corporation, it was also used to argue for government intervention. When the indeterminacy of an essentialist theory is exposed in this manner, it becomes more translucent and the interests behind the theory become more visible.

As with his rejection of the concession theory, when Bainbridge rejects the entity theory, he provides another excellent example of how some aggregate contractarian theorists fail to appreciate that all essentialist theories, including the aggregate contractarian theory, are indeterminate. Bainbridge writes:

[An entity theory] requires one to reify the corporation; i.e., to treat the corporation as something separate from its various constituents. While reification provides a necessary semantic shorthand, it creates a sort of false consciousness when taken to extremes. The corporation is not a thing. The corporation is a legal fiction representing the unique vehicle by which large groups of individuals, each offering a different factor

¹⁶² Galbraith, *supra* note 159.

¹⁶³ Dewey, "Corporate Legal Personality", *supra* note 31 at 669.

¹⁶⁴ Millon, *supra* note 26 at 204, 242-51.

¹⁶⁵ Horwitz, *Transformation of American Law*, *supra* note 74 at 68.

of production, privately order their relationships so as to collectively produce marketable goods or services.¹⁶⁶

Bainbridge steps into the world of the sociology of knowledge when he chooses to discuss how theory reifies reality, and he is only partly correct in his assessment. The entity theory reifies the corporation, but all essentialist theories “reify the corporation.”¹⁶⁷ The entity theory provides a form of “semantic shorthand,” but all essentialist theories are forms of “semantic shorthand.”¹⁶⁸ The entity theory creates “false consciousness,” but all theories create “false consciousness.”¹⁶⁹ Bainbridge slips when suggesting that aggregate contractarian theory is superior to the other theories. Simply put, his tacit claim that aggregate contractarian theory is non-reifying is unsupportable.

Dewey appreciated this point: the factualness of a claim was neither absolute nor arbitrary.¹⁷⁰ He suggested that the “eventful character of all existences” was no reason to attempt to find balance by clinging to either extreme.¹⁷¹ Instead, he advised

¹⁶⁶ Bainbridge, *New Corporate Governance*, *supra* note 5 at 27-28.

¹⁶⁷ *Ibid.*

¹⁶⁸ *Ibid.*

¹⁶⁹ *Ibid.*

¹⁷⁰ Dewey, *Experience and Nature*, *supra* note 38 at 64.

¹⁷¹ *Ibid.*

that the inquirer should examine the relevant variables involved in a problem,¹⁷² so that no claim is uncritically reified as fact.¹⁷³ Dewey suggested that without a reflective re-assessment of claims within specific social contexts, these claims stop serving as tools for the honest observation of social function, and can start “prevent[ing] the communication of ideas,”¹⁷⁴ and thus learning. Consequently, if Dewey is correct, embracing the indeterminacy of various essentialist theories ought to better equip legal thinkers to learn how corporations function.

IV. THE RISE OF THE AGGREGATE CONTRACTARIAN THEORY

The entity theory of the corporation as private property began to lose its hold on American corporate legal thinking in the 1960s.¹⁷⁵ In 1962, Henry Manne attacked Berle’s model of ownership and control, arguing that there were links between the price of stocks on secondary markets, the residual value of the corporation, and

¹⁷² *Ibid.*

¹⁷³ *Ibid.*

¹⁷⁴ John Dewey, “The Unity of the Human Being” in John Dewey, *The Later Works, 1925-1953, 1938-1939: Experience and Education, Freedom and Culture, Theory of Valuation, and Essays*, vol 13, Jo Ann Boydston, ed, (Carbondale, Ill: Southern Illinois University Press, 1988) 323 at 323 [Dewey, “Unity of the Human Being”].

¹⁷⁵ Henry G Manne, “The ‘Higher Criticism’ of the Modern Corporation” (1962) 62 *Colum L Rev* 399 at 402-07 [Manne, “Higher Criticism”].

managerial behavior that anachronistic thinkers like Berle never appreciated.¹⁷⁶ For instance, Manne detailed how poor corporate management can depress share price to a level in which share price does not reflect the corporation's potential profitability; the corporation at this point may lure an investor to take over the corporation and replace its management team in order to improve corporate performance (profitability).¹⁷⁷ Such threats to corporate boards thus become a control mechanism for managerial performance.¹⁷⁸ What is most germane to the rise of the aggregate contractarian perspective is that, to make such arguments, Manne employed classical economic thinking, which understands the corporation by observing it through the lens of the aggregate theory.¹⁷⁹

Manne borrowed from the contribution made by economists, like Ronald Coase,¹⁸⁰ who set out to challenge the entity theory of the corporation.¹⁸¹ Coase suggested that to better understand the corporation, observers ought to focus on the

¹⁷⁶ *Ibid.*

¹⁷⁷ Henry G Manne, "Mergers and The Market for Corporate Control" (1965) 73 J Pol Econ 110 at 112-14 [Manne, "Corporate Control"].

¹⁷⁸ *Ibid* at 114.

¹⁷⁹ Manne, "Higher Criticism", *supra* note 175 at 430-32.

¹⁸⁰ *Ibid.*

¹⁸¹ RH Coase, "The Nature of the Firm" (1937) 4 *Economica* 386 at 386-87 [Coase, "Nature of the Firm"].

transaction costs that a corporation confronted when operating within the market.¹⁸² By directing legal thinkers to understand the corporation in terms of how its aggregates make decisions about how to allocate resources based on price indicators, Manne planted the seeds of the modern aggregate theory within corporate legal thinking.¹⁸³ At the core of Manne's thinking were ideas like Friedrich Hayek's. Hayek suggested that private ordering depended upon the price mechanism, which facilitated the necessary information transfers between actors for decentralized market-based transactions to occur.¹⁸⁴ Such decentralized transactions were desirable, Hayek argued, because they were efficient at allocating scarce resources to meet demands within an economic system.¹⁸⁵

Coase observed the operation of large corporations and concluded that these economic units function in a manner that circumvented the operation of the price mechanism.¹⁸⁶ The corporation took what was occurring in the market and internalized that function of the market within itself.¹⁸⁷ For instance, instead of a shoe

¹⁸² *Ibid* at 392.

¹⁸³ Manne, "Higher Criticism", *supra* note 175 at 430-32.

¹⁸⁴ Friedrich A Hayek, "The Use of Knowledge in Society" (1945) 35 *Am Econ Rev* 519 at 526-27.

¹⁸⁵ *Ibid* at 527.

¹⁸⁶ Coase, "Nature of the Firm", *supra* note 181 at 389-91.

¹⁸⁷ *Ibid* at 391-92.

producer contracting individually in the market with the makers of shoe soles, leather uppers, laces, insoles, and so forth, a corporation may hire all of the people necessary to make the shoes and thus it centralizes all of the components of production in-house. The result is that the corporation makes shoes less expensively by controlling production.

From Coase's perspective, the corporation was like a more highly coordinated micro-market that operated within the larger market and imposed cost efficiencies upon the components of production.¹⁸⁸ Put differently, the corporation was a centrally controlled production system within the larger economy that avoided transaction costs by reducing the price of production to less than what occurred in the market without such coordinated efforts. Thus, the function of the corporation could be understood in terms of the transaction costs within the firm versus those outside the firm.

From this understanding of the corporation, Coase argued that it was possible to understand what controlled the size of corporations.¹⁸⁹ He suggested that corporations are created to lower costs below the cost of production in the market.¹⁹⁰ The corporation would only internalize transactions (components of production) until the cost of production was equal to or higher than the cost of transactions in the

¹⁸⁸ *Ibid* at 394-96.

¹⁸⁹ *Ibid* at 396-98.

¹⁹⁰ *Ibid*.

market.¹⁹¹ At this point, the centralized system was no longer more efficient than the function of the market.¹⁹² Thus, firm size was dependent on the transaction costs inside and outside of the corporation.¹⁹³ A good example of how this theory actually translated into practice is when a number of corporations reduced their size in the 1990s as a result of innovations in communication, logistics and transportation, which made outsourcing more cost-effective than maintaining many components of production in-house.¹⁹⁴ In other words, innovations in communication, logistics and transportation made production in market more efficient than production in the corporation.

In 1970, Manne's theory for a market for managerial control was reinforced by a brilliant young economist named Eugene Fama, who had just completed his doctoral work on the efficiency of markets.¹⁹⁵ Building upon how price mechanisms reflect the available knowledge about products and the role that competitive markets

¹⁹¹ *Ibid* at 394-98.

¹⁹² *Ibid* at 395-97.

¹⁹³ *Ibid*.

¹⁹⁴ Barry C Lynn, *End of the Line: The Rise and Coming Fall of the Global Corporation* (New York: Doubleday, 2005).

¹⁹⁵ Eugene F Fama, "Efficient Capital Markets: A Review of Theory and Empirical Work" (1970) 25 J Fin 383 [Fama, "Efficient Capital Markets"]; Eugene F Fama, "The Behavior of Stock-Market Prices" (1965) 38 J Bus 34 (Fama's PhD dissertation) [Fama, "Stock-Market Prices"].

played in gathering that knowledge, Fama suggested that the price of corporate securities was based on the available information about corporate stocks known by investors.¹⁹⁶ His research became synonymous with the “efficient capital markets hypothesis,” which assumes that financial markets efficiently respond to available information.¹⁹⁷

In a practical sense, Fama’s economic model provides an empirical basis for studying how sophisticated financial analysts and investors, who closely examine the data about publicly traded companies, ensure that stock markets are always highly efficient at pricing firm value.¹⁹⁸ As new information about a company becomes publicly known, the theory asserts that stock price will adjust accordingly.¹⁹⁹ Thus, the price of a stock reflects the best available opinion as to whether or not a company will be profitable moving forward.²⁰⁰

¹⁹⁶ *Ibid.*

¹⁹⁷ Fama first mentioned the idea of “efficient” market in his 1965 PhD dissertation. Fama, “Stock-Market Prices”, *supra* note 195 at 90, 94. However, his 1970 article solidified his idea of “efficient” markets. Fama, “Efficient Capital Markets”, *supra* note 195.

¹⁹⁸ Eugene F Fama, Lawrence Fisher, Michael C Jensen & Richard Roll, “The Adjustment of Stock Prices to New Information” (1969) 10 Int’l Econ Rev 1.

¹⁹⁹ *Ibid.*

²⁰⁰ This conclusion is implicit in the conclusion of his 1970 article. Fama, “Efficient Capital Markets”, *supra* note 195.

Fama's theory explained the complex interrelationship of managers (directors and executives) and risk bearers (investors) as aggregate participants within corporate governance. Fama's work reinforced the work of Henry Manne, which argued that investors far removed from the nuances of a corporate governance structure could meaningfully participate in corporate governance by responding to price signals that reduced the complexity of information into a readily understandable signal: the rise and fall of stock value.²⁰¹ Thus, the evolution of "efficient capital markets hypothesis" helped to kindle faith in the ability of market competition to produce optimal corporate governance outcomes, leading to the general opinion that government intervention in corporate governance and markets was not only unnecessary, but could in fact hamper the performance of corporations, and even possibly, as Milton Friedman, suggested lead to totalitarianism!²⁰² If markets occurred naturally, and if regulation impeded their natural operation, then it was assumed that efficient function of financial markets prevented suboptimal corporate governance arrangements, simply by exit (selling their stocks).²⁰³ In other words, if financial markets were largely free from regulation, and if securities law required

²⁰¹ Manne, "Corporate Control", *supra* note 177.

²⁰² Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 2002) at 119-36 [Friedman, *Capitalism*].

²⁰³ For more on the power of exit and the precursor of the theory of shareholder exit, see Albert O Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge: Harvard University Press, 1970).

corporate managers to provide relevant information about corporate governance, sophisticated financial analysts and investors could adjust stock value based on the present potential for profitability of any particular corporation.

Fama's theory and method for establishing the correlations that existed between poor corporate governance performance and stock price gave Manne's "market for corporate control" empirical prowess.²⁰⁴ Discounting the stock value not only impacted the capability of a corporation to raise capital, but it also increased the risk of corporate takeover, which directly threatened the jobs of corporate managers.²⁰⁵ The theory made a convincing argument that it was possible to accurately discount stock value as a response to poor corporate governance performance.²⁰⁶ It also provided a flexible, responsive and consensual mechanism for enforcement, which ensured that corporate managers were performing effectively. More specifically, it provided a picture of corporate governance as a complex web of aggregate risk bearers and managers all joined by the price mechanism.

A couple of years after Fama published his seminal 1970 article,²⁰⁷ Armen Alchian and Harold Demsetz made another landmark contribution to the aggregate

²⁰⁴ Manne, "Corporate Control", *supra* note 177.

²⁰⁵ *Ibid.*

²⁰⁶ Fama, Fisher, Jensen & Roll, *supra* note 198.

²⁰⁷ Fama, "Efficient Capital Markets", *supra* note 195.

theory of the corporation by introducing the nexus-of-contracts theory as an expansion and revision of Coase's theories.²⁰⁸ They argued that Coase exaggerated the importance of transaction costs when attempting to understand why corporations exist.²⁰⁹ For Alchian and Demsetz, it was not the reduction of transaction costs that made the firm more efficient than markets; rather the firm was more efficient because it could channel information between aggregate constituents of the corporation better than the market could (resulting in lower information costs).²¹⁰

Another perspective that added to the advancement of the aggregate theory was the 1976 article by Michael Jensen and William Meckling.²¹¹ This article changed the way American legal scholarship thought about agency theory by more firmly harnessing an expanded theory of transaction costs to agency theory.²¹² The authors tacitly appreciated the operation of the disclosure requirements of the

²⁰⁸ Alchian & Demsetz, *supra* note 29 at 783-84.

²⁰⁹ *Ibid.*

²¹⁰ *Ibid* at 783, 785, 793-95.

²¹¹ Michael C Jensen & William H Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 J Fin Econ 305.

²¹² Lewis A Kornhauser, "The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel" (1989) 89 Colum L Rev 1449; see also Bratton, "Nexus of Contracts", *supra* note 3.

Security Exchange Commission,²¹³ when they argued that one way that managers could be held accountable would be to require financial disclosure and inspection of the firm's accounts by independent auditors.²¹⁴ The work of such independent auditors necessarily created "monitoring costs," which were necessary evils if competition was to police managerial discretion.²¹⁵ This suggestion was much in line with Fama's work on efficient capital markets²¹⁶ and Manne's work on market for control.²¹⁷ However, the authors admitted that monitoring strategies²¹⁸ could not eliminate the risk of opportunism and other inefficiencies created by the agency relationship.²¹⁹ They called these inevitable costs "residual loss,"²²⁰ referring to the shareholder's residual claim on the corporation. With the growing acceptance of this

²¹³ See e.g. *Securities Exchange Commission Rule 10b-5*, 17 CFR § 240.10b-5 (2013).

²¹⁴ Jensen & Meckling, *supra* note 211.

²¹⁵ *Ibid* at 308-10, 319-28.

²¹⁶ Fama, "Efficient Capital Markets", *supra* note 195; Fama, "Stock-Market Prices", *supra* note 195.

²¹⁷ Manne, "Corporate Control", *supra* note 177.

²¹⁸ In addition to monitoring costs the authors also discussed "bonding costs," which provided managers the opportunity to demonstrate their performance and loyalty, but are being left out of the present discussion. See Jensen & Meckling, *supra* note 211 at 308-10, 325-30.

²¹⁹ *Ibid* at 357.

²²⁰ *Ibid* at 308-10, 319.

understanding of the agency relationship, the issues of agency theory were decisively shifted from the entity to aggregate theory.²²¹ Jensen and Meckling's theory also was much in line with Alchian and Demsetz's.²²² They also argued that all of the firm's activities could be explained in terms of the contracts (the formalized normative legal information) that shape the relationships between constituents.²²³ They suggested that the corporation was no more than a "nexus for a set of contracting relationships among individuals."²²⁴

²²¹ Well, at least it had in economics; it would not be until the 1980s that it was popularized in corporate legal scholarship. See Frank H Easterbrook & Daniel R Fischel, "Close Corporations and Agency Costs" (1986) 38 Stan L Rev 271 [Easterbrook & Fischel, "Close Corporations"]; Frank H Easterbrook & Daniel R Fischel, "Optimal Damages in Securities Cases" (1985) 52 U Chicago L Rev 611 [Easterbrook & Fischel, "Optimal Damages"]; Frank H Easterbrook & Daniel R Fischel, "Limited Liability and the Corporation" (1985) 52 U Chicago L Rev 89 [Easterbrook & Fischel, "Limited Liability"]; Frank H Easterbrook & Daniel R Fischel, "Mandatory Disclosure and the Protection of Investors" (1984) 70 Va L Rev 669 [Easterbrook & Fischel, "Mandatory Disclosure"]; Frank H Easterbrook, "Two Agency-Cost Explanations of Dividends" (1984) 74 Am Econ Rev 650; Frank H Easterbrook & Daniel R Fischel, "Voting in Corporate Law" (1983) 26 JL & Econ 395 [Easterbrook & Fischel, "Voting"]; Frank H Easterbrook & Daniel R Fischel, "Auctions and Sunk Costs in Tender Offers" (1982) 35 Stan L Rev 1 [Easterbrook & Fischel, "Auctions"]; Frank H Easterbrook & Daniel R Fischel, "Corporate Control Transactions" (1982) 91 Yale LJ 737 [Easterbrook & Fischel, "Corporate Control Transactions"]; Frank H Easterbrook & Daniel R Fischel, "The Proper Role of a Target's Management in Responding to a Tender Offer" (1981) 94 Harv L Rev 1161 [Easterbrook & Fischel, "The Proper Role"].

²²² Alchian & Demsetz, *supra* note 29 at 783-84.

²²³ *Ibid.*

²²⁴ Jensen & Meckling, *supra* note 211 at 311.

In the 1980s, Frank H. Easterbrook and Daniel R. Fischel crystalized the aggregate contractarian theory within American corporate law by publishing the lion's share of this legal and economic theorizing.²²⁵ Their translation of the arguments of Coase,²²⁶ Hayek,²²⁷ Friedman,²²⁸ Fama,²²⁹ and other economists²³⁰ persuaded corporate legal thinkers that if corporate law better facilitated freedom of contract, then the potential of markets could be unleashed.²³¹ Furthermore, there was no need to be concerned about the loss of regulatory control, because competitive markets insured a consensual enforcement mechanism for managerial decision-making based on the ability of self-interested actors to hold each other in check.²³² Thus, if markets were left to their own devices, then they would find an equilibrium

²²⁵ See sources cited *supra* note 221.

²²⁶ RH Coase, "The Problem of Social Cost" (1960) 3 *JL & Econ* 1 [Coase, "Social Cost"]; Coase, "Nature of the Firm", *supra* note 181.

²²⁷ Hayek, *supra* note 184.

²²⁸ Friedman, *Capitalism*, *supra* note 202.

²²⁹ Fama, "Efficient Capital Markets", *supra* note 195.

²³⁰ See e.g. Jensen & Meckling, *supra* note 211; Alchian & Demsetz, *supra* note 29.

²³¹ See *supra* note 221 and accompanying text.

²³² For production of these economic presumptions in corporate legal scholarship, see Easterbrook & Fischel, *The Economic Structure*, *supra* note 20 at 38.

that established an optimal balance between all corporate constituents.²³³ With Easterbrook and Fischel's publications, these already popular economic notions about corporate governance, markets and regulation soon prevailed over other essentialist theories within corporate legal thought.²³⁴

By the 1990s, Easterbrook and Fischel marveled at the efficiency of modern corporate law.²³⁵ They detailed the consequences of providing off-the-rack default rules for incorporation.²³⁶ On the one hand, these optional rules assisted less sophisticated incorporators to select a low-cost framework that, for most firms, would "maximize the value of corporate endeavor[s] as a whole".²³⁷ On the other hand, their optional nature averted corporate law from imposing a rigid regulatory framework, which most certainly would restrict shrewd business people from customizing corporate entities to exploit uncommon business opportunities.²³⁸ They described

²³³ See e.g. Bainbridge, *New Corporate Governance*, *supra* note 5 at 30-31 (Bainbridge's application of "The Hypothetical Bargain Methodology").

²³⁴ Ian Ayres, "Making a Difference: The Contractual Contributions of Easterbrook and Fischel" (1992) 59 U Chicago L Rev 1391.

²³⁵ Easterbrook & Fischel, *The Economic Structure*, *supra* note 20.

²³⁶ *Ibid* at 34-35.

²³⁷ *Ibid* at 35.

²³⁸ *Ibid*.

modern corporate law as an “economizing device” which reduced the cost of consensual bargaining without sacrificing dynamism.²³⁹

Easterbrook and Fischel compared corporate law to the regulation of other areas of society, determining that it was unique.²⁴⁰ They compared it to administrative law, observing that the discretion of administrative officials was tightly constrained by regulation and closely scrutinized by judicial oversight.²⁴¹ By comparison, they observed that corporate law “allow[ed] managers and investors to write their own tickets, to establish systems of governance without substantive scrutiny from a regulator,”²⁴² and furthermore, that the “business judgment rule” instructed courts to adopt a “hands-off approach.”²⁴³ While the administrative officials were tightly regulated and closely scrutinized, corporate managers were free to do basically whatever they like.²⁴⁴

²³⁹ *Ibid.*

²⁴⁰ *Ibid* at 2.

²⁴¹ *Ibid.*

²⁴² *Ibid.*

²⁴³ *Ibid.*

²⁴⁴ *Ibid.*

Easterbrook and Fischel explained that, upon close inspection, corporate managers were not as free as they might appear at first glance.²⁴⁵ Although corporate law stepped back from imposing command-and-control regulation upon corporate governance, they asserted that there were still enforcement mechanisms that regulated the action of corporate managers.²⁴⁶ They detailed how other constituents of the firm (such as investors, employers, consumers, creditors etc.) contracted/negotiated with corporate managers in a manner that would make some decisions profitable and others not.²⁴⁷ For instance, corporate managers did not engage in opportunistic behavior, not because the law was capable of preventing such behavior, but because it would decrease the performance of the corporation, which would in turn decrease the value of its shares, resulting in ex ante contractual penalties for the managers.²⁴⁸ Examples of such ex ante contractual penalties include the decreased potential value of a manager's stock options, the threat of removal due to poor performance and/or the threat of damage to reputation.²⁴⁹ Thus, a cocktail of free contracting, highly liquid markets, free flow of information, and self-interest created a balancing of

²⁴⁵ *Ibid* at 3.

²⁴⁶ *Ibid*.

²⁴⁷ *Ibid* at 2-3.

²⁴⁸ *Ibid* at 6.

²⁴⁹ *Ibid*.

interests between market actors within corporate governance that tended to optimize corporate performance in each particular situation, depending upon the competence of the negotiating parties in question.²⁵⁰ And, in a world of consensual contracting, without notable power imbalances and information asymmetries, equity was satisfied in all but a few cases, because those who freely obliged themselves to bad bargains could be expected to suffer the burden of the bargains, hopefully learning from the experience, and thus, better equipping themselves for future contracting.²⁵¹

The classic concern of corporate governance was the separation of ownership and control.²⁵² From this perspective, the most obvious challenge to letting markets police managerial behavior was that investors did not have the time, skill, or knowledge in order to be able to properly negotiate and enforce the terms of corporate governance.²⁵³ The authors were quick to suggest how this was a misconception.²⁵⁴

²⁵⁰ *Ibid* at 6-7.

²⁵¹ See e.g. Donald C Langevoort, “Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers” (1996) 84 Cal L Rev 627 at 639 (“[O]ver time investors should learn from their mistakes, acquiring a natural humility.”) [Langevoort, “Selling Hope”]; see also *Carlson v Hamilton*, 332 P 2d 989 at 990 (Utah Sup Ct 1958) (“People should be entitled to contract on their own terms without the indulgence of paternalism by courts in the alleviation of one side or another from the effects of a bad bargain.”).

²⁵² Berle & Means, *supra* note 125.

²⁵³ Easterbrook & Fischel, *The Economic Structure*, *supra* note 20 at 17-19, 23.

²⁵⁴ *Ibid* at 23-24.

They explained that American stock markets had teams of professional investors working alongside investment advisors in order to oversee corporate performance.²⁵⁵ Even though an individual investor might not have the capacity to contract effectively they would be able to respond to increases or decreases in stock value triggered by more sophisticated and powerful investors in the market.²⁵⁶

The large sophisticated investors, having enough financial might in stock markets, could push the price enough to signal other investors that a stock value is too high or too low.²⁵⁷ These professional investors constantly engage in detailed analysis of corporate management, governance structure, debt/equity ratios, and relative prowess when compared to competitors.²⁵⁸ Thus, tacitly relying on the commonly accepted arguments of Friedrich Hayek,²⁵⁹ Henry Manne²⁶⁰ and Eugene Fama,²⁶¹ the authors suggested that the operation of an effective price mechanism provided enough

²⁵⁵ *Ibid* at 17-19, 23-24.

²⁵⁶ *Ibid* at 23-24.

²⁵⁷ *Ibid* at 17-19.

²⁵⁸ *Ibid* at 17-19, 23-24.

²⁵⁹ Hayek, *supra* note 184.

²⁶⁰ Manne, “Corporate Control”, *supra* note 177.

²⁶¹ Fama, “Efficient Capital Markets”, *supra* note 195.

information for decentralized actors to make efficient decisions.²⁶² The corporate legal world quickly warmed to the idea that a corporate law that allows actors to “consensually” contract to protect their own interests resulted in more optimal corporate governance structures.²⁶³ By doing less and allowing markets to function efficiently, corporate law encourages “what is optimal for the firm and investors.”²⁶⁴

In the 1980s and 1990s, a number of powerful critiques reacted to the aggregate contractarian theory.²⁶⁵ In 1985, Mark Granovetter noted that modeling based on this theory tended to either undersocialize²⁶⁶ or oversocialize²⁶⁷ the

²⁶² Easterbrook & Fischel, *The Economic Structure*, *supra* note 20 at 19.

²⁶³ *Ibid* at 6-7.

²⁶⁴ *Ibid* at 7.

²⁶⁵ See e.g. Mark Granovetter, “Economic Action and Social Structure: The Problem of Embeddedness” (1985) 91 *Am J Soc* 481; Bratton, “Nexus of Contracts”, *supra* note 3; Lawrence E Mitchell, “Cooperation and Constraint in the Modern Corporation: An Inquiry into the Causes of Corporate Immorality” (1995) 73 *Tex L Rev* 477 [Mitchell, “Cooperation and Constraint”]; Lawrence E Mitchell, “Trust. Contract. Process.” in Lawrence E Mitchell, ed, *Progressive Corporate Law* (Boulder, Colo: Westview Press, 1995) at 185 [Mitchell, “Trust. Contract. Process.”].

²⁶⁶ For instance, Granovetter describes undersocialized as an atomized utilitarianism, which emanated from the Hobbesian tradition and underestimates the importance of how actors are embedded within a social context. Granovetter, *supra* note 265 at 483.

²⁶⁷ Granovetter describes oversocialized as “a conception of people as overwhelmingly sensitive to the opinions of other and hence obedient to the dictates of consensually developed systems of norms and values, internationalized through socialization.” *Ibid*.

corporation, leading to the same result of formalizing the actual social relationships to a degree that did not reflect what was actually happening within corporations.²⁶⁸ In 1989, Bratton carefully contemplated a number of questionable assumptions about discrete contracts and contractual gaps, which needed to be accepted, if the theory was to work.²⁶⁹ In 1995, Lawrence Mitchell argued that the theory favored shareholders at the expense of other corporate constituents, who either had no contract (like the community at large), or had little power to negotiate the terms of their contract (like un-unionized workers).²⁷⁰ Each of these critiques, and others like them, suggested that, in the end, this seemingly neutral theory might not be as objective as some assumed.²⁷¹ But, in the end, these critiques had little impact on the use of this theory in corporate legal academia.²⁷²

During the last decade, one model of the aggregate contractarian theory, which largely mirrors the operation of Delaware's General Corporation Law,²⁷³

²⁶⁸ *Ibid* at 485-87.

²⁶⁹ Bratton, "Nexus of Contracts", *supra* note 3 at 461-63.

²⁷⁰ Mitchell, "Cooperation and Constraint", *supra* note 265; Mitchell, "Trust. Contract. Process.", *supra* note 265.

²⁷¹ Mitchell, "Cooperation and Constraint", *supra* note 265 at 448, 455, 461, 464.

²⁷² See e.g. Joo, "Contract, Property", *supra* note 7; Joo, "Theories and Models", *supra* note 6.

²⁷³ *General Corporation Law*, 8 Del C § 101 et seq (Lexis 2013).

stands out: Bainbridge's director primacy model.²⁷⁴ Bainbridge adopts a hierarchical management structure that earlier contractarians tempted to flatten.²⁷⁵ These earlier contractarians used contract to explain away corporate hierarchy,²⁷⁶ but Bainbridge rejects such temptations, embracing the need for contract theory to account for "asymmetric information" and "bilateral monopoly."²⁷⁷ Bainbridge is not as willing as Easterbrook and Fischel were in 1991 to optimistically believe in the power of the market to arbitrate equity within corporate governance.²⁷⁸ Bainbridge describes his model as follows:

Instead of viewing the corporation either as a person or an entity, contractarian scholars view it as an aggregate of various inputs acting together to produce goods or services. Employees provide labor. Creditors provide debt capital. Shareholders initially provide capital and subsequently bear the risk of losses and monitor the performance of management. Management monitors the performance of employees and coordinates the activities of all the firm's inputs. Accordingly, the firm is not a thing, but rather a nexus of explicit and implicit contracts establishing rights and obligations among various inputs making up the firm.²⁷⁹

²⁷⁴ Bainbridge, *New Corporate Governance*, *supra* note 5.

²⁷⁵ *Ibid.*

²⁷⁶ Bratton, "Nexus of Contracts", *supra* note 3.

²⁷⁷ Bainbridge, *New Corporate Governance*, *supra* note 5 at 24.

²⁷⁸ *Ibid.*

²⁷⁹ *Ibid* at 28.

This model does have its contractarian challengers. Contractarian purists, like Lucian Bebchuk, are not so willing to give up the market for corporate control.²⁸⁰ Bebchuk rejects Bainbridge’s notion that allowing for managerial discretion maximizes shareholder wealth and most effectively protects the interests of shareholders as a class.²⁸¹

The Bebchuk–Bainbridge debate²⁸² may prove to be the high watermark for the present embodiment of the aggregate contractarian theory. The debate exemplifies how, in the highest echelons of American corporate legal discourse, such debates could fit comfortably within the still largely uncontested aggregate contractarian theory. This chapter uses the words “largely uncontested,” because in 2005–2006, when their debate occurred, cracks had emerged in this paradigm. The succession of shockwaves, which started in March 2000 when the Dot-Com Bubble started to burst, damaged the credibility of this theory.²⁸³ The Enron fiasco did not help things

²⁸⁰ Lucian Arye Bebchuk, “The Case for Increasing Shareholder Power” (2005) 118 Harv L Rev 833 [Bebchuk, “Increasing Shareholder Power”].

²⁸¹ Lucian A Bebchuk, “Reply: Letting Shareholders Set the Rules” (2006) 119 Harv L Rev 1784 [Bebchuk, “Shareholders Set the Rules”].

²⁸² *Ibid.*; Stephen M Bainbridge, “Director Primacy and Shareholder Disempowerment” (2006) 119 Harv L Rev 1735 [Bainbridge, “Director Primacy”]; Bebchuk, “Increasing Shareholder Power”, *supra* note 280.

²⁸³ For a critique highlighting the flaws in the efficient markets hypothesis just prior to the crash, see Robert J Shiller, *Irrational Exuberance* (Princeton: Princeton University Press, 2000). To put the Dot-Com Bubble within a historical context, see

either,²⁸⁴ marking a potential opportunity for a significant shift in corporate law.²⁸⁵ By 2008, confidence in the efficient market hypothesis was clearly shaken;²⁸⁶ even some of the most prominent advocates of the market efficiency theory, such as Alan Greenspan, publicly began to express doubt about it as presently conceived.²⁸⁷

In light of this, Thomas Joo envisions that corporate legal scholarship is about to enter into a new post-contractarian era,²⁸⁸ seeing promise in the work being done in behavioral finance,²⁸⁹ although some scholars question the merits of a turn to

Charles P Kindleberger & Robert Z Aliber, *Manias, Panics and Crashes: A History of Financial Crises*, 6th ed (Basingstoke, Hampshire: Palgrave Macmillan, 2011).

²⁸⁴ Rapoport, Van Niel & Dharan, *supra* note 9.

²⁸⁵ David A Westbrook, “Corporation Law After Enron: The Possibility of a Capitalist Reimagination” (2003) 92 *Geo LJ* 61 at 69-70.

²⁸⁶ Paul Krugman, “How Did Economists Get It So Wrong?”, *The New York Times* (6 September 2009) MM36; John Cassidy, “After the Blowup: Laissez-faire Economists Do Some Soul-Searching—And Finger-Pointing”, *The New Yorker* 85:44 (11 January 2010) at 28, online: [The New Yorker.com <http://www.newyorker.com/reporting/2010/01/11/100111fa_fact_cassidy>](http://www.newyorker.com/reporting/2010/01/11/100111fa_fact_cassidy).

²⁸⁷ Edmund L Andrews, “Greenspan Concedes Error on Regulation”, *The New York Times* (24 October 2008) B1. For an example of the Chicago School academia distancing itself from such theory, see Richard A Posner, *A Failure of Capitalism: The Crisis of '08 and the Descent into Depression* (Cambridge: Harvard University Press, 2009).

²⁸⁸ Joo, “Theories and Models”, *supra* note 6 at 170. Joo points to the work of Donald Langevoort, see Donald C Langevoort, “Taming the Animal Spirits of the Stock Market: A Behavioral Approach to Securities Regulation” (2002) 97 *Nw UL Rev* 135 [Langevoort, “Taming the Animal Spirits”].

²⁸⁹ *Ibid.*

psychology in corporate law and scholarship.²⁹⁰ This chapter agrees with Joo's observation that a shift appears to be occurring,²⁹¹ but predicts a different outcome. It expects that the emerging innovations will be generated within the aggregate contractarian theory. As this chapter has illustrated, history indicates that the indeterminacy of a given essentialist theory of the corporation allows for counter positions and apposing policy positions to emerge within it.²⁹² There does not appear to be any reason why it would not happen again within the aggregate contractarian theory. In other words, if an understanding of history helps foresee the potential for future events, the aggregate contractarian theory ought to remain the dominant theoretical approach in legal academia. Leading thinkers will still regard the corporation as being a group of aggregate constituents who are connected through contract, but their assumptions about contracts and markets will change to accommodate factual circumstances, leading to different policy prescriptions.

²⁹⁰ Mae Kuykendall & David Westbrook, "Introduction: Unsettling Questions, Disquieting Stories" (2009) 2009 Mich St L Rev 817 at 828.

²⁹¹ *Ibid.*

²⁹² See *supra* notes 148-165 and accompanying text.

V. CONCLUSION

The contestation that has emerged about aggregate contractarian theory is like the history of the entity theory at the beginning of the twentieth century.²⁹³ As covered in this chapter, the entity theory shifted from defending claims about the private nature of the corporation to defending the opposite claim by the 1930s.²⁹⁴ And yet, the future of corporate legal theory does not need to be predetermined; history does not have to repeat itself. As an alternative, we could embrace the indeterminacy of the aggregate contractarian theory (and the other essentialist theories of the corporation), providing a path to a corporate legal discourse with greater contestation and complexity. Such contestation and complexity ought to be welcomed. Joo argues when considering post-contractarian directions in corporate theory that, “[a]s the best theorists appreciate, rational behavior theory, and grand constructs generally, offer ease of comprehension at the cost of oversimplification. The spectacular recent failures in the financial markets illustrate how the costs of oversimplification can outweigh the benefits.”²⁹⁵

Of course, Joo is not suggesting that there is a direct correlation between the prevailing version of the aggregate contractarian theory and the recent failures in the

²⁹³ See *supra* notes 124-165 and accompanying text.

²⁹⁴ Joo, “Theories and Models”, *supra* note 6 at 170.

²⁹⁵ *Ibid.*

financial markets. Rather, he is suggesting that this example provides a dire warning about how theorizing that blindly adheres to oversimplified versions of reality risks disastrous results.²⁹⁶ If Joo is correct, then corporate legal theory ought to offer complexity and indeterminacy to legal thought, not an “ease of comprehension,” because such “oversimplification” can lead to the serious risk of misapprehension and poor judgment.²⁹⁷

This final thought brings this chapter back to the introduction with Bratton’s comment about the elements of a “wholesome” corporate legal dialectic.²⁹⁸ Consider his words carefully:

Whatever the future interplay of theory and power, the concepts that make up theories of the firm – entity and aggregate, contract and concession, public and private, discrete and relational – will stay in internal opposition. This tendency toward contradiction should be accepted, not feared. The contradictions are intrinsic. No foreseeable scholarship or legislative reform will resolve them. The contradictions also are wholesome. Studying and reflecting on their interplay in the law enhances our positive and normative understanding. Legal theories that heavily privilege one or another opposing concept risk positive error. Theory, instead of denying the existence of the contradictions, should synchronize their coexistence in law.²⁹⁹

²⁹⁶ *Ibid.*

²⁹⁷ *Ibid.*

²⁹⁸ Bratton, “Nexus of Contracts”, *supra* note 3 at 465.

²⁹⁹ *Ibid* at 464-65.

Unfortunately, this particular message of Bratton never gained enough traction in corporate legal academia to bring about the quality of discourse that this passage suggests.

This chapter will end with the recommendation that it endorsed at the outset. We as corporate scholars need be self-critical of our roles in the manufacturing of corporate knowledge and, in part, be leery of accepting *a priori* knowledge as fact. If we will do this, it should lead to a more wholesome corporate law, whatever that law might look like.

CHAPTER 3: BERLE'S CONCEPTION OF SHAREHOLDER PRIMACY: A FORGOTTEN PERSPECTIVE FOR RECONSIDERATION DURING THE RISE OF FINANCE

I. INTRODUCTION

The 1970s marked an American revolution in corporate governance as managers shifted their focus toward greater market accountability with the rebirth of the shareholder primacy argument.¹ By the late 1980s, the resulting efficiency gains

¹ Much of this revolution occurred in the economic literature, which built on the work of Henry Manne in the 1960s. For Manne's work on shareholder primacy, see Henry G Manne, "Mergers and the Market for Corporate Control" (1965) 73 J Pol Econ 110 [Manne, "Mergers and the Market"]; Henry G Manne, "Some Theoretical Aspects of Share Voting: An Essay in Honor of Adolf A. Berle" (1964) 64 Colum L Rev 1427 [Manne, "Theoretical Aspects"]; Henry G Manne, "The 'Higher Criticism' of the Modern Corporation" (1962) 62 Colum L Rev 399 [Manne, "Higher Criticism"]; Henry G Manne, "Corporate Responsibility, Business Motivation, and Reality" (1962) 343 Annals Am Acad Pol & Soc Sci 55 [Manne, "Corporate Responsibility"]; Henry G Manne, "Current Views on the 'Modern Corporation'" (1961) 38 U Det LJ 559 [Manne, "Modern Corporation"]; Henry G Manne, "Accounting for Share Issues Under Modern Corporation Laws" (1959) 54 Nw UL Rev 285 [Manne, "Accounting for Share Issues"]. For more on the economic literature of the 1970s, see Armen A Alchian & Harold Demsetz, "Production, Information Costs, and Economic Organization" (1972) 62 Am Econ Rev 777; Michael C Jensen & William H Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure" (1976) 3 J Fin Econ 305. This economic literature was translated by Frank H. Easterbrook and Daniel R. Fischel in the early 1980s. See Frank H Easterbrook & Daniel R Fischel, "Close Corporations and Agency Costs" (1986) 38 Stan L Rev 271 [Easterbrook & Fischel, "Close Corporations"]; Frank H Easterbrook & Daniel R Fischel, "Optimal Damages in Securities Cases" (1985) 52 U Chicago L Rev 611 [Easterbrook & Fischel, "Optimal Damages"]; Frank H Easterbrook & Daniel R Fischel, "Limited Liability and the Corporation" (1985) 52 U Chicago L Rev 89 [Easterbrook & Fischel, "Limited Liability"]; Frank H Easterbrook & Daniel R Fischel, "Mandatory Disclosure and the Protection of Investors" (1984) 70 Va L Rev 669 [Easterbrook & Fischel, "Mandatory Disclosure"]; Frank H Easterbrook, "Two Agency-Cost Explanations of Dividends" (1984) 74 Am Econ Rev 650; Frank H Easterbrook & Daniel R Fischel,

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.

As detailed in Chapter 2, although a collection of academics created the theoretic groundwork that inspired this heroic rebirth of the American firm, Henry Manne deserves much of the credit. Manne's success can be attributed, at least in part, to how he redefined the interests of shareholders by "flipping"² Adolf A Berle,

"Voting in Corporate Law" (1983) 26 JL & Econ 395 [Easterbrook & Fischel, "Voting"]; Frank H Easterbrook & Daniel R Fischel, "Auctions and Sunk Costs in Tender Offers" (1982) 35 Stan L Rev 1 [Easterbrook & Fischel, "Auctions"]; Frank H Easterbrook & Daniel R Fischel, "Corporate Control Transactions" (1982) 91 Yale LJ 737 [Easterbrook & Fischel, "Corporate Control Transactions"]; Frank H Easterbrook & Daniel R Fischel, "The Proper Role of a Target's Management in Responding to a Tender Offer" (1981) 94 Harv L Rev 1161 [Easterbrook & Fischel, "The Proper Role"]. Easterbrook and Fischel's work from the 1980s was then used to form the basis for *The Economic Structure of Corporate Law*, which is perhaps their most influential work to date. Frank H Easterbrook & Daniel R Fischel, *The Economic Structure of Corporate Law* (Cambridge: Harvard University Press, 1991) [Easterbrook & Fischel, *The Economic Structure*].

² A flip occurs when legal language is used to endorse a particular reform (like Berle advocating shareholder primacy to open the corporation to public-interest concerns) and then that same language is used to endorse the opposed reform (like Manne advocating shareholder primacy to close the corporation to public-interest concerns). For more on how arguments can be flipped, see Duncan Kennedy, *A Critique of Adjudication: Fin de siècle* (Cambridge: Harvard University Press, 1997); see also Kerry Rittich, "Functionalism and Formalism: Their Latest Incarnations in Contemporary Development and Governance Debates" (2005) 55 UTLJ 853 at 857.

Jr's "shareholder primacy" argument.³ For the Berle of the 1920s and 1930s, shareholders were the middle- and working-class "Everyman."⁴ Berle believed that if shareholder primacy was ensured, it would correct the democratic deficit that existed in the management of the American economy. For Manne of the 1960s, shareholders were much different; they were rational actors whose constructed intentions could be used to ascertain and justify market function.⁵ 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

³ For Manne's work on shareholder primacy, see Manne, "Mergers and the Market", *supra* note 1; Manne, "Theoretical Aspects", *supra* note 1; Manne, "Higher Criticism", *supra* note 1; Manne, "Corporate Responsibility", *supra* note 1; Manne, "Modern Corporation", *supra* note 1; Manne, "Accounting for Share Issues", *supra* note 1.

⁴ "Everyman" is a reference to *The Summoning of Everyman*, usually referred to simply as *Everyman*, written in the late fifteenth century. See Anonymous, *The Summoning of Everyman*, Geoffrey Cooper & Christopher Wortham, eds (Nedlands, WA: University of Western Australia Press, 1980) (15th century). The term may not be altogether the best term to use because there was a large population of female investors at the time. See Harwell Wells, "The Birth of Corporate Governance" (2010) 33 *Seattle UL Rev* 1247 at 1257, n 39 [Wells. "Birth of Corporate Governance"].

⁵ The aggregate, private, contractual theory of the corporation that Manne endorsed was later employed by Armen A Alchian, Harold Demsetz, Michael Jensen, and William Meckling in a manner that allowed theorists to use the sum of the constructed motives of economic actors to explain why organizations (like corporations) and institutions (like the market) functioned as they did. See Alchian & Demsetz, *supra* note 1; see also Jensen & Meckling, *supra* note 1 at 308-10, 319.

with those of Ronald Coase's on transaction cost theory,⁶ what emerged was a powerful reconceptualization of the corporation in legal thought.⁷ With the success of Manne's perspective, the shareholder wealth maximization norm eventually became firmly embedded within the corporate legal literature,⁸ defining the interest of shareholders and planting the seeds for the financialization of the firm.⁹

⁶ RH Coase, "The Nature of the Firm" (1937) 4 *Economica* 386.

⁷ See Oliver E Williamson, "The Economics of Governance" (2005) 95 *Am Econ Rev* 1 at 2-5. See generally Alchian & Demsetz, *supra* note 1; Jensen & Meckling, *supra* note 1.

⁸ See e.g. Easterbrook & Fischel, *The Economic Structure*, *supra* note 1; Henry Hansmann & Reinier Kraakman, "The End of History for Corporate Law" (2001) 89 *Geo LJ* 439 at 439 (arguing that it is settled that corporate law's main purpose is to maximize "long-term shareholder value"); Roberta Romano, "Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance" (2001) 18 *Yale J on Reg* 174 at 186, n 30 (arguing that "the objective of U.S. corporate law...is to maximize share value").

⁹ Financialization of the corporation occurred when the understanding of the corporation successfully endeavored to narrow the understanding of all social relationships within the corporation so that their value can be translated into an exchangeable instrument, which makes it possible for the financial industry to assess value to them and trade them. See generally Simon Deakin, "The Rise of Finance: What Is It, What Is Driving It, What Might Stop It? A Comment on 'Finance and Labor: Perspectives on Risk, Inequality and Democracy' by Sanford Jacoby" (2008) 30 *Comp Lab L & Pol'y J* 67; Lawrence E Mitchell, "The Morals of the Marketplace: A Cautionary Essay for Our Time" (2009) 20 *Stan L & Pol'y Rev* 171 [Mitchell, "Morals of the Marketplace"]; Peer Zumbansen, "The Evolution of the Corporation: Organization, Finance, Knowledge and Corporate Social Responsibility" (Osgoode Hall L Sch Comp Res in L & Pol Econ Res Paper Series, Paper No 6/2009, 2009) online: <<http://ssrn.com/abstract=1346971>>.

Today, Berle is celebrated as the grandfather of modern shareholder primacy,¹⁰ but this description glosses over his opposition to Manne’s flip of his argument.¹¹ Berle’s objection is not always appreciated in commentaries of his shareholder primacy argument. For this reason, this chapter offers a closer reading of Berle’s argument, providing a clear observation point for examining the shift from his shareholder primacy argument to the one of today. This shift is a transition from promoting shareholder primacy in order to protect minority constituents to promoting shareholder primacy in order to protect majority rights and the right of exit for any disgruntled minority.¹² It is also the shift from promoting shareholder primacy in order to tie corporate managers to public interest to promoting shareholder primacy in order to endorse minimizing transaction costs—even when efficacy gains unfortunately result in costs being externalized upon people who did not *ex ante* negotiate contract safeguards to protect themselves against such risk.¹³ From this

¹⁰ See William W Bratton & Michael L Wachter, “Shareholder Primacy’s Corporatist Origins: Adolf Berle and *The Modern Corporation*” (2008) 34 J Corp L 99 at 101.

¹¹ Adolf A Berle, “Modern Functions of the Corporate System” (1962) 62 Colum L Rev 433 at 435 [Berle, “Modern Functions”]. And for what inspired Berle to reply to Manne, see Manne, “Higher Criticism”, *supra* note 1 at 400-06.

¹² William W Bratton, “Welfare, Dialectic, and Mediation in Corporate Law” (2005) 2 Berkeley Bus LJ 59 at 74-76 [Bratton, “Welfare”].

¹³ Williamson, *supra* note 7 at 11-13.

point of observation, the shareholder primacy argument offers another perspective upon investor empowerment during the “rise of finance.”¹⁴

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

II. BACKGROUND TO THE DEBATE: 1923–1926

A. *Berle as a Young Man*

Adolf Augustus Berle, Jr showed his intellectual capacity from an early age. He was homeschooled¹⁵ by his father, who taught him “how to learn what he needed to know before others [could detect] his ignorance.”¹⁶ This teaching probably served

¹⁴ Deakin, *supra* note 9.

¹⁵ Jordan A Schwarz, *Liberal: Adolf A. Berle and the Vision of an American Era* (New York, London, UK: Free Press, Collier Macmillan, 1987) at 7-9.

¹⁶ *Ibid* at 23.

him well, as he entered Harvard at the age of fourteen.¹⁷ By the age of twenty-one, he had received three Harvard degrees and was the youngest student ever to graduate from Harvard Law School.¹⁸ After a year at Louis Brandeis's Boston law firm,¹⁹ Berle enlisted in the army²⁰ and was placed on inactive duty to assist in sorting out the title system in American-occupied territories in order to boost sugar production, which was in high demand and short supply.²¹ Berle was next assigned by the military to the Paris Peace Conference as an expert (which he was not) on Russian economics.²² The destruction, disease, starvation, and general desolation of postwar Europe horrified and marked young Berle.²³ Upon returning to America, he spent a short time at a lucrative New York law firm before establishing a modest practice on Wall Street in

¹⁷ *Ibid* at 13.

¹⁸ *Ibid* at 13-17. For additional information on Berle's education, see *ibid* at 1-17.

¹⁹ *Ibid* at 16.

²⁰ *Ibid* at 17.

²¹ Adolf A Berle, *Navigating the Rapids 1918–1971: From the Papers of Adolf A. Berle*, Beatrice Bishop Berle & Travis Beal Jacobs, eds (New York: Harcourt Brace Jovanovich, 1973) [Berle, *Navigating the Rapids*].

²² *Ibid* at 23-24 (writing of how his “expertise” consisted of a few months research after coming back from the Dominican Republic).

²³ *Ibid* at 28.

1924. This position freed Berle to pursue more legal scholarship and social activism.²⁴

B. Berle's Foundation of a Shareholder Primacy Theory

The beginning of the twentieth century was marked by a period of violent labor relations.²⁵ Berle regarded the trends toward the consolidation of economic power in the hands of elites as a dangerous misstep toward plutocracy and away from egalitarianism and democracy,²⁶ which could further destabilize American society. Berle wanted to place economic and corporate power in the hands of the people.

Berle published an early plan for how this transfer of power could be accomplished in a short article entitled "How Labor Could Control".²⁷ In the article, he explained that the corporation could be used as a tool for the redistribution of wealth and power to "the staff of the plant, including, of course, the chairman of the

²⁴ Berle, *Navigating the Rapids*, *supra* note 21 at 19 (entry from Berle's personal diary on 25 August 1932).

²⁵ See generally Graham Adams, Jr, *Age of Industrial Violence, 1910-1915: The Activities and Findings of the United States Commission on Industrial Relations* (New York: Columbia University Press, 1971).

²⁶ Berle suggests that the rise of Bolshevism in Italy and Russia was being caused by the needless division between capitalists and labor. See AA Berle, Jr, "How Labor Could Control" (1921) 28 *New Republic* 37 [Berle, "Labor Could Control"].

²⁷ *Ibid.*

board, the directors, as well as the oilers and feeders and loomfixers.”²⁸ He suggested that organized labor (unions) could pool its resources to purchase or create corporations, and then could grant the shares of such corporations to the “staff of the plant.”²⁹ Berle further explained:

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

Each worker would be given ownership and control of the corporation in proportion to his contribution to the firm. Berle argued that if this occurred: “No single process in the industry would have to be changed, but each man would be working for himself and his ‘wage slavery’ would become merely an occupation in cooperative endeavor.”³¹

²⁸ *Ibid* at 38.

²⁹ *Ibid*.

³⁰ *Ibid*.

³¹ *Ibid* at 37.

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

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

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

He wrote:

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

In summary, Berle not only advocated for keeping the corporate structure of the business organization, but also for repopulating the shareholder class. He wanted to remove those shareholders who merely bought, hoped, held, and cashed in “when

³² *Ibid* at 38.

³³ *Ibid*.

³⁴ *Ibid* at 37-38.

they [could] reap where they did not sew.”³⁵ These shareholders did not deserve more than “the current rate of interest”³⁶ because “the value of their management was nil.”³⁷ Berle concluded that his argument was “[n]o . . . attack on private property; on the contrary, it [was] the emphasis of the strength of property. It [was] not a blow at our settled economic institutions; it [was] the sane use of them.”³⁸

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

³⁵ *Ibid* at 38.

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ *Ibid* at 39.

³⁹ See Schwarz, *supra* note 15 at 65-66.

⁴⁰ *Ibid* at 66.

personal and candid writings, he revealed that these concerns motivated him to promote shareholder primacy.⁴¹

Berle envisioned how an empowered shareholder class, with its expanded working- and middle-class membership, could transform American society.⁴² This corporate liberal revolution⁴³ was, as Berle put it, merely “the logical working out of [the American] system,” which, as a liberal, he believed to be a sound foundation for social order.⁴⁴ His vision of the corporate liberal revolution placed the corporation at its center because the corporation had the capacity to disperse ownership and economic power widely with little change to the legal structure of the corporation and the economy.⁴⁵ All the safeguards were in place to protect this emerging class of shareholders; all that was needed was the will to follow through.

Berle became convinced that the key to unlocking the potential of the corporation as a tool of economic revolution was to firmly establish the property and

⁴¹ *Ibid.*; see also Berle, *Navigating the Rapids*, *supra* note 21 at 19 (entry from Berle’s personal diary on 25 August 1932, in which he reflects upon how the fact that directors and managers abused their authority inspired him to advocate for greater fiduciary protection of shareholder rights from 1923 to 1926).

⁴² Schwarz, *supra* note 15 at 66.

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

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*

fiduciary rights of shareholders within the governance mechanism. This governance mechanism would be a safeguard against the action of powerful elite interests that would want to counteract the threats of the egalitarian operation of the corporation. Although too radical to be an explicit policy-reform agenda, the Corporate Liberal Revolution was at the core of the shareholder primacy argument that Berle would develop in the 1920s.

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

C. Berle's Shareholder Primacy Theory

Berle's 1923, 1925, and 1926 articles map the progress of his shareholder primacy theory.⁴⁶ Berle stated explicitly in his diary that these articles "led to the next

⁴⁶ For a complete record of Berle's published works up to the early 1960s, see Manne, "Theoretical Aspects", *supra* note 1.

stage of [his] career.”⁴⁷ In a diary entry from August 1932, he further reflected upon these four articles, writing:

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

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

The first article, published in 1923, argued that the discretion of management was not so broad that it could ignore the contracted procedure for the manner in which dividends were to be distributed.⁴⁹ In his second article, Berle advanced his

⁴⁷ Berle, *Navigating the Rapids*, *supra* note 21 at 19 (entry from Berle’s personal diary on 25 August 1932).

⁴⁸ *Ibid.*

⁴⁹ Berle noted that the trend in corporate law to grant directors broad power to distribute dividends could violate shareholders’ rights, which necessitated a more narrow interpretation of managerial power. Although the discretion to withhold dividends to bolster the capital of the corporation was absolute and equitable, if the corporation used the dividends of non-cumulative preferred stockholders, these dividends were not lost to this class, but had to be recorded and returned to them before common shareholders could receive dividends. See AA Berle, Jr, “Non-

theory, arguing that managers had an equitable duty that controlled managerial discretion when financial innovations (like the discretionary issue of non-par stocks) created holes in preexisting contractual obligations.⁵⁰

The final two articles were both written in 1926. The first, published in the *Columbia Law Review*, argued that equity guided managerial discretion beyond contract. Essentially, when contractual safeguards failed to protect minority shareholders, management still had an equitable duty to defend weaker shareholders from powerful ones who might exercise their influence over management in a manner oppressive to the minority.⁵¹ Finally, in his 1926 *Harvard Law Review* article, Berle

Cumulative Preferred Stocks” (1923) 23 Colum L Rev 358 at 358-59, 367 [Berle, “Non-Cumulative Preferred Stock”].

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

⁵¹ Berle explored how management allocated dividends (and losses) between share classes of the corporation. Once again, he employed the theory of the corporation as the private property of shareholders. He asserted that even after management allocated initial preferred dividends in accordance with explicit contractual requirements, the remaining surplus, if it was to be allocated as dividends, was subject to an equitable distribution. This illustrated how principles of equity, beyond contract, provided a rationale for ordering how dividends were to be

furthered this argument by demonstrating that equity compensated for the de facto imbalance of power between shareholders. He argued that the law would ensure that management treated all shareholders evenhandedly, guaranteeing that the interests of ownership were not undermined.⁵²

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.⁵³ 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.⁵⁴ Accordingly, his objective was to help empower shareholders (which he saw as representative of the middle and working classes) to make corporate managers firmly accountable to their control: in other words, the wider polity. He envisioned the distribution of corporate ownership through the middle and working classes as a

portioned among shareholders. This protected weaker shareholders from the influence of powerful ones. See AA Berle, Jr, "Participating Preferred Stock" (1926) 26 Colum L Rev 303 at 303, 305, 317 [Berle, "Preferred Stock"].

⁵² See AA Berle, Jr, "Non-Voting Stock and 'Bankers' Control'" (1926) 39 Harv L Rev 673 [Berle, "Non-Voting Stock"].

⁵³ Berle, *Navigating the Rapids*, *supra* note 21 at 19 (entry from Berle's personal diary on 25 August 1932).

⁵⁴ Schwarz, *supra* note 15 at 66.

mechanism to place the power of economic concentration under a form of democratic control through shareholder power. In fact, Berle had the bold ambition of becoming the prophet of the shareholding class, or as he so modestly put it, “the American Karl Marx.”⁵⁵

Berle’s articles did not express his radical hopes for the corporate-liberal revolution. This restraint is understandable. As a young academic attempting to establish his reputation, it would have been unwise to frame his shareholder primacy theory in line with his radical labor and anticapitalist views. Although the hostilities and violence that characterized America’s industrial relations at the turn of the century seemed to have ended,⁵⁶ the “age of industrial violence” was still fresh in the minds of Americans.⁵⁷ Consequently, such extreme opinions would likely have been either rejected outright or would have drawn serious and unnecessary criticism to Berle’s project. He figured that he did not have to preach the revolution because the market was evolving the corporate form toward an ever-more widely dispersed share

⁵⁵ Berle exclaimed to his wife that “his real ambition in life is to be the American Karl Marx—a social prophet.” See Schwarz, *supra* note 15 at 62; see also Thomas K McCraw, “Berle and Means” (1990) 18 Rev Am His 578 at 579.

⁵⁶ In 1928, only 694 strikes occurred representing the fewest since 1884, and in 1929, there were only 900 work stoppages, involving merely 1.2% of the labor force. For more details on how the rise of living standards in the 1920s helped smooth the way for more peaceful industrial relations, see Robert H Zieger & Gilbert J Gall, *American Workers, American Unions: The Twentieth Century*, 3d ed (Baltimore: Johns Hopkins University Press, 2002) at 45.

⁵⁷ Adams, *supra* note 25.

ownership. So, as long as the rights of shareholders were protected, his more radical surreptitious agenda would be furthered without making his goals explicit. In other words, Berle predicted that the existing regulation and market function would guide the radical social work so long as the corporate legal infrastructure was in place to protect the rights of shareholders.

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

⁵⁸ Berle, “Non-Cumulative Preferred Stock”, *supra* note 49; Berle, “Non-Par Stocks”, *supra* note 50; Berle, “Preferred Stock”, *supra* note 51; Berle, “Non-Voting Stock”, *supra* note 52.

⁵⁹ See *supra* notes 44-47.

It makes sense to track Berle's work up to 1927 because that is when he likely wrote the first article in the Berle–Dodd debate, “Corporate Powers as Powers in Trust.” And this article is a word-for-word reproduction of most of a chapter from *The Modern Corporation and Private Property* (a point noted in detail in the following sections). And because Berle's work on the book started in 1927, a draft of this article could have been written anytime between 1927 and 1931. Thus, the article could have been drafted in 1927.⁶⁰ This fact creates a reasonable end point for the consideration of Berle's shareholder primacy argument prior to the writing of *The Modern Corporation and Private Property*.

⁶⁰ The obvious challenge to drawing a distinction as early as 1927 is that the footnotes in “Corporate Powers as Powers in Trust” make reference to cases as late as 1930. But this detail is less significant in light of the fact that in practice, drafts of articles are constantly modified prior to 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 Powers in Trust” is to the other law review articles up to 1927. In fact, this article could easily be regarded as a direct extension of the 1923, 1925, and 1926 articles. Thus, it is quite reasonable—even if unconfirmed by the historical record—to suggest that “Corporate Powers as Powers in Trust” might have been one of the first parts of the book written, making 1927 a cautious and prudent ending point for Berle's history up to the Berle–Dodd Debate.

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.⁶¹ The grant was contingent upon him obtaining an academic appointment,⁶² which he soon received from Columbia University.⁶³ The grant requirements also demanded that the project use the expertise of an associate economist.⁶⁴ By chance, his old bunkmate from officer training at Plattsburg Camp,⁶⁵ Gardiner C. Means, had just enrolled at Harvard as a candidate for a Ph.D. in

⁶¹ Edwin F. Gay actually devised the project. Gay was an economic historian who became the founding dean of the Harvard Business School. He was advising various foundations (including the Social Science Research Council, which sponsored the Laura Spelman Rockefeller Foundation) on what types of economic issues deserved funding. For his Rockefeller project, he wanted to blend the expertise of a lawyer and an economist to study the modern corporation. See Herbert Heaton, *A Scholar in Action: Edwin F. Gay* (Cambridge: Harvard University Press, 1952) at 211.

⁶² Berle, *Navigating the Rapids*, *supra* note 21 at 21 (entry from Berle's personal diary on 25 August 1932).

⁶³ "C250 Celebrates Columbians Ahead of Their Time: Adolf Augustus Berle, Jr." online: Columbia University <http://c250.columbia.edu/c250_celebrates/remarkable_columbians/a_a_berle.html>.

⁶⁴ Adolf A Berle & Gardiner C Means, *The Modern Corporation and Private Property*, 2d ed (New York: Harcourt, Brace & World, 1968) at xxxix.

⁶⁵ Schwarz, *supra* note 15 at 51; see also Julius Goebel, *A History of the School of Law, Columbia University* (New York: Columbia University Press, 1955) at 299-305, 316-17.

economics.⁶⁶ Means's interests in the economic implications of the separation of ownership and control dovetailed nicely with Berle's legal study of the modern corporation,⁶⁷ so Berle invited him to assist.⁶⁸ The end result was *The Modern Corporation and Private Property*.

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

As planned, the book became famous as a warning of the potential threat of corporate managerial plutocracy over American society, demonstrating how modern

⁶⁶ Berle, *Navigating the Rapids*, *supra* note 21 at 20 (entry from Berle's personal diary on 25 August 1932).

⁶⁷ *Ibid* at 51.

⁶⁸ *Ibid* at 20 (entry from Berle's personal diary on 25 August 1932).

⁶⁹ Schwarz, *supra* note 15 at 62.

⁷⁰ *Ibid* at 14, 67-68, 83-85, 89, 104.

corporations were consuming the American economy⁷¹ 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 antitrust advocates but still focus his recommendations on the distinct issue of the control of management. In short, he appeased the antitrusters for the time being while still progressing with his alternative agenda of transforming the corporation into a mechanism that ensured the greater democratization of economic power. In the end, Berle succeeded in his ambition; when published, the book was celebrated as one of the most important of its time.⁷²

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

⁷² In *Liberal: Adolf A. Berle and the Vision of an American Era*, Schwarz notes that the book review from the *New York Herald Tribune* applauded the book as a “masterly achievement of research and contemplation” and wondered if it could be “the most important work bearing on American statecraft” since the Federalist Papers. Jerome Frank wrote, “This book will perhaps rank with Adam Smith’s *Wealth of Nations* as the first detailed description in admirably clear terms of the existence of a new economic epoch.” Ernest Gruening called it “epoch-making.” Harry W Laigler proclaimed it was “bound to make economic history.” In 1932, Justice Brandeis cited the book calling it the work of “able, discerning scholars” in *Liggett v. Lee*, 288 US 517 (1933). By the spring of 1933, *Time* magazine dubbed it “the economic Bible of the Roosevelt administration.” Schwarz, *supra* note 15 at 60-61 (internal citations omitted).

B. The Modern Corporation and Private Property

Berle and Means pointed to the key features of the modern corporation's evolution, namely: an increase in corporate concentration of property⁷³ and a decrease in control over corporate management by owners,⁷⁴ which was a by-product of ever-increasing stock ownership dispersion.⁷⁵ They noted that this led to an increased concentration of power for corporate managers⁷⁶ and elite financial groups.⁷⁷ The book cast the threat of corporate hegemony over freedom, suggesting that plutocracy could supersede state democracy as the dominant form of social organization.

Berle and Means centered on the need for shareholders to have meaningful control over their corporations. What Means's empirical research proved was that the

⁷³ Berle & Means, *supra* note 64 at vii-viii, 44-45; see also Adolph A Berle, "Property, Production and Revolution" (1965) 65 Colum L Rev 1 at 1 [Berle, "Property"].

⁷⁴ Berle & Means, *supra* note 64 at 119-40.

⁷⁵ *Ibid* at 64-65.

⁷⁶ Berle and Means prophesize:

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

Ibid at 217-18.

⁷⁷ See *ibid* at 206. For an example of such control groups, see Berle, "Non-Voting Stock", *supra* note 52 at 673-77.

opposite was occurring,⁷⁸ resulting in a fracture between ownership and control of property.⁷⁹ The authors warned that this emergent situation might cause market distortions,⁸⁰ especially if the gap between ownership and control continued to widen, amplifying the perversion of the classic theory of market function.⁸¹ To explain their logic, if profit was to work as a virtuous incentive, the traditional logic demanded that only a “fair return” be dispersed to the shareholders (as the owners of the property without control) and that the remainder go to the management (who control the property) because profit would induce the most efficient decision-making, and management made the decisions.⁸² 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.”⁸³

⁷⁸ Berle & Means, *supra* note 64 at 128-31, 245; see also Gardiner C Means, “The Separation of Ownership and Control in American Industry” (1931) 46 QJ Econ 68 (an article that Means published a year before with much of the core research findings).

⁷⁹ Berle & Means, *supra* note 64 at 303-08.

⁸⁰ *Ibid* at 302-08.

⁸¹ *Ibid* at 302.

⁸² *Ibid*.

⁸³ *Ibid*.

What Berle and Means probably meant by “the traditional logic of property” is that there is control of that piece of property. Or, as Morris Cohen characterized it, a right over a possession,⁸⁴ which implicitly is assumed to grant a right to self-assertion,⁸⁵ or a claim to a sovereign power⁸⁶ over a possession, without the interference of government power.⁸⁷ To put the term 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 nonowners.

Berle and Means predicted that separation of ownership and control would create a new logic for property,⁸⁸ which would be inspired by the better appreciation of the “economic relationships” between economic actors.⁸⁹ They did not provide any hints as to what these new “economic relationships” would be like. And no evidence

⁸⁴ Morris R Cohen, “Property and Sovereignty” (1927) 13 Cornell LQ 8 at 12.

⁸⁵ *Ibid* at 18.

⁸⁶ *Ibid* at 29.

⁸⁷ *Ibid* at 11.

⁸⁸ Berle & Means, *supra* note 64 at 302.

⁸⁹ *Ibid* at 308.

exists that Berle ever seriously entertained the more radical ideas of the legal realists regarding property.⁹⁰

C. A Note on the Use of Corporatism

William W Bratton and Michael L Wachter discuss how Berle and Dodd competed in their advocacy of rivaling models of corporatism.⁹¹ In Bratton and Wachter's opinion, Berle endorsed planners' corporatism,⁹² which describes the cooperative relationship between business, civil society, and government. Together, these parties determine and coordinate policies that satisfy the public interest. Bratton and Wachter also suggest that Dodd endorsed business commonwealth corporatism.⁹³ Like planners' corporatism, this form of corporatism focuses on the collaborative relationships shared by different groups in order to establish what is in the public interest.⁹⁴ After the public interest is established, policies are adopted, adapted, and

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

⁹¹ Bratton and Wachter adopt their models of corporatism from Ellis Hawley. See Bratton & Wachter, *supra* note 10 at 122-23; see also Ellis W Hawley, *The New Deal and The Problem of Monopoly: A Study in Economic Ambivalence* (Princeton: Princeton University Press, 1966) at 36-43.

⁹² Bratton & Wachter, *supra* note 10 at 123.

⁹³ *Ibid.*

⁹⁴ *Ibid* at 122-23.

coordinated among different groups in order to achieve the agreed-upon goals. The distinction between the two models of corporatism is that while planners' corporatism advocates that the government take the lead role, business commonwealth corporatism argues for industrialists to take the lead, "relegating government to a backstop, supporting role."⁹⁵ This chapter agrees that Berle could have been characterized as a planners' corporatist, but rejects the notion that Dodd was a business commonwealth corporatist.

John Cioffi offers complexity to Bratton and Wachter's use of "corporatism." Cioffi argues that characterizing Berle as an advocate of corporatism is misplaced.⁹⁶ He argues that, at best, Berle advocated for "quasi-corporatist arrangements during the early New Deal," which were contradictory and vague in nature.⁹⁷ Mindful of Cioffi's position,⁹⁸ this chapter will continue to use the term "corporatism" (more

⁹⁵ *Ibid* at 122 (Bratton and Wachter's explanation of corporatism).

⁹⁶ John W Cioffi, "Fiduciaries, Federalization, and Finance Capitalism: Berle's Ambiguous Legacy and the Collapse of Countervailing Power" (2011) 34 *Seattle UL Rev* 1081 at 1085.

⁹⁷ *Ibid* at 1086.

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

precisely, Bratton and Wachter’s planners’ corporatism and business commonwealth corporatism) in order to maintain a continuity of language between this chapter and the ongoing discussion about Berle and corporatism that Bratton and Wachter sparked. This chapter, however, is also mindful that planners’ corporatism cannot be said to be a form of corporatism as classically defined.⁹⁹ To be clear, “corporatism” in this chapter refers to the “quasi-corporatist arrangements” that Berle envisioned and not corporatism as classically defined.

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

It may be useful to sum up before moving forward. In the 1920s, Berle regarded the trends toward managerialism as a dangerous mistake that could destabilize American society. He feared that managerialism, without safeguards, could amplify the economic inequalities in America and provoke Bolshevik elements in American society. As a result, Berle started to construct arguments based on property rights, which justified shareholder authority over corporate management.

⁹⁹ Corporatism is classically defined as “a system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, non-competitive, hierarchically ordered, and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and support.” Cioffi, *supra* note 96 at 1088 (quoting Philippe C Schmitter, “Still the Century of Corporatism?” (1974) 36 Rev Pol 85 at 93-94).

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.

Against this background, the importance of *The Modern Corporation and Private Property* to the Berle–Dodd debate becomes clear. The first article in the debate was an exact replication of a chapter from the book, with one key omission. The article did not contain his candid admission that his arguments were constructed “with full realization of the possibility that private property may one day cease to be the basic concept in terms of which the courts handle problems of large scale enterprise.”¹⁰⁰ 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.¹⁰¹ But he qualified

¹⁰⁰ Berle & Means, *supra* note 64 at 219.

¹⁰¹ *Ibid.*

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.”¹⁰² He suggested that finding a superior theory to explain the distortion created by modern corporations upon private property was “rather the [reflection] of a movement which [was] likely to take form in the future, than the statement of a present ordering of affairs.”¹⁰³ 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.”¹⁰⁴ 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”¹⁰⁵ without qualification.

At first glance, Berle’s apparent support for planners’ corporatism might seem to contradict his argument for shareholder primacy. Berle’s arguments, however, are consistent because he only meant judicial protection of shareholder primacy to be an interim measure. He concluded that the shareholder primacy position, which he fully acknowledged was less than adequate, would need to be advocated until a satisfactory

¹⁰² *Ibid.*

¹⁰³ *Ibid.*

¹⁰⁴ *Ibid* at 219-20.

¹⁰⁵ *Ibid* at 220; AA Berle, Jr, “Corporate Powers as Powers in Trust” (1931) 44 Harv L Rev 1049 at 1049 [Berle, “Corporate Powers”].

solution to the corporate power problem could be established.¹⁰⁶ Berle thought that the chapter endorsing planners' corporatism was the most important¹⁰⁷ because it pointed toward what he believed to be the future direction of corporate law. Thus, the book is rightly interpreted to be both endorsing planners' corporatism¹⁰⁸ and shareholder primacy. This clarification provides critical insight into the nature of his shareholder primacy argument and contextualizes it with the rest of the arguments from the book.¹⁰⁹ As a result, Berle's evolving position was not inconsistent, as most scholars suggest.¹¹⁰

¹⁰⁶ See Berle & Means, *supra* note 64 at 219-20.

¹⁰⁷ Schwarz, *supra* note 15 at 63; see also Bratton & Wachter, *supra* note 10 at 121.

¹⁰⁸ *Ibid* at 118-222.

¹⁰⁹ It is unfortunate that none of Berle's personal writings, his biography, or any of his other publications acknowledge this connection between the article "Corporate Powers as Powers in Trust" and *The Modern Corporation and Private Property*. As a result, no explanation exists for why he omitted this important insight from the 1931 article that was published just before the book was released. The missing text is critical to properly contextualize the Berle-Dodd debate. This insight clearly establishes that, although Berle appeared to be entirely committed to his shareholder primacy argument in the 1931 article, he undoubtedly acknowledged that this argument represented no more than an interim solution. Thus, although the argument in "Corporate Powers as Powers in Trust" appeared unequivocal, the missing text, which would soon appear in the book, established that his argument was equivocal.

¹¹⁰ See Bratton & Wachter, *supra* note 10 at 101, n 5. For allusions to the contradictions in Berle's work and thus the danger of misrepresenting his position, see David Millon, "Theories of the Corporation" (1990) 1990 Duke LJ 201 at 222, and see generally CA Harwell Wells, "The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century" (2002) 51 U Kan L Rev 77 at

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

IV. THE BERLE–DODD DEBATE

A. Berle’s Declaration: “Corporate Powers as Powers in Trust”

While working on *The Modern Corporation and Private Property*, Berle continued to publish other pieces.¹¹¹ These works continued to argue for greater

95-99, 101-04 (describing Berle’s transitions of opinion from 1931 up to the 1960s) [Wells, “Cycles of Corporate Social Responsibility”].

¹¹¹ Those pieces were the following: Adolf A Berle, Jr, *Cases and Materials in the Law of Corporation Finance* (St. Paul, Minn: West, 1930) [Berle, *Cases and Materials*]; AA Berle, Jr, “The Organization of the Law of Corporation Finance” (1931) 9 Tenn L Rev 125 [Berle, “Organization of the Law”]; AA Berle, Jr, “Corporate Devices for Diluting Stock Participations” (1931) 31 Colum L Rev 1239

protection of shareholder rights. His writing inspired a range of reactions. Although some agreed that new safeguards were needed to protect shareholders (especially to secure a higher rate of investment),¹¹² the majority argued that Berle's assessment was a reactionary overstatement that ran "counter to the historical evolution of the corporation."¹¹³ With "Corporate Powers as Powers in Trust," he probably expected

[Berle, "Corporate Devices"]; AA Berle, Jr, "Liability for Stock Market Manipulation" (1931) 31 Colum L Rev 264 [Berle, "Stock Market Manipulation"]; AA Berle, Jr, "Compensation of Bankers and Promoters Through Stock Profits" (1929) 42 Harv L Rev 748 [Berle, "Compensation"]; AA Berle, Jr, "Promoters' Stock in Subsidiary Corporations" (1929) 29 Colum L Rev 35 [Berle, "Promoters' Stock"]; AA Berle, Jr, "Investors and the Revised Delaware Corporation Act" (1929) 29 Colum L Rev 563 [Berle, "Investors"]; AA Berle, Jr, "Subsidiary Corporations and Credit Manipulation" (1928) 41 Harv L Rev 874 [Berle, "Subsidiary Corporations"]; AA Berle, Jr, "Convertible Bonds and Stock Purchase Warrants" (1927) 36 Yale LJ 649 [Berle, "Convertible Bonds"]; AA Berle, Jr, "Publicity of Accounts and Directors' Purchases of Stock" (1927) 25 Mich L Rev 827 [Berle, "Publicity of Accounts"].

¹¹² Karl McGinnis believed that the law was progressing toward greater protection of shareholders and that Berle's *Cases and Materials in the Law of Corporation Finance* was an important contribution toward understanding the problem of shareholder protection. See E Karl McGinnis, Book Review of *Cases and Materials in the Law of Corporation Finance* by Adolf A Berle, Jr (1931) 10 Tex L Rev 122. Irving Levy observed that Berle's suggestions in *Studies in the Law of Corporation Finance* were heterodox, acknowledging the protest of corporate lawyers to Berle's advocacy of the equitable control of management by shareholders. He explained that some practitioners believed that Berle's theory in action would be paramount to judicial interference with the ability of managers to exercise their professionally informed discretion over the corporation. That said, Levy sided with Berle because he believed that establishing safeguards over managerial dissertation was prudent. See Irving J Levy, Book Review of *Studies in the Law of Corporation Finance* by Adolf A Berle, Jr, (1929) 7 NYULQ Rev 552.

¹¹³ Joseph L Kline, who was a Wall Street corporate lawyer, argued, "Any movement to increase the power of shareholders as such runs counter to the historical

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.¹¹⁴

In the initial article, Berle argued that because “all powers granted to a corporation . . . [were] at all times exercisable only for the ratable benefits of all the

evolution of corporations. Mr. Berle’s thesis is therefore essentially reactionary.” See Joseph V Kline, Book Review of *Studies in the Law of Corporation Finance* by Adolf A Berle, Jr, (1929) 42 Harv L Rev 714 at 717. Laylin K James, in reviewing Berle’s *Cases and Materials in the Law of Corporation Finance*, attacked his arguments for the greater protection of shareholders as too zealous. See Laylin K James, Book Review of *Cases and Materials in the Law of Corporation Finance* by Adolf A Berle, Jr, (1932) 26 Ill L Rev 712. 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” (1928) 38 Yale LJ 57. 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 of *Studies in the Law of Corporation Finance* by Adolf A. Berle, Jr, (1929) 38 Yale LJ 1003 at 1004. And Wilber G Katz argued that Berle overstated the law; he also rejected his shareholder primacy theory, arguing that Berle underemphasized the potential downside of his equitable solutions, condemning him for being too critical of management and being too eager to create the impression that the complexities of many financial and intercorporate transactions are all the result of “corporate skullduggery.” See Wilber G Katz, Book Review of *Cases and Materials in the Law of Corporation Finance* by Adolf A Berle, Jr, (1931) 40 Yale LJ 1125 at 1128.

¹¹⁴ For the observation that Berle considered himself the American Karl Marx, see McCraw, *supra* note 55. For his outrage at being accused of being a Tory, see Schwarz, *supra* note 15 at 66.

shareholders as their interest appears,”¹¹⁵ a legal foundation, based on the property rights of shareholders, could be bolstered to develop and enforce fiduciary ties between management and shareholders. He explained that the existing rights and restrictions of corporate law were no more than “nominal[.]” rules,¹¹⁶ in the sense that they were only guidelines for how corporate governance ought to function. But when these guidelines conflicted with the equitable rights of shareholders, he opined that equity prevailed.¹¹⁷ 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.¹¹⁸ 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.¹¹⁹

¹¹⁵ Berle & Means, *supra* note 64 at 220; Berle, “Corporate Powers”, *supra* note 105.

¹¹⁶ Berle & Means, *supra* note 64 at 220; Berle, “Corporate Powers”, *supra* note 105.

¹¹⁷ Berle & Means, *supra* note 64 at 220; Berle, “Corporate Powers”, *supra* note 105.

¹¹⁸ Berle & Means, *supra* note 64 at 220; Berle, “Corporate Powers”, *supra* note 105 at 1050.

¹¹⁹ Berle & Means, *supra* note 64 at 220; Berle, “Corporate Powers”, *supra* note 105 at 1049-50.

Berle further described five scenarios¹²⁰ in which shareholders granted management wide discretion over corporate conduct.¹²¹ In each, no matter how absolute the discretion appeared, such power had to be exercised in accordance with equitable limitations.¹²² The underlying theory that 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 shareholders.¹²³ But Berle hesitated to assert that this understanding of the fiduciary duty of management could evolve into a branch of trust law because such a duty must be less rigorous than other trust situations. Otherwise, the burden placed upon corporate management could be too great to reasonably optimize market efficiency.¹²⁴

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

¹²¹ Berle & Means, *supra* note 64 at 220; Berle, “Corporate Powers”, *supra* note 105 at 1050-72.

¹²² Berle & Means, *supra* note 64 at 221; Berle, “Corporate Powers”, *supra* note 105 at 1050.

¹²³ Berle & Means, *supra* note 64 at 241; Berle, “Corporate Powers”, *supra* note 105 at 1072-73.

¹²⁴ Berle & Means, *supra* note 64 at 242; Berle, “Corporate Powers”, *supra* note 105 at 1074.

The timing of the publication of “Corporate Powers as Powers in Trust” is noteworthy because it occurred just months before the publication of *The Modern Corporation and Private Property*.¹²⁵ 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.¹²⁶ 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.¹²⁷ 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.

¹²⁵ This original publisher decided shortly after the original publication that it “could not handle the book properly” and arrangements were made to transfer the book to Macmillan and Company. It was General Motors (a client of Corporation Trust) that pressured the publishing house to drop the book. Schwarz, *supra* note 15 at 67.

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

¹²⁷ Schwarz, *supra* note 15 at 62-64.

B. Dodd, the Anti-Managerialist

Edwin Merrick Dodd, the son of a wool merchant, was born in Providence, Rhode Island, in 1888.¹²⁸ He entered Harvard College in 1910.¹²⁹ His first teaching position in law was at Washington & Lee,¹³⁰ but the Great War interrupted his fledgling career. During the war, he served as a member of the legal staff for the War Industries Board.¹³¹ After the war, he practiced law for a short time but soon realized that he preferred academia.¹³² He taught at both the Universities of Nebraska and Chicago¹³³ before returning to Harvard Law School in 1928,¹³⁴ where he taught for twenty-three years.¹³⁵

Two recurring anti-managerialist leanings can be found in Dodd's work. First, he emphasizes the promotion of the fiduciary duty of corporate management. Second, he places importance on the protection of fairness and equity between classes of

¹²⁸ Zechariah Chafee, Jr, "Edwin Merrick Dodd" (1952) 65 Harv L Rev 379 at 379.

¹²⁹ *Ibid.*

¹³⁰ *Ibid* at 380.

¹³¹ *Ibid* at 380-81.

¹³² *Ibid.*

¹³³ *Ibid.*

¹³⁴ Ralph J. Baker, "Edwin Merrick Dodd" (1952) 65 Harv L Rev 388 at 389.

¹³⁵ Chafee, *supra* note 128 at 381.

security holders.¹³⁶ Dodd consistently asserted that managers were in a position of trust and confidence, which led him to urge courts to be more diligent in enforcing managerial obligations.¹³⁷ His works indicated that he generally argued the anti-managerialist position, so one would assume that he would agree with Berle's position. But this was not the case, for although they may have shared much common ground, upon reading Berle's 1931 article (and possibly all of his legal articles up to

¹³⁶ Baker, *supra* note 134 at 389.

¹³⁷ A review of examples that support this claim from the body of Dodd's work follows. In a two-part series, Dodd explored the limits of management power to alter corporate charters. See E Merrick Dodd, Jr, "Dissenting Stockholders and Amendments to Corporate Charters" (1927) 75 U Pa L Rev 585 [Dodd, "Dissenting Stockholders and Amendments"]; E Merrick Dodd, Jr, "Dissenting Stockholders and Amendments to Corporate Charters (Continued)" (1927) 75 U Pa L Rev 723 [Dodd, "Dissenting Stockholders and Amendments (Continued)"]. 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" (1941) 54 Harv L Rev 917 [Dodd, "Modern Corporation"]. 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" (1941) 89 U Pa L Rev 697 [Dodd, "Purchase and Redemption"]. Dodd again argued that corporate management ought to act in light of their fiduciary obligation for the benefit of security holders in relation to their interest. See E Merrick Dodd, Jr, "Fair and Equitable Recapitalizations" (1942) 55 Harv L Rev 780 [Dodd, Recapitalizations"]. 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, "Liability of a Holding Company for Obtaining for Itself Property Needed by a Subsidiary—The *Blaustein* Case" (1944) 58 Harv L Rev 125 [Dodd, "Liability of a Holding Company"]. For supporting commentary, see Baker, *supra* note 134 at 390; Chaffee, *supra* note 128 at 382.

1931), Dodd deduced that Berle was too radical in his protection of shareholder rights. Berle's radical stance, from Dodd's perspective, was sacrificing the broader responsibility of managers to the community, as well as the potential that corporatism had to stabilize American capitalism at the time.¹³⁸

In fact, Dodd was so disturbed by the implications of Berle's argument that he uncharacteristically employed a managerialist argument in order to attempt to undermine Berle's shareholder primacy theory. He determined that Berle's extreme stance was dangerous, making management no more than advocates solely for shareholders by limiting the scope of managerial accountability to the maximization of profits, and when necessary, doing this at the expense of all other corporate constituents.

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

Both authors had different views on to whom duties should be owed. Dodd argued that the managers' duty ought to be extended to other stakeholders. From his perspective, managers were granted many freedoms to conduct business in a manner that would not necessarily maximize profits.¹³⁹ Dodd observed that this freedom appeared to have agitated Berle to place undue emphasis on the fiduciary relationship

¹³⁸ Bratton & Wachter, *supra* note 10 at 124-28.

¹³⁹ E Merrick Dodd, Jr, "For Whom Are Corporate Managers Trustees?" (1932) 45 Harv L Rev 1145 at 1147 [Dodd, "Corporate Managers"].

between managers and shareholders.¹⁴⁰ Dodd's assumption regarding Berle's motivations was incorrect, even at face value: Berle was clearly attempting to prevent managerial opportunism.¹⁴¹ In other words, he wanted to bring managerial discretion under legal control, not line shareholders' pockets regardless of the consequences.

Dodd also wanted to maintain the gap between ownership and control of the modern corporation so that private property rights would not restrict management's decisions. He adopted an understanding of the underlying structure of the corporation and agreed with Berle that managers owed a fiduciary duty to the shareholders, not as individuals, but only to shareholders as a group.¹⁴² What Dodd meant by this was that it was not the actual interest of particular shareholders (actual people), 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.

¹⁴⁰ *Ibid.*

¹⁴¹ Berle & Means, *supra* note 64 at 302-08.

¹⁴² Dodd, "Corporate Managers", *supra* note 139 at 1146.

Dodd further asserted that his suggestion was not a dramatic shift of perception from Berle's understanding of the firm, for the picture was altered "more in form than in substance"¹⁴³ because the sole function of the corporation (to make profit for its shareholders) remained unaltered.¹⁴⁴ But this statement was not altogether true. Although the sole function of the corporation was still profit-making, Dodd's perspective would further jam the wedge between ownership and control, aligning managerial discretion with the best interests of the corporation rather than the shareholders. This opened a debate as to what was in the best interests of the corporation. Such ambiguity was what Berle was attempting to eradicate, so as to limit managerial opportunism—at least in the interim. Dodd hoped that if this theoretical tweak were accepted, it would free management enough to take into consideration the interests of other stakeholders, even at the expense of maximizing profits.¹⁴⁵

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

¹⁴³ *Ibid.*

¹⁴⁴ *Ibid.*

¹⁴⁵ *Ibid* at 1147-48.

create a serious obstacle to achieving socially responsible managers.¹⁴⁶ Dodd wrote: “Desire to retain their present powers accordingly encourages [managers] to adopt and disseminate the view that they are guardians of all the interests which the corporation affects and not merely servants of its absentee owners.”¹⁴⁷ He suggested that one must look to the managers, not to the owners, for professionalized corporate conduct,¹⁴⁸ 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.”¹⁴⁹ Moreover, if corporate managers had a duty solely to shareholders, all other stakeholders with a vested interest in the corporation (including employees, consumers, and the community) would have to find protection from corporate power when their interests were contrary to maximizing profits for shareholders.¹⁵⁰ Therefore, to promote socially responsible behavior, corporate managers needed to be the guardians of all interests that the corporation affected, and this result could only happen if corporate managers were freed to be able to employ the corporation’s “funds in a manner appropriate to a person practicing a profession

¹⁴⁶ *Ibid* at 1162.

¹⁴⁷ *Ibid* at 1157.

¹⁴⁸ *Ibid* at 1153.

¹⁴⁹ *Ibid*.

¹⁵⁰ *Ibid* at 1162.

and imbued with a sense of social responsibility without thereby being guilty of a breach of trust.”¹⁵¹

If freed from the constraints of a shareholder primacy agenda, why would managers use this broad discretion for the betterment of the community when they could use it to enrich themselves instead? Dodd acknowledged the problem of opportunism and then stated that it was not the concern of his article to question “whether the voluntary acceptance of social responsibility by corporate managers [was] workable, but whether experiences in that direction [ran] counter to fundamental principles of the law of business corporations.”¹⁵² But he tacitly contradicted himself by appealing to the claims of high-minded managers who espoused the virtue of public duty.¹⁵³ He used this approach to establish that managers might be worthy of trust.¹⁵⁴

¹⁵¹ *Ibid* at 1161.

¹⁵² *Ibid* at 1162.

¹⁵³ *Ibid*.

¹⁵⁴ But why would one attempt to wrench managers out of fiduciary relationships without understanding the outcome? As William W Bratton has pointed out, the advocates of greater corporate responsibility have followed Dodd down this slippery slope ever since by asking observers to bet on the fact that if management had greater freedom from shareholder expectations, they would be more responsible to the community. See Bratton, “Welfare”, *supra* note 12 at 73-74; William W Bratton, “Never Trust a Corporation” (2002) 70 *Geo Wash L Rev* 867 at 867 (arguing this point to Lawrence Mitchell in response to his book *Corporate Irresponsibility: America’s Newest Export*) [Bratton, “Never Trust”]. For an example of such Doddish assumptions, see Lawrence E Mitchell, *Corporate Irresponsibility: America’s Newest*

Dodd merely employed optimism for the new generation of managers who claimed to be enlightened enough to use their discretion to assist other stakeholders, like employees, who needed protection from the inequities of their bargaining positions with the corporation.¹⁵⁵ He romanticized 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.¹⁵⁶ His arguments were inspiring, but also lacking substance, rendering them no more than corporate futurism.

But, when one considers Dodd’s broader publication record,¹⁵⁷ 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.¹⁵⁸ But when one puts the 1932 article to one side and reviews Dodd’s

Export (New Haven: Yale University Press, 2001) at 276-78 [Mitchell, *Corporate Irresponsibility*].

¹⁵⁵ Dodd, “Corporate Managers”, *supra* note 139 at 1146, 1148, 1151-53, 1165-67.

¹⁵⁶ *Ibid* at 1148.

¹⁵⁷ Baker, *supra* note 134 at 388-93 (reviewing Dodd’s writing).

¹⁵⁸ Bratton & Wachter, *supra* note 10 at 123-24.

other writings before and after the 1932 article, it becomes clearer that Dodd was primarily an anti-managerialist. Therefore, one can conclude that Dodd was merely open-minded to Young and Swope's business commonwealth corporatism, adopting a wait-and-see approach to "whether experiences in that direction [ran] counter to fundamental principles of the law of business corporations."¹⁵⁹

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, 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).¹⁶⁰ This is why he later admitted that this

¹⁵⁹ Dodd, "Corporate Managers", *supra* note 139 at 1162.

¹⁶⁰ Baker, *supra* note 134 at 388-93 (reviewing Dodd's writing).

argument was “rash” and riddled with “legal difficulties.”¹⁶¹ 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 to the potential for enlightened managerial behavior, but Dodd was overzealous in making this point, at least in Berle’s opinion. Therefore, though the case can be made that Dodd advocated business commonwealth corporatism, his level of enthusiasm actually skews 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.¹⁶²

D. Berle’s Reply: “For Whom Corporate Managers Are Trustees: A Note”

One could imagine a number of ends to this story. For instance, Berle could have explained his position in a congenial manner, highlighting the similarities of his arguments with those of Dodd and explaining their differences as not so dissimilar after all. But this never happened. Instead, Berle’s biographer explains that Berle was

¹⁶¹ E Merrick Dodd, Book Review of *Bureaucracy and Trusteeship in Large Corporations* by Marshall E Dimock & Harold K Hyde, (1942) 9 U Chicago L Rev 538 at 546 [Dodd, Book Review].

¹⁶² Baker, *supra* note 134 at 388-93 (reviewing Dodd’s writing).

outraged by Dodd's accusation that he was a conservative, writing: "Dodd's real crime was making Berle seem like a Tory in the midst of an American revolution."¹⁶³

Imagine how agonizing it must have been for the sometimes pompous Berle to endure such an affront on the eve of the release of his crowning achievement, which was to be (by his design) his coming-out party into the world of the left-leaning intellectual elites of America.¹⁶⁴ Berle had expected a managerialist attack from conservatives, who would rhetorically defend the status quo ante of managerial discretion, but he did not expect to be accused of being a conservative. Dodd was probably equally surprised that Berle's reply was left-leaning. This family feud of the left exposed Berle's argument as being less than ideal, based on the weak assumption that the interests of absentee owners would make management more accountable, while also exposing Dodd's corporate responsibility argument as being naively trusting of corporate managers.¹⁶⁵

To address Dodd's criticism and, one surmises, 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

¹⁶³ *Ibid* at 66.

¹⁶⁴ See Schwarz, *supra* note 15 at 62.

¹⁶⁵ AA Berle, Jr, "For Whom Corporate Managers Are Trustees: A Note" (1932) 45 Harv L Rev 1365 at 1367 [Berle, "A Note"].

the shareholders as their interest appears.”¹⁶⁶ He argued that the present law established that managers were required to manage the corporation in the interest of its shareholders, and that although many groups, notably labor, were gaining recognition as having claims against the corporation (which created legitimate cost to industry), the recognition of these costs (which reduced profits) did not alter the main objective of the corporate managers.¹⁶⁷ 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,¹⁶⁸ which Berle tacitly (and spitefully) suggested was a foolhardy reason because managers did not see themselves as such.¹⁶⁹

Berle did not dispute Dodd’s suggestion that the corporation needed to be accountable to the wider polity.¹⁷⁰ This concession probably shocked Dodd because it was a slippery slope, which opened the door to the primacy of the public interest over property rights. This is an argument that a clever and conservatively minded liberal,

¹⁶⁶ Berle & Means, *supra* note 64 at 220; Berle, “Corporate Powers”, *supra* note 105 at 1049.

¹⁶⁷ Berle, “A Note”, *supra* note 165 at 1365.

¹⁶⁸ *Ibid* at 1367.

¹⁶⁹ *Ibid*.

¹⁷⁰ *Ibid* at 1372.

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 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.¹⁷¹ And to make matters worse, no mechanism existed to enforce the applications of Dodd’s pseudo-theory of the corporation.¹⁷² Furthermore, if the fiduciary obligation of managers to shareholders was ignored, then the management and *control*¹⁷³ would become “for all practical purposes absolute”—resulting in greater corporate irresponsibility.¹⁷⁴ Therefore, until such time as Dodd (or any others who sympathized with the noble manager) was prepared to offer a “clear and reasonable enforcement scheme of responsibilities,” emphasis would have to be placed on the fact that the corporation’s sole purpose was to make profits for their shareholders. This was because there existed no other legal control over corporate power, however

¹⁷¹ *Ibid* at 1367.

¹⁷² *Ibid*.

¹⁷³ Berle explained that “control” in this context refers to individuals or small groups of individuals who are able to mobilize or cast sufficient votes to elect a corporate board of directors. This is the sense in which the word is used in financial communities. See *ibid* at 1366. He also contemplated “control” in his earlier works. See Berle & Means, *supra* note 64 at 206; Berle, “Non-Voting Stock”, *supra* note 52.

¹⁷⁴ Berle, “A Note”, *supra* note 165.

imperfect it may be.¹⁷⁵ 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.¹⁷⁶

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

The administration of corporations—peculiarly, a few hundred large corporations—is now the crux of American industrial life. Upon the securities of these corporations has been erected the dominant part of the property system of the industrial east. A major function of 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.¹⁷⁷

¹⁷⁵ *Ibid.*

¹⁷⁶ *Ibid* at 1368.

¹⁷⁷ *Ibid* at 1365.

In his conclusion, Berle reiterated that the law could not surrender the present fiduciary controls over management before the social sciences could more adequately explain the corporate form in a manner that could frame a substantial reform of corporate law, noting that “legal technique [did] not contemplate intervening periods of chaos,”¹⁷⁸ but would only respond to new outcomes or theories as they were established.¹⁷⁹ He foresaw that social theorists would guide the establishment of a revised institutional design of American society, and that at this point, the law could play a role stabilizing expectations and relations between stakeholders as they emerged.¹⁸⁰ 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.¹⁸¹ And as it stood, the shareholder primacy model worked as a method to ensure public interest, if envisaged in the correct manner.

Berle punctuated his reply to Dodd, declaring that “it is one thing to say that the law must allow for such developments. It is quite another to grant uncontrolled

¹⁷⁸ *Ibid* at 1371.

¹⁷⁹ *Ibid*.

¹⁸⁰ *Ibid* at 1371-72.

¹⁸¹ *Ibid*.

power to corporate managers in the hope that they will produce that development.”¹⁸² Berle’s bad-natured reactions aside, he focused his attack on what Dodd had actually attempted to accomplish in his article, namely weakening the fiduciary obligations of managers to shareholders before social theorists could rationalize the modern corporation in a manner that could be adopted by law. Berle did so because he thought that the application of Dodd’s argument would result in a *carte blanche* for corporate irresponsibility, and because Dodd did not appreciate what Berle was attempting to accomplish with shareholder primacy.

In sum, Berle argued clearly that shareholders’ fiduciary controls over management could not be abandoned by lawyers until a new order emerged. He noted that “legal technique [did] not contemplate intervening periods of chaos,” but would only respond to new outcomes or theories as they were established.¹⁸³ 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.¹⁸⁴ Without providing hints as to what sort of reforms might be

¹⁸² *Ibid* at 1372.

¹⁸³ *Ibid* at 1371.

¹⁸⁴ *Ibid* at 1371-72.

implemented, Berle emphasized that lawyers needed new legal tools to bring corporate behavior under greater control.¹⁸⁵

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

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

¹⁸⁵ *Ibid.*

the Roosevelt Administration and presumably was jealous to protect his influence.¹⁸⁶

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.¹⁸⁷ But the authors are vague as to when this offer was made, writing only: it was “early in [Roosevelt’s] 1932 presidential campaign.”¹⁸⁸ The argument calls for more precision. If a connection is to be established between Berle’s reply to Dodd and Berle’s Roosevelt years, pinpointing months matters. So to be more exact, Berle was aware that he would be functioning in his new position as a political advisor for a presidential candidate in May.¹⁸⁹ Dodd published his reply to

¹⁸⁶ Bratton & Wachter, *supra* note 10 at 128.

¹⁸⁷ *Ibid* at 109; see also Schwarz, *supra* note 15 at 71.

¹⁸⁸ Bratton & Wachter, *supra* note 10 at 109.

¹⁸⁹ Although some disagreement between Sam Rosenman (Governor Roosevelt’s counsel at the time) and Moley existed as to when Moley joined Roosevelt’s bid for the Presidency (Moley saying January 1932 and Rosenman saying March 1932), Berle could not have joined the campaign prior to Moley. Berle also noted that his first memorandum to Roosevelt was in May of 1932. For more on the disagreement, see Schwarz, *supra* note 15 at 71 (paraphrasing Berle), and see generally Samuel B Hand, *Counsel and Advise: A Political Biography of Samuel I. Rosenman* (New York: Garland Publishing, 1979); Raymond Moley, *After Seven Years* (New York: Harper & Brothers, 1939) [Moley, *Seven Years*]; Raymond Moley, *The First New Deal* (New York: Harcourt, Brace & World, 1966) [Moley, *New Deal*]; Samuel I Rosenman, *Working with Roosevelt* (New York: Harper, 1952). For evidence as to the date of his first memorandum to Roosevelt, see a passage from Berle’s 1956 article entitled “The Reshaping of the American Economy,” reprinted in Berle, *Navigating the Rapids*, *supra* note 21 at 31; see also Schwarz, *supra* note 15 at 71 (dating Berle’s first memorandum to late May).

Berle on May 8, 1932,¹⁹⁰ and Berle fired back his reply to Dodd after that date in the following edition.¹⁹¹ 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.¹⁹²

The “New Individual” speech argued that citizens had the right to have their interest in the economy protected from the irresponsible exercise of corporate power, and that the government needed to protect this right.¹⁹³ As Bratton and Wachter explained, this speech called for “government controls” over managerial power so that managers would be compelled to “assume responsibility for the public good, end their internecine disputes, come together as industrial groups, and cooperate toward a common end.”¹⁹⁴ If industrial groups failed to do so, the government would make them do so.¹⁹⁵

¹⁹⁰ Dodd, “Corporate Managers”, *supra* note 139 at 1145.

¹⁹¹ Berle, “A Note”, *supra* note 165.

¹⁹² The draft of the “New Individual” speech as delivered, with only a few minor changes, at the Commonwealth Club in San Francisco on 23 September 1932. Berle, *Navigating the Rapids*, *supra* note 21 at 62-70.

¹⁹³ *Ibid* at 69.

¹⁹⁴ Bratton & Wachter, *supra* note 10 at 111.

¹⁹⁵ *Ibid*.

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

Bratton and Wachter, however, did not get it totally right. The battle behind closed doors was not between Berle's corporatism and business commonwealth corporatism. The battle was actually between: (1) his corporatism, and (2) Brandeis-style antitrust economics.¹⁹⁶ The champion of the latter was Felix Frankfurter and his acolytes, whom Berle called "the would-be Brandeis followers of today" who "lacked the great man's admirable genius for being both radical and practical."¹⁹⁷

The tension between Frankfurter and Berle goes back to their time at Harvard.¹⁹⁸ Frankfurter joined the faculty at Harvard when Berle was in his first year

¹⁹⁶ Schwarz, *supra* note 15 at 89.

¹⁹⁷ *Ibid* at 104.

¹⁹⁸ *Ibid* at 14.

of law school.¹⁹⁹ Frankfurter's biographer describes his chief personality imperfection in the following passage:

Because his self-image was inflated, and because his psychological peace rested upon that self-image, Frankfurter could not accept serious, sustained opposition in fields he considered his domain of expertise; he reacted to his opponents with vindictive hostility.²⁰⁰

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

Later in life neither man cared to discuss the other, and there are only snippets of stories concerning their Harvard years. Yet, what emerges is an arrogant young Berle bent on cutting others down to size. The young Adolf relentlessly challenged Frankfurter in class, thereby making himself an unforgivable embarrassment to the professor. According to William O. Douglas, later a Columbia Law School and New Deal colleague, in the years following Berle's enrollment in Frankfurter's course, Berle began attending it for a second year in a row. Frankfurter was puzzled and asked Berle if he had taken the course the previous year. Berle replied affirmatively and Frankfurter asked, "Then why are you back?" "Oh," Berle responded, "I wanted to see if you had learned anything since last year." Another story had a vengeful Frankfurter blocking the young Berle from making the Law Review.²⁰¹

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

¹⁹⁹ *Ibid.*

²⁰⁰ HN Hirsch, *The Enigma of Felix Frankfurter* (New York: Basic Books, 1981) at 5-6.

²⁰¹ Schwarz, *supra* note 15 at 14-15.

professor without inciting disciplinary action. But for Frankfurter to personally retaliate against the immature Berle (remember Berle started law school three or four year earlier than most students), thereby exhibiting transparent signs of vindictiveness to a poorly adjusted (yet arrogant) student might be seen as unprofessional.

Putting this relationship into relevant context, Roosevelt strategically divided his advisors so that no one camp within his ranks enjoyed the position of privileged insider,²⁰² thus creating a competitive decision-making process. Berle and Frankfurter fit this mold because any decision-making process that involved both men could be nothing less than competitive. While on the campaign trail before Berle had written the “New Individual” speech, Roosevelt invited Frankfurter’s opinion regarding policy development. Berle’s biographer writes: “Felix Frankfurter’s intrusion into the campaign [was] intolerable. Aside from his old personal animus to the Harvard law professor, Berle saw in Frankfurter an ideological adversary—a Brandeisian “atomist” who opposed the brain trust consensus on large economic units for industrial planning.”²⁰³

Berle warned Roosevelt that he should not give Frankfurter’s “New Freedom” speech, which was similar to what Brandeis had drafted for Woodrow Wilson.²⁰⁴

²⁰² *Ibid* at 88.

²⁰³ *Ibid* at 76.

²⁰⁴ *Ibid* at 77.

Berle thought that Brandeis-style individualism was what the Coolidge and Hoover Administrations used as a euphemism for inaction. He argued, “Whatever the economic system does permit, it is not individualism.”²⁰⁵ He then advised Roosevelt:

[I]t is necessary to do for [the American] system what Bismarck did for the German system in 1880, as [a] result of conditions not unlike these Otherwise only one of two results can occur. Either [the] handful of people who run the economic system now will get together making an economic government which far outweighs in importance the federal government; or in their struggles they will tear the system to pieces. Neither alternative is sound national policy.²⁰⁶

Berle pressured Roosevelt to make a “pronouncement” arguing for “public collective planning.”²⁰⁷ 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.”²⁰⁸ 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.²⁰⁹

²⁰⁵ *Ibid.*

²⁰⁶ *Ibid* at 78.

²⁰⁷ *Ibid.*

²⁰⁸ *Ibid.*

²⁰⁹ *Ibid.*

The antipathy between Berle and Frankfurter helps explain why Berle did not defend his ideas as strongly as he could have against Dodd. Indeed, the timing was wrong. But the battle was not between his corporatism and business commonwealth corporatism, it was between his vision and Frankfurter's vision. As far as the business commonwealth corporatism model, no evidence exists that Frankfurter, or others in the democratic camp, directly advocated it. Furthermore, Berle did want, as Bratton and Wachter put it, "to ensure his vision of corporatism was the one that would be adopted by the Roosevelt Administration."²¹⁰ He "was jealous to protect his influence,"²¹¹ but not from his few members of the brain trust at the time (Moley, Rexford Tugwell, and James Warburg), rather from his old nemesis—Felix Frankfurter.

From the outset of joining Roosevelt's campaign, Berle would probably have known that Frankfurter had been informally advising Roosevelt from the time that Roosevelt was Governor of New York State,²¹² and that at some point Frankfurter would be called in to assume a similar role during this campaign. Furthermore, Frankfurter was Brandeis's protégé, and Berle knew the ideological connection

²¹⁰ Bratton & Wachter, *supra* note 10 at 128.

²¹¹ *Ibid.*

²¹² Max Isenbergh, "Claims of History? or What the Market Will Bear?" (1969) 45 Va Q Rev 345 at 347.

between Frankfurter and Brandeis.²¹³ So Berle, being a former student of Frankfurter and a young lawyer for a year at Brandeis's law firm, would have known that a battle was coming. He also would have known the position that Frankfurter would be espousing to Roosevelt. Here, Berle had an advantage because he knew Frankfurter's plan of action, but Frankfurter was blind to Berle's. Berle's biographer sets the scene in the following passage:

Both men were anxious to succeed and there developed between them a strong animus that would ripen into the bitterest and most ideological of New Deal rivalries . . . the issue between them being whether the antitrust laws should be used to break up big corporations and restore the competition [Frankfurter's view] or whether big corporations were the products of natural economic forces and should be controlled through federal regulation [Berle's view].²¹⁴

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.²¹⁵ Berle must have felt that it was too risky to reveal his position in the Harvard Law Review (Frankfurter's backyard).

²¹³ Schwarz, *supra* note 15 at 14.

²¹⁴ *Ibid.*

²¹⁵ 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 23 September 1932. See *ibid* at 78.

Berle could have foreseen the “vindictive” Frankfurter not only being aware of, but also enjoying, Dodd’s reply to Berle on the eve of the much-anticipated release of *The Modern Corporation and Private Property*. Berle must have figured that publishing a full disclosure to Frankfurter of how he would advise Roosevelt in the coming months would not be worth the possibility of Frankfurter winning the opinion of Roosevelt on this issue at such a critically sensitive moment in American history. Having a hand in the future course of American society at a time when it was on the verge of economic collapse raised the stakes so high that Berle had to play his cards close to his chest.

F. A Final Word From Berle and Dodd

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

I was rash enough to suggest that our law of business corporations . . . might develop a broader view which would make the proposition that corporate managers are, to some extent, trustees for labor and for the consumer more than meaningless rhetoric. The legal difficulties which were involved were clear enough, as Mr. A. A. Berle was quick to point out.²¹⁶

²¹⁶ Dodd, Book Review, *supra* note 161.

On the other hand, Berle never made such a concession.²¹⁷ Even when confronted by contemporaries for his apparent shift in opinion without sufficient explanation,²¹⁸ he denied he ever made concessions, claiming that others misunderstood his writing.²¹⁹ Hopefully, revisiting the Berle–Dodd debate has

²¹⁷ Although it is claimed that maybe he did, such claims assume that the position he endorsed in *The 20th Century Capitalist Revolution* was contrary to his shareholder primacy argument. In fact, considering that he regarded shareholder primacy as merely an interim and inadequate measure, there is no inconsistency between his arguments. For his supposed concession, see Adolf A Berle, Jr, *The 20th Century Capitalist Revolution* (New York: Harcourt, Brace & Company, 1954) at 137 [Berle, *Capitalist Revolution*].

²¹⁸ For instance, John Lintner mockingly commented:

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

John Lintner, “The Financing of Corporations” in Edward S Mason, ed, *The Corporation in Modern Society* (Cambridge: Harvard University Press, 1966) 166 at 170. Eugene Rostow also commented: “In 1954, Professor Berle accepted Professor Dodd’s initial position, apparently because he concludes that the directors of endocratic corporations, as keepers of the public conscience, can now be safely trusted to exercise their vast power in the public interest, without the safeguard of either stockholder or effective public supervision.” Eugene V Rostow, “To Whom and For What Ends Is Corporate Management Responsible?” in Mason, *supra* 46 at 62.

²¹⁹ Berle denies his concessions by claiming that he was misunderstood. See Adolf A Berle, Jr, “Foreword” in Mason, *supra* note 218, xi at xii [Berle, “Forward”].

clarified Berle's position, rectifying the long-held misunderstanding of his shareholder primacy argument.

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

A. Commoditization, Financialization, and Society

Commoditization means to treat something as though it were a product that could be bought and sold. Karl Polanyi's *The Great Transformation: The Political and Economic Origins of Our Time* tells the story of a critical point in the commoditization of English society.²²⁰ It describes how peasant farmers were evicted from land that was communally used for generations and then were forced to accept harsh factory work. In other words, Polanyi explains the result of transforming the natural environment and the traditional ways of life of a people into commodities (property and labor)²²¹ and harnessing these commodities to the price mechanism in order to create a new social order.²²² Although Polanyi regarded this social

²²⁰ Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, 2d ed (Boston: Beacon Press, 2001).

²²¹ For his complete argument on commodity fiction, see *ibid* at ch 6.

²²² *Ibid* at 83.

experiment as a “stark utopia,”²²³ others disagreed, arguing that it was an essential step in the birth of modern society.²²⁴

The financialization of society has much in common with this story of *The Great Transformation*. Financialization is an evolution of the commoditization process that Polanyi contemplated. Financialization holds great potential benefits for society by dispersing risk throughout society; however, it is also dangerous because it makes society more complex to manage by creating layers of interconnected markets for commodities. Maybe the best example of such financialization is the operation of derivatives.

B. Some Questions and Answers on Berle’s Shareholder Primacy and Today’s Rise of Finance

Can corporate legal scholarship contribute to a better understanding of financialization? On one hand, stocks are different from other exchangeable instruments in the sense that only shares have rights attached to them that grant shareholders power within corporate governance.²²⁵ Yet many shareholders treat

²²³ *Ibid* at 3.

²²⁴ For Hayek’s arguments as to why the price mechanism is essential to ordering complex modern society, see Friedrich A Hayek, “The Use of Knowledge in Society” (1945) 35 *Am Econ Rev* 519 at 527-29.

²²⁵ Charles RT O’Kelley & Robert B Thompson, *Corporations and Other Business Associations: Cases and Materials*, 6th ed (New York: Aspen Publishers, 2010) at 156-58.

stocks much the same as they would other exchangeable instruments: “buy, hope, hold, and cash in.”²²⁶ In other words, they do not participate in corporate governance directly. As with financialization, the existence of stocks creates two worlds: the market world (stock markets) and the social world (the corporation’s social relationship²²⁷ or “nexus of contracts”²²⁸). For these reasons, events in corporate governance that are affected by stock price and passive investors are comparable to the phenomena of financialization.

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

First is that government was capable of determining the course of the economy and that it could enforce this course.²²⁹ Modern governance theory resists the sort of heavy-handed government interference that Berle envisioned, preferring to

²²⁶ Berle, “Labor Could Control”, *supra* note 26 at 38.

²²⁷ Mark Granovetter, “Economic Action and Social Structure: The Problem of Embeddedness” (1985) 91 *Am Jour Soc* 481 at 481-90.

²²⁸ Stephen M Bainbridge, *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at 28.

²²⁹ Adolf A Berle, Jr, “Constitutional Limitations on Corporate Activity—Protection of Personal Rights from Invasion Through Economic Power” (1952) 100 *U Pa L Rev* 933 at 933-36 [Berle, “Constitutional Limitations”]; AA Berle, Jr, “The Developing Law of Corporate Concentration” (1952) 19 *U Chicago L Rev* 639 at 641-43, 660-61 [Berle, “Developing Law”].

relegate government to steering market actors toward targeted ends without dictating the means by which market actors achieve these ends.²³⁰ And yet, Berle believed in a responsible exercise of private economic power in harmony with public authority, which carried with it the implicit understanding that government would step in to protect the public interest as a measure of last resort.²³¹ So, it is possible to interpret Berle’s insights in a manner that is not so far from what modern governance theory is attempting to do today.²³²

Second is that a new theory would resolve the public–private tension trapped within corporate theory.²³³ One could argue that Bratton and Millon have made short work of the argument that a theory could have such influence.²³⁴ But upon further

²³⁰ See generally John Braithwaite, *Regulatory Capitalism: How it Works, Ideas for Making it Work Better* (Cheltenham, UK: Edward Elgar Publishing, 2008) [Braithwaite, *Regulatory Capitalism*]; Colin Scott, “Regulation in the Age of Governance: The Rise of the Post-Regulatory State” in Jacint Jordana & David Levi-Faur, eds, *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (Cheltenham, UK: Edward Elgar, 2005) 145 at 145-74; Alfred C Aman, Jr, “Law, Markets and Democracy: A Role for Law in the Neo-Liberal State” (2007) 51 *NYL Sch L Rev* 801; Levi-Faur, *supra* note 98.

²³¹ Berle, “Developing Law”, *supra* note 229 at 641-43, 660-61.

²³² Braithwaite, *Regulatory Capitalism*, *supra* note 230 at 88-94.

²³³ Berle & Means, *supra* note 64 at 219-20.

²³⁴ William W Bratton, Jr, “The ‘Nexus of Contracts’ Corporation: A Critical Appraisal” (1989) 74 *Cornell L Rev* 407 at 464-65 [Bratton, “Nexus of Contracts”]; Bratton, “Welfare”, *supra* note 12 at 61-64; Millon, *supra* note 110 at 204-05, 240-51.

inspection, it may not be a theory of the firm that resolves this public–private tension.²³⁵ As will be explained below, there are ever-more frequent examples of the “private” corporation adopting roles once reserved for the very “public” welfare state, causing what Braithwaite calls the “reality of hybridity between the privatization of the public and publicization of the private.”²³⁶

Third is that Berle argued that when a theoretical model of the corporation emerged, it would reject classical economic theory and might make the property theory of corporations obsolete.²³⁷ To date, the winner of the race for a better theoretical model of the corporation might be Oliver Williamson and his theory of markets, networks, and hierarchies (New Institutional Economic Theory).²³⁸ Williamson’s work is derived from classical economic theory and is based on the cost of exchanging property (transaction cost theory).²³⁹ Berle would certainly adjust his arguments to compensate for the realities of the modern corporation and governance today, but as suggested, at least in some cases, the adjustment need not be that drastic.

²³⁵ See Part V.D., below.

²³⁶ Braithwaite, *Regulatory Capitalism*, *supra* note 230 at 8.

²³⁷ Berle & Means, *supra* note 64 at 219-20; see also Berle, “Modern Functions”, *supra* note 11 at 435-36.

²³⁸ Williamson, *supra* note 7.

²³⁹ *Ibid* at 3-4.

Taking into account Berle's body of work covered in this chapter from 1921 to 1932, it can be concluded that he argued that the shareholder class needed to provide something more to the corporation and society than merely creating passive investors.²⁴⁰ He envisioned three different ways that the shareholder class could be legitimized: first, by being a mechanism for the egalitarian distribution of profits and power to labor;²⁴¹ second, by being a mechanism for the egalitarian distribution of profits and power to the broader American population;²⁴² and third, by attracting sophisticated business expertise that could take an active and constructive role in managing the corporation toward the creation of a wealthier and more stable society.²⁴³ Assuming that the shareholder class was legitimized, he argued that "all powers granted to a corporation [ought to be] at all times exercisable only for the ratable benefits of all the shareholders as their interest appears"²⁴⁴ without qualification. But Berle did not have complete faith in its legitimacy, admitting that it

²⁴⁰ See e.g. Berle, "Labor Could Control", *supra* note 26 at 38.

²⁴¹ For how labor could share the ownership of corporations, see Berle, "Labor Could Control", *supra* note 26 at 38-39.

²⁴² For how ever-wider distribution of shareholdings could create more egalitarian distribution of wealth and economic power, see Schwarz, *supra* note 15 at 66.

²⁴³ For how investors could legitimize their roles in corporations by contributing to management strategy, see Berle, "Labor Could Control", *supra* note 26 at 37-38.

²⁴⁴ Berle, "Corporate Powers", *supra* note 105.

was a less than fully satisfying interim measure to help eliminate the democratic deficit within the American economy.²⁴⁵

Would Berle still endorse shareholder primacy today? The answer is probably not. Consider the three different ways that he believed the shareholder class could legitimize their position within corporate governance. The first was the emancipation of labor through worker control of the shareholder class. This never happened and is only realizable in one's imagination today.²⁴⁶

The second was the egalitarian distribution of profits and power within the corporation through broader shareholder distribution. Today, the middle- and lower-wage workers that invest in shares generally do so through institutional investors (pension funds and mutual funds). These individuals have contracted away their rights, allowing that institutional investors can participate in corporate governance on their behalf with few exceptions.²⁴⁷ In terms of profit, what these "shareholders" gain

²⁴⁵ Berle & Means, *supra* note 64 at 219-20.

²⁴⁶ See generally Katherine VW Stone, "A Labor Law for the Digital Era: The Future of Labor and Employment Law in the United States" in Kenneth G Dau-Schmidt, Seth D Harris & Orly Lobel, eds, *Encyclopedia of Labor and Employment Law and Economics*, 2d ed (Cheltenham, UK: Edward Elgar, 2009) 689.

²⁴⁷ Eric John Finseth, "Shareholder Activism by Public Pension Funds and the Rights of Dissenting Employees Under the First Amendment" (2011) 34 Harv JL & Pub Pol'y 289 at 289-91.

through such investments, they may be losing through pension privatization.²⁴⁸ Thus, the egalitarian distribution of profits and power has not lived up to Berle's high hopes.

The third can be posed as a question: Can today's greater shareholder empowerment lead to the sort of active and constructive roles for management that Berle had in mind? In other words, can good decisions in the financial world translate into good decisions in the social world? The answer to this question is less than clear and invites debate. Yet, this tension is healthy²⁴⁹ because private entrepreneurs and public lawmakers need to be reminded that the gaps between markets and society must be bridged as they create the new hybrid regulatory mechanisms of tomorrow.²⁵⁰

²⁴⁸ Sarah M Brooks, "Interdependent and Domestic Foundations of Policy Change: The Diffusion of Pension Privatization Around the World" (2005) 49 Int'l Stud Q 273 at 290.

²⁴⁹ Bratton, "Nexus of Contracts", *supra* note 234; Bratton, "Welfare", *supra* note 12 at 61-64.

²⁵⁰ See Brooks, *supra* note 263. See generally Braithwaite, *Regulatory Capitalism*, *supra* note 230; Aman, *supra* note 230; Levi-Faur, *supra* note 98; Scott, *supra* note 230 at 145-74.

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

As will be explored in more detail in Chapter 5, the privatization of public services²⁵¹ and the use of meta-regulation²⁵² demonstrate how governments have placed the day-to-day regulation of public interest in the hands of private actors. Business readily accepts these government gifts when they are granted, and rightly so. Business wants the profits from managing segments of the public sector. It also wants to self-regulate in order to achieve flexibility and a competitive edge. At the same time, investors want to capitalize on a full menu of investment opportunities that are only limited by the capacity of the imagination of the financial engineers of Wall Street and the Square Mile.

These private actors may soon learn that there is a darker side to privatization and financialization. Private actors and governments are blurring the line between government responsibility and private freedoms. This blurring of traditional roles is shifting some of the underlying assumptions about how society ought to be governed. Letting markets regulate society was supposed to fix the problems of political organization by removing government from governance.²⁵³ But when the power of

²⁵¹ Aman, *supra* note 230 at 802-04.

²⁵² Braithwaite, *Regulatory Capitalism*, *supra* note 230 at 1-29.

²⁵³ Hayek, *supra* note 224.

the market is unleashed, it can create as much vice as virtue.²⁵⁴ Thus, the shift to the market may have solved some problems of political organization, but as the credit crisis demonstrated, it has also created new problems of market organization.

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

What is this precarious situation? It is the circumstances in which private actors may find themselves if there is a swing in public opinion. To explain, Polanyi argued that there is a “double movement” within society in which people eventually

²⁵⁴ For the theory of how markets create virtue and vice, see John Braithwaite, *Markets in Vice, Markets in Virtue* (Oxford: Oxford University Press, 2005) at 3-15 [Braithwaite, *Markets in Vice*].

refuse to tolerate the market overwhelming other social needs.²⁵⁵ 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.²⁵⁶ 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,²⁵⁷ 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.²⁵⁸ As the pendulum’s weight swings, the pendulum’s pivot shifts as well, thus the weight never returns to precisely the same point. In other words, if Polanyi’s “double movement” is right again (as it was in 1944), and the primacy of the political over the economic is once again restored, there will be no welfare state

²⁵⁵ For a detailed commentary on the double movement, see Fred Block, “Introduction” in Polanyi, *supra* note 220, xviii at xxiii-xxvii.

²⁵⁶ Deakin, *supra* note 9.

²⁵⁷ Deakin argues that the rise of finance “takes many forms,” including: hostile takeover bids, private-equity deals, hedge-fund activism, rise in stock-market values relative to national wealth, the use of shareholder-value metrics to measure corporate performance, stock-based remuneration, and the shifting boundary between the public and private sectors. See *ibid* at 67-68.

²⁵⁸ Douglass C North, *Institutions, Institutional Change and Economic Performance* (Cambridge, UK: Cambridge University Press, 1990) at 92-106.

welcoming the swing back, nor will there be a classic twentieth-century public–private divide to protect the interest of capital. What is unnerving about this precarious situation is that the permutations of how it could be mismanaged dramatically dwarf the potential productive ways it could be managed. One thing is for certain: the smaller the gap between the needs of markets and the needs of society, the easier it will be for the swing to be managed prudently.

VI. CONCLUSION

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

CHAPTER 4: THE PLACE OF CORPORATE LAWMAKING IN AMERICAN SOCIETY

I. INTRODUCTION

The concept of “embeddedness” can be traced to Karl Polanyi’s *The Great Transformation: The Political and Economic Origins of Our Time*.¹ The book is a history of the commoditization of English society from the eighteenth century forward, recounting how markets became unstitched from the fabric of society. As markets became more distinct from everyday life, society began to change in order to meet trending economic needs. One example of this transformation was the enclosure of English farmlands and the end of the ancient system of farming on land that was considered free for the use of all. This created a radical disruption in social function. Without farmland, thousands were forced to move to sites of industrial production, generating a radical shift in society from traditional agrarian life to one that was dominated by factory work. In other words, Polanyi’s book explains how markets became disembedded from society and then how these disembedded markets altered social activities as they became re-embedded into market function.²

Polanyi never believed that society could become completely embedded within the market function, concluding that society’s members would never tolerate a

¹ Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, 2d ed (Boston: Beacon Press, 2001).

² Mark Granovetter, “Economic Action and Social Structure: The Problem of Embeddedness” (1985) 91 *Am Jour Soc* 481 at 482.

market function which completely overwhelmed their social needs. This resistance to market pressures is what Polanyi called the “double movement.”³ Simon Deakin has elaborated on Polanyi’s idea of the double movement, explaining how it also operates in reverse.⁴ In other words, market actors will resist projects for greater equality when these social demands compromise market functionality. The balance between favoring the needs of markets with the needs of society has fluctuated throughout the twentieth century.⁵ According to Deakin, the pendulum is swinging toward the modern economy’s increased need for markets as societal governance has become ever more closely tied to the expectations of investors.⁶ Today, certainly, the pendulum appears to be swinging in a different yet still unknown direction.⁷

In his seminal article of 1985, “Economic Action and Social Structure: The Problem of Embeddedness,” Mark Granovetter elaborated upon Polanyi’s disembedded market theory and expanded it into a more complete (and complex)

³ For a detailed commentary on the double movement, see Fred Block, “Introduction” in Polanyi, *supra* note 1 xviii at xxiii-xxvii.

⁴ 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” (2008) 30 *Comp Lab L & Pol’y J* 67 at 67-69.

⁵ Block, *supra* note 3 at xxvii-xxvix.

⁶ See Deakin, *supra* note 4 at 67-68.

⁷ See Lawrence E Mitchell, “Financialism: A Lecture Delivered at Creighton University School of Law” (2009) 43 *Creighton L Rev* 323.

sociological theory of how embedded social behavior affects economic institutions.⁸ Granovetter argued that to adequately study economic institutions, like corporations, one must take into consideration how the behavior of such institutions is “constrained by ongoing social relations.”⁹ Granovetter’s central contention was that when economic reasoning ignores an institution’s social embeddedness, such reasoning is blinded to the actual social relationships within it and, accordingly, it is unlikely one will be able to understand how a particular institution functions (or fails to function).¹⁰

Granovetter’s call to scrutinize the social relationships that affect an organization’s function has been seen as a sociological plea explaining *why* institutions behave as they do. He criticized the assumptions of New Institutional Economics by highlighting how actual social networks inside and outside of the corporation operate in ways that handcuff economic thought. Specifically, Granovetter took issue with Oliver Williamson’s theory of transaction costs, arguing that while there was a certain analytical value to Williamson’s eventually highly

⁸ Granovetter, *supra* note 2.

⁹ *Ibid* at 482.

¹⁰ *Ibid* at 481-82.

influential market/hierarchy model of the corporation,¹¹ it remained blind to the *social reality* of corporate function.¹²

Up until now, Granovetter has served as something of a connector between Polanyi's efforts and current ongoing investigations into the concept of embeddedness.¹³ Certainly, the new interest in economic sociology and its relevance in bridging discourses in sociology, legal theory, and political economy¹⁴ contributes to a better understanding of the merits and boundaries of "economic governance;"¹⁵ something of particular importance at a time of fundamental readjustments to the financial credo of the last two decades.

¹¹ See Oliver E Williamson, "The Modern Corporation: Origins, Evolution, Attributes" (1981) 19 J Econ Literature 1537 [Williamson, "The Modern Corporation"]; Oliver E Williamson, "The New Institutional Economics: Taking Stock, Looking Ahead" (2000) 38 J Econ Literature 595 [Williamson, "New Institutional Economics"]; Peer Zumbansen & Galf-Peter Calliess, "Law, Economics and Evolutionary Theory: State of the Art and Interdisciplinary Perspectives" (Osgoode Hall L Sch Comp Res in L & Pol Econ Res Paper Series, Paper No 10/2010, 2010) online: <<http://ssrn.com/abstract=1595158>>.

¹² Granovetter, *supra* note 2, at 493-504.

¹³ Jens Beckert, "The Great Transformation of Embeddedness: Karl Polanyi and the New Economic Sociology" (Max Planck Inst for the Study of Societies, Discussion Paper No 07/1, 2007) online: <http://www.mpifg.de/pu/mpifg_dp/dp07-1.pdf>.

¹⁴ Jens Beckert & Wolfgang Streeck, "Economic Sociology and Political Economy: A Pragmatic Perspective" (Max Planck Inst for the Study of Societies, Working Paper, 08/4, 2008) online: <<http://www.mpifg.de/pu/workpap/wp08-4.pdf>>.

¹⁵ Zumbansen & Calliess, *supra* note 11.

Legal theory itself reflects the early beginnings of such critical engagement with an exclusively economic bias. John Dewey, in a famous inquiry into the law's constitution of the corporation,¹⁶ identified the law as a powerful tool with the ability to take an abstract idea (such as the suggestion that the corporation was a "person") and transform it into something more concrete and real (by, for example, granting a corporation the right to contract or equipping it with constitutional protections). Such legal reification, according to Dewey, shapes how people think about a corporation. As a consequence, this reification also shapes people's behavior within, and in relation to, corporations.

An important strand in studies on embeddedness and comparative variations in national political economies around the world has been to focus on different forms of market organization.¹⁷ Central to such inquiries has been the analysis of the particular dynamics of reform politics that often emerged against the background of historically evolved path-dependencies.¹⁸ Similarly, sociologists have long focused on sites where law is produced as "sites of contestation" between influential groups attempting to maintain or change the embedded patterns of social relationships. In

¹⁶ John Dewey, "The Historical Background of Corporate Legal Personality" (1926) 35 Yale LJ 655.

¹⁷ Peter A Hall & David Soskice, eds, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001).

¹⁸ John W Cioffi, "Restructuring 'Germany Inc.': The Politics of Company and Takeover Law Reform in Germany and the European Union" (2002) 24 Law & Pol'y 355.

“Competition as a Cultural Phenomenon,” Karl Mannheim detailed how preferences become entrenched or embedded within society through social processes like lawmaking and, in particular, through the competitive actions between influential social groups within these social processes.¹⁹ From this perspective, Mannheim can be seen as providing a promising approach for connecting Polanyi’s and Granovetter’s ideas of embeddedness with Dewey’s understanding of the legal reification of business ideas. Building upon this connection of ideas, Mannheim’s article explores one of the most important sites of contestation between influential business groups; namely, the place that has historically triumphed in attracting the highest number of Fortune 500 business incorporations in America: Delaware – America’s regulatory laboratory for *de facto* “national” corporate law.

The social process of how preferences become entrenched or embedded within American corporate charters is of particular importance to understanding such behavior within the American corporation. If Dewey was correct and the law shapes the behavior of actors within the business world, then the corporate charter and its bylaws form essential tools in this process. They form the foundational contract of the corporation, establishing the distribution of wealth and power between its members and. Although the charter and bylaws do not dictate all social relations within the

¹⁹ Karl Mannheim, *Essays on the Sociology of Knowledge*, Paul Kecskemeti, ed (London, UK: Routledge & Kegan Paul, 1952) at 197-98.

corporation, they do set a standard for expectations for social relations and are influential in the embedding process.

This chapter provides a history of the legal debates over corporate charters in the American context beginning with a famous dispute that originated in a series of contesting law review articles in the 1970s. A brief literature review will recount the academic arguments that have provided the intellectual support for sustaining Delaware's primacy over corporate lawmaking in the face of constant attack. By understanding the debates that have sustained Delaware's ability to lead the American competition for incorporation, this chapter provides insight into what is regarded as the most important legal instrument for maintaining status quo for actual social relationships within the American corporation: the "market for incorporation."

However, this chapter will also draw attention to the growing skepticism over Delaware's ability to consistently legislate optimal corporate law. This skepticism is most clearly evident in the federal government's growing willingness to design and to pursue corporate law policies in the face of corporate governance scandal, notwithstanding the fact that corporate law in the United States is governed by the states. The consequences of these developments are subject to much discussion and debate. In sum, this chapter provides an example of how shifts in lawmaking networks outside of the firm demand the potential to shift the embeddedness of the behavior of social relationships inside the firm.

II. HISTORICAL INTRODUCTION

During the American republic's early decades, state legislatures restricted the rights of corporate action by scrutinizing petitions for incorporation just as they would any other piece of legislation.²⁰ In theory, democratic representatives granted incorporation only if it served the public interest, but healthy skepticism should be reserved for anyone who claims that this was always the case.²¹ Restrictions on the corporation were severe by today's standards; for instance: 1) a corporation could not accumulate more than a set amount of capital;²² 2) a corporation's life was usually fixed to the time required to finish the task(s) that it was incorporated to accomplish;²³ 3) a corporation could not engage in activities that were not explicitly

²⁰ For the boundaries of government's authority over incorporation, especially after the corporate charter was issued by the state, see *Trustees of Dartmouth College v Woodward*, 17 US (4 Wheat) 518 (1819). For greater detail, see David Millon, "Theories of the Corporation" (1990) 1990 Duke LJ 201 at 206-10.

²¹ David Sciulli, *Corporations vs. The Court: Private Power, Public Interests* (Boulder: L. Rienner, 1999) at 85 (arguing that each request for incorporation was subject to the same lobbying and debate as any other bill, including "power plays, personal intrigues and local favoritism").

²² For a thorough collection of references to specific legislation from the 19th century, see *Liggett Co v Lee*, 288 US 517 at 550-54 (1933) (Brandeis, J, dissenting) [*Lee*].

²³ *Ibid* at 555.

defined in the terms of its incorporation;²⁴ and 4) a corporation's business activities could not extend beyond the boundaries of the state in which it was incorporated.²⁵

Yet in spite of such limitations, the corporation was still a coveted investment vehicle. One reason for this was that the status of shareholders was a rare and prestigious privilege.²⁶ However, it would be misleading to conclude that this investment vehicle was desired merely because it offered a degree of social status. The main attraction to the corporation was more likely the limited liability protection it offered to businessmen²⁷ and the opportunities for power and profits which large "public interest" projects presented.²⁸

²⁴ *Bank of Augusta v Earle*, 38 US (13 Pet) 519 at 588 (1839) (holding that since the powers conferred on the corporation can be no greater than state power, which granted the incorporation, the firm had no authority to operate outside the state).

²⁵ *Ibid.*

²⁶ James Willard Hurst, *The Legitimacy of the Business Corporation in the Law of the United States, 1780-1970* (Charlottesville: University Press of Virginia, 1970) at 14, 25, 28.

²⁷ Morton J Horwitz, "Santa Clara Revisited: The Developments of Corporate Theory" (1985) 88 W Va L Rev 173 at 208-09 (arguing that although the common law had evolved to the point of presuming limited liability, state legislatures enacted legislation to extend their shareholder liability a bit further than the value of their share).

²⁸ Millon, *supra* note 20 at 207 (arguing that there was fear that the potential for power and wealth associated with incorporation caused Americans to fear that such organizations could threaten the opportunity of others to enter the market; adding that, as a result, governments rarely confer monopoly privileges).

By the Panic of 1857,²⁹ Americans had endured a depression, multiple stock market crashes, and witnessed what was perceived to be the floundering public management of large interstate canal projects. These events provoked a profound shift of public opinion regarding the relationship between public and private power in American society.³⁰ People began viewing government intervention in private transactions less as a means of securing liberty and more in terms of restricting it. Public authorities found themselves faced with a public that demanded justification for why the corporation must be a servant of public interest and, more importantly from the individual's perspective, why private citizens should not use such corporations solely for personal advantage in the pursuit of happiness.³¹ Citizens also became less trusting of government discretion in granting incorporations because

²⁹ For more, see generally James L Huston, *The Panic of 1857 and the Coming of the Civil War* (Baton Rouge, La: Louisiana State University Press, 1987); Timothy J Riddiough & Howard E Thompson, "Déjà Vu All Over Again: Agency, Uncertainty, Leverage and the Panic of 1857" (HKIMR Working Paper No 10/2012, 2012) online: <<http://ssrn.com/abstract=2042316>>.

³⁰ For more on how the canals fiasco shifted public opinion, see Carter Goodrich, *Government Promotion of American Canals and Railroads, 1800-1890* (New York: Columbia University Press, 1960); see also Carter Goodrich et al, *Canals and American Economic Development*, ed by Carter Goodrich (New York: Columbia University Press, 1961) at 241, 246-47 (describing what was perceived to be the costly financial failures of the nineteenth century canal projects, of which almost 3/4 of the \$188 million invested between 1815 and 1860 came from the public purse). For more on how the other mentioned financial crisis affected public opinion, see William G Roy, *Socializing Capital: The Rise of the Large Industrial Corporation in America* (Princeton: Princeton University Press, 1997) at 71-75.

³¹ Sciulli, *supra* note 21 at 89.

accusations of favoritism and corruption became widespread.³² With these adverse changes in public opinion, the government walls that confined corporate behavior began to crumble. Emerging state policy began to challenge the long-established understanding that the function of the corporation was solely to serve the community.³³ This shift, in turn, opened the door for the considerably activist U.S. Supreme Court to determine that corporations had constitutional rights, protecting corporations from the threat of public meddling in their affairs.³⁴

With the loosening of state policy and advancements in technology, the number of incorporations increased exponentially. Professional management teams, in turn, were hired more frequently as majority shareholders became less commonly involved in the corporation's day-to-day management.³⁵ These radical transformations created a flood of new and complex issues into state courts –

³² Hurst, *supra* note 26 at 33-36, 136.

³³ Gregory A Mark, “The Personification of the Business Corporation in American Law” (1987) 54 U Chicago L Rev 1441 at 1447 (arguing that changes in state law incorporation policies “eliminated any notion that incorporation was a special grant from the state, even the public nature of a corporation’s purpose could be called into doubt”).

³⁴ *Santa Clara County v Southern Pacific Railroad Co*, 118 US 394 (1886) [*Santa Clara*]. For a detailed understanding of the case and a detailed argument regarding the fallout from this case in America, see Horwitz, *supra* note 27. For a contrasting point of view, see Millon, *supra* note 20.

³⁵ Sciulli, *supra* note 21 at 90.

necessitating the call for legal clarity.³⁶ This inspired the creation of specific state judiciaries to oversee corporate practice.³⁷ Willing jurisdictions (in particular, New Jersey and Delaware) customized regulatory environments to attract those businessmen shopping for the most advantageous jurisdiction to incorporate their businesses.³⁸ Such states also began to adopt new management-friendly legislation, mostly because the franchise taxes, fee revenues, and taxation on extra business opportunities (which followed incorporation) filled state coffers.³⁹

Beginning in the mid-1800s, a gradual loosening of government policy occurred. For example, in 1846, New York started a trend in state reform which blocked the legislature from creating corporations by special act, except in the rare case where the objectives for devising the corporation could not be attained under

³⁶ Hurst, *supra* note 26 at 82-83.

³⁷ *Ibid.*

³⁸ Lucian Arye Bebchuk, “Federalism and The Corporation: The Desirable Limits on State Competition in Corporate Law” (1992) 105 Harv L Rev 1435 at 1443 (describing the pressures and incentives, which started jurisdiction competition for incorporation) [Bebchuk, “Federalism and the Corporation”]; William L Cary, “Federalism and Corporate Law: Reflections Upon Delaware” (1974) 83 Yale LJ 663 at 669-70 (arguing that state competition has led to a “a race for the bottom” in terms of the standards for corporate governance – in particular to the disadvantage of shareholders).

³⁹ Curtis Alva, “Delaware and the Market for Corporate Charters: History and Agency” (1990) 15 Del J Corp L 885 at 888; Cary, *supra* note 38 at 668-69; John C Coffee, Jr, “The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards” (1987) 8 Cardozo L Rev 759 at 762.

general law.⁴⁰ In addition, in 1867, the U.S. Congress expanded bankruptcy protections to include corporations.⁴¹ Further, in 1875, New Jersey eliminated the restrictions on the corporation's ability to accumulate capital.⁴² In 1886, the U.S. Supreme Court held that the private corporation was a legal person entitled to similar rights afforded a natural person under the U.S. Constitution, therefore protected by the Bill of Rights, which broadly protected the corporations from public authority.⁴³ New Jersey offered the first standard articles of incorporation for private businesses in 1888.⁴⁴ In one reflexive jerk away from the growing power of the mighty corporation, the *Sherman Antitrust Act* was signed in 1890.⁴⁵ But still racing forward at the state level, in 1896, New Jersey adopted what could be recognized as the first modern corporate statutes and, thus, it became the home to the majority of America's largest corporations (a title that Delaware would steal within twenty years).⁴⁶ In 1910, the Supreme Court nullified restrictions on corporate capacity to conduct business

⁴⁰ NY Const of 1846 art VIII, § 1.

⁴¹ Sciulli, *supra* note 21 at 91.

⁴² *Ibid.*

⁴³ See *Santa Clara*, *supra* 34; see also generally Horwitz, *supra* note 27, Millon *supra* note 20.

⁴⁴ Roy, *supra* note 30 at 152-53.

⁴⁵ *Sherman Antitrust Act*, 15 USC § 1 et seq (2006).

⁴⁶ Bebchuk, "Federalism and the Corporation", *supra* note 38 at 1443.

outside the states in which it was chartered.⁴⁷ By 1933, Mr. Justice Brandeis, reflecting on this historical trend toward state competition in corporate law in *Liggett Co v. Lee*,⁴⁸ expressed concern over how the fear of losing existing state revenue and the allure of earning greater state revenue was eroding the diligent construction of corporate legal development by replacing it with a permissive consumer product that pandered to powerful corporate interests.

III. THE FIRST WAVE: DRAWING THE DISTINCTION

In 1974, William Cary reconsidered the trends in federalism and corporate law from the nineteenth century forward and declared that modern state corporate law was a product of state competition.⁴⁹ Most importantly, states were legislatively competing to attract incorporation to increase state revenues, creating a dangerous “race-to-the-bottom” for corporate governance standards.⁵⁰ Cary’s focus quickly turned to the by-then leader of this race, Delaware. He opined that Delaware’s motivation for its considerably softened stance on corporate governance standards was motivated by the state’s budget dependence on revenues from incorporations, therefore creating an inversely indebted relationship between the state and those

⁴⁷ Millon, *supra* note 20 at 212-13.

⁴⁸ *Lee*, *supra* note 22 at 557.

⁴⁹ Cary, *supra* note 38 at 666.

⁵⁰ *Ibid.*

corporate managers looking to incorporate. This compelled Delaware to offer advantageous corporate legal arrangements that allowed managers broad and unchecked authority; therefore, corporations were no longer faced with the disincentive required to curb less-than-optimal corporate performance.⁵¹ Cary argued that it was time for the federal government and the judiciary to “import lifting standards” that would set a level beyond which corporate standards would not be allowed to fall below and “deteriorate.”⁵²

Three years later, in 1977, Ralph K Winter wrote a reply to Cary’s position which by this time had almost universally become endorsed as a matter of fact. In the face of this general consensus, Winter boldly rejected Cary’s position arguing that state competition should “tend toward optimality so far as the shareholders’ relationship to the corporation is concerned” and thus corporate governance standards, like those of Delaware, “are optimal legal arrangements.”⁵³ Put differently, what Cary regarded as a “race-to-the-bottom” Winter replaced as a “race-to-the-top.”

Borrowing from the ideas of Henry G Manne,⁵⁴ Oliver E Williamson,⁵⁵ and Armen A Alchian,⁵⁶ Winter constructed an argument which suggested that because

⁵¹ *Ibid* at 668-69.

⁵² *Ibid* at 705.

⁵³ Ralph K Winter, Jr, “State Law, Shareholder Protection, and the Theory of the Corporation” (1977) 6 J Legal Stud 251 at 254.

⁵⁴ See Henry G Manne, “Mergers and the Market for Corporate Control” (1965) 73 J Pol Econ 110 [Manne, “Corporate Control”]; see also Henry G Manne, “Our

corporations acquired capital by selling bonds and equity, management was therefore forced to weigh the interests of such financial actors and instruments.⁵⁷ Winter posited that “the state which ‘rigs’ its code to benefit management will drive debt and equity capital away.”⁵⁸ Furthermore, he argued that, although Cary was correct in assessing that managers ultimately had the consumer power to decide which jurisdiction to incorporate, managers would not select a jurisdiction that would cause their business to: 1) earn lower-than-normal returns; and/or 2) have a higher cost of capital.⁵⁹ On the contrary, managers would select jurisdictions that afforded the opposite for the sake of self-preservation. Thus, state competition, also known as the

Two Corporation Systems: Law and Economics” (1967) 53 Va L Rev 259 [Manne, “Two Corporation Systems”].

⁵⁵ Oliver E Williamson, “Corporate Control and the Theory of the Firm” in Henry G Manne, ed, *Economic Policy and the Regulation of Corporate Securities* (Washington, DC: American Enterprise Institute for Public Policy Research, 1969) 281 at 281 [Manne, *Economic Policy*] [Williamson, “Corporate Control”].

⁵⁶ Armen A Alchian & Reuben A Kessel, “Competition, Monopoly, and the Pursuit of Pecuniary Gain” in *Aspects of Labor Economics* (Princeton: Princeton University Press for Universities-National Bureau Committee for Economic Research, National Bureau of Economic Research, 1962) 157; see also Armen A Alchian, “Corporate Management and Property Rights” in Manne, *Economic Policy*, *supra* note 55, 337; see also Armen A Alchian & Harold Demsetz, “Production, Information Costs, and Economic Organization” (1972) 62 Am Econ Rev 777.

⁵⁷ Winter, *supra* note 53 at 289.

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

charter market, produced an optimal corporate law regime which accurately reflected the demands that corporate constituents had for corporate governance.⁶⁰

The rationale for the charter market that causes the race-to-the-top can be restated as follows: If the corporate legal regime is structured so that management cannot maximize the corporate output (profits), debt holders may make it more expensive to: 1) hold debt; and 2) raise new debt.⁶¹ This corporate legal regime will also depress stock price potential thereby making it more expensive to raise new capital as well as maintain optimal relations with shareholders and creditors. Such underperforming firms will become targets for takeover, and the threat of takeover will create a market for managerial control.⁶² Thus, managers will have ample incentive to demand an off-the-rack default statutory model of corporate governance that encourages shareholder wealth maximization.⁶³ Since such a default model can be assumed to be what managers are shopping for when they select a jurisdiction to incorporate, this is what state competition will foster.⁶⁴ Thus, the charter market creates a race-to-the-top. Furthermore, it creates a system of legal innovation that is

⁶⁰ *Ibid.*

⁶¹ *Ibid.*

⁶² *Ibid.*

⁶³ *Ibid* at 290.

⁶⁴ *Ibid.*

not compromised by political interference – which would ultimately be the result of Cary’s recommendation for federal government intervention.

With the two sides of the Cary–Winter debate delineated, the stage seemed set for the next three decades with the advocates of Cary’s position representing: 1) anti-managerialism; 2) federal intervention in state competition; and 3) more centralized planning, and the advocates of Winter’s position representing: 1) managerialism; 2) unfettered state competition; and 3) more decentralized market rationality.⁶⁵ Underpinning both positions was an understanding that the firm was a distinct market actor that focused squarely upon finding an optimal solution to the shareholder-management problem.

⁶⁵ For more analysis on Winter’s theory, see Roberta Romano, “Law as a Product: Some Pieces of the Incorporation Puzzle” (1985) 1 *JL Econ & Org* 225 [Romano, “Law as a Product”]; Roberta Romano, *The Genius of American Corporate Law* (Washington, DC: AEI Press, 1993) [Romano, *American Corporate Law*]; Stephen M Bainbridge, “The Creeping Federalization of Corporate Law” (2003) 26 *Regulation* 26 [Bainbridge, “Creeping Federalization”]; Leo E Strine, Jr, “Toward a True Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America” (2006) 119 *Harv L Rev* 1759 at 1775 [Strine, “True Corporate Republic”]; Stephen M Bainbridge, *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) [Bainbridge, *New Corporate Governance*]. For representatives from the Cary camp, see Melvin A Eisenberg, “The Structure of Corporation Law” (1989) 89 *Colum L Rev* 1461 at 1508 [Eisenberg, “Structure of Corporation Law”]; Lucian Arye Bebchuk & Allen Ferrell, “Federalism and Corporate Law: The Race to Protect Managers from Takeovers” (1999) 99 *Colum L Rev* 1168 at 1170; Lucian Arye Bebchuk & Assaf Hamdani, “Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters” (2002) 112 *Yale LJ* 553; Lucian Arye Bebchuk, “The Case for Increasing Shareholder Power” (2005) 118 *Harv L Rev* 833 [Bebchuk, “Increasing Shareholder Power”].

IV. THE SECOND WAVE: EVENT STUDIES AND THE ATTEMPTS TO SETTLE THE CARY–
WINTER DEBATE

Winter's economic analysis of charter markets forced Cary proponents to adjust their arguments by taking a more economically sophisticated position. Following Winter's lead, they employed more economically savvy arguments to suggest that shareholders (and creditors) had much less control over managers' incorporation preferences in practice than Winter's charter market theory suggested and, thus, the race-to-the-top argument was flawed.⁶⁶ In response, others became inspired to settle this theoretical tit-for-tat debate by engaging in empirical research in the form of "event studies."⁶⁷ These studies established that many stocks affected by the amendments rose in value when the markets learned of the amendments, thereby bolstering Winter's position that state competition was advantageous for shareholders.

Those defending Cary's position fired back. Melvin Eisenberg rejected these event studies, arguing that they had "only limited usefulness" in the context of the

⁶⁶ Eisenberg, "Structure of Corporation Law", *supra* note 65.

⁶⁷ Event studies were simply empirical tests which gauged market responses to corporate law amendments. See generally Peter Dodd & Richard Leftwich, "The Market for Corporate Charters: 'Unhealthy Competition' vs. Federal Regulation" (1980) 53 J of Business 259; Romano, *American Corporate Law*, *supra* note 65; Jeffrey Netter & Annette Poulsen, "State Corporation Laws and Shareholders: The Recent Experience" (1989) 18 Fin Mgmt 29.

Cary-Winter debate.⁶⁸ Specifically, Eisenberg contended that if a uniformly low-grade corporate law regime existed – as Cary seemed to suggest – then the notice of an amendment from “one low-grade regime to another would not be a significant event.”⁶⁹ He also suggested that Delaware’s mature case law increased predictability, which helped to countervail potentially suboptimal rules and amendments. More importantly, Eisenberg emphasized that other contributory factors may have skewed the results of the event studies.⁷⁰ One example of such factors included packaging negative amendments to existing law with positive ones.⁷¹ Eisenberg suggested that such event studies were limited because the economic analysis was so superficial that it could not adequately appreciate the complexity of the American “charter market.”⁷² Lucian Bebchuk made similar arguments that suggested how negative information can be packaged with positive information in order to maintain or improve stock value, while also re-emphasizing that Cary’s position was still correct.⁷³

⁶⁸ Eisenberg, “Structure of Corporation Law”, *supra* note 65 at 1508.

⁶⁹ *Ibid.*

⁷⁰ Eisenberg posited that such contributing factors were not taken into consideration during the event studies. *Ibid.*

⁷¹ *Ibid.*

⁷² *Ibid* at 1509.

⁷³ Bebchuk, “Federalism and the Corporation”, *supra* note 38.

Within four years of Eisenberg's reply, Roberta Romano published what would become the landmark statement in support of Winter.⁷⁴ Aimed at responding to Eisenberg's demand for "deeper economic analysis,"⁷⁵ Romano employed the lenses of: 1) financial risk management within equity markets; 2) agency cost theory; and 3) the relational understanding between socio-legal norms and market forces, which – taken together – helped to better understand the mechanics of the charter market. In the end, this deeper economic analysis led both Eisenberg and Romano closer to a centrist position, with Eisenberg leaning toward Cary's position⁷⁶ and Romano toward Winter's.⁷⁷

V. THE THIRD WAVE: POST-ENRON

Alas, the debate was not dead. Lucian Bebchuk took Cary's side and warned that state competition encouraged a race-to-the-bottom given the states' obvious inclination to make rules attractive to managers and controllers.⁷⁸ In 1999, Bebchuk and Allen Ferrell illustrated how anti-takeover statutes were inefficient and reduced

⁷⁴ Romano, *American Corporate Law*, *supra* note 65.

⁷⁵ See Eisenberg, "Structure of Corporation Law", *supra* note 65 (Eisenberg uses this language to level his criticism of the superficial nature of the event studies).

⁷⁶ *Ibid* at 1509.

⁷⁷ Romano, *American Corporate Law*, *supra* note 65 at 148.

⁷⁸ Bebchuk & Ferrell, *supra* note 65.

shareholder wealth,⁷⁹ and illustrated one clear example of how states provided default rules that benefited only managers to the detriment of all other constituents, and “should lead the many who offer unqualified support of state competition to reassess their position.”⁸⁰ But in 1999, the U.S. economy was hot, the inflation-adjusted aggregate output was up, real gross domestic product was up, corporate profits were up, employment was up, and everyone was making money. Bebchuk’s concerns were inaudible over the sound of investors’ portfolios filling with money. Corporate America seemed to be anything but broken.

All that changed in 2001 when the Enron scandal outraged Americans and pulled corporate governance under the microscope.⁸¹ In step with this change in climate, Bebchuk reiterated his position that the empirical evidence supported the view that state competition offered harmful incentives, which privileged managers to the detriment of all other corporate constituents.⁸² Building on this critique, Bebchuk went on to argue that Delaware’s position in the charter market was so strong that assumptions about the operation of state competition were false. In other words, Delaware was more sheltered from the influence of other states’ actions than was

⁷⁹ *Ibid.*

⁸⁰ *Ibid* at 1199.

⁸¹ See William W Bratton, “Enron and the Dark Side of Shareholder Value” (2002) 76 Tul L Rev 1275.

⁸² See Lucian Bebchuk, Alma Cohen & Allen Ferrell, “Does the Evidence Favor State Competition in Corporate Law?” (2002) 90 Cal L Rev 1775.

assumed in the literature, producing suboptimal corporate rules and justifying federal intervention.⁸³

In the summer of 2002, the federal government induced measures to appease populist reactions to the Enron scandal. Suddenly, there was a rash movement toward Cary's federal intervention that may have been procedurally pleasing to some corporate governance observers, but was ultimately substantively disappointing to most. With this came renewed interest in the Cary–Winter debate.

Mark Roe set out to offer some fresh insight building on Bebchuk's suggestion that Delaware was in fact insulated from state competition, not its catalyst.⁸⁴ Roe concluded that the nature of corporate regulatory competition had been “misconceived – and badly so,” arguing that Delaware's chief competition was never other states but, instead, the federal government.⁸⁵ Other states did not have the constitutional authority to trump Delaware's default rules for corporate governance, but the federal government did. In other words, Delaware's incorporation regime existed because the federal government tolerated it. Accordingly, the results of corporate law evolution may have been due in part to state competition, but the ever-looming threat of federal intervention was also a major factor. Which of these two

⁸³ Bebchuk & Hamdani, *supra* note 65.

⁸⁴ Mark J Roe, “Delaware's Competition” (2003) 117 Harv L Rev 588 [Roe, “Delaware's Competition”].

⁸⁵ *Ibid* at 591.

factors affected the evolution of corporate law was difficult to determine because the world of Delaware policymaking was opaque.

Roe further suggested that if the competition between Delaware and the federal government was considered when attempting to understand the traditionally conceived mechanism of state competition, the state race debate did not play out the way charter market analysis had been assuming all along.⁸⁶ He suggested that a new theory was necessary to explain how policy networks forged American corporate law, arguing that top-down “centralized strategic” planning had as much responsibility for corporate law outcomes as did lateral state competition.⁸⁷ This would give support to the idea that the federal political dimension compromises the narrow quest for solely understanding state competition through the assumed model of charter markets as constructed during the second wave of the debate.

In 2003, Stephen Bainbridge took a polarizing position as far to the Winter end of the continuum as Bebchuk had taken to Cary’s.⁸⁸ Bainbridge blasted the federalization of corporate law, calling the actions of Congress and other regulators “deeply flawed.”⁸⁹ He argued that, since the Enron scandal, the actions of the federal government represented “the most dramatic expansion of federal regulatory power

⁸⁶ *Ibid* at 646

⁸⁷ *Ibid.*

⁸⁸ Bainbridge, “Creeping Federalization”, *supra* note 65.

⁸⁹ *Ibid* at 26.

over corporate governance since the New Deal.”⁹⁰ Rejecting the federal reforms as an unnecessary encroachment on state jurisdiction, Bainbridge pointed to Romano’s event study in support of his claim that state competition, and Delaware’s default rules, favored shareholders by maximizing shareholder wealth.⁹¹ When addressing Bebchuk’s 1999 argument about the negative effects of state competition upon shareholder wealth by legislating anti-takeover statutes, his response was, “[S]o what? Nobody claims that state competition is perfect.”⁹² He also proclaimed that “even if Bebchuk could prove that state competition is a race-to-the-bottom, basic principles of federalism would still counsel against federal preemption of corporate law,” because the potential for regulatory innovation would be seriously compromised.⁹³

In 2005, Roe reemphasized that American scholars ought to recognize that the presumptions on state competition were skewing their perception, arguing that instead of looking at the results of horizontal state competition, observers needed to understand when the federal government decided to leave such authority in the hands

⁹⁰ *Ibid.*

⁹¹ *Ibid* at 30.

⁹² *Ibid.*

⁹³ *Ibid.*

of the states and when it decided to claw back such authority for itself.⁹⁴ Instead of Delaware being the product of market pressures, Roe viewed Delaware as a political group with a narrowly-defined range of concerns within the larger policy network of corporate law development.⁹⁵ In this light, Delaware's policymaking network was like a caucus of managers and investors. And within this caucus, Roe deemed that managers clearly had the "upper hand" in guiding policy development, but these same managers also appeared to exercise self-restraint because they understood "the game could move to Washington" if the scales were pushed too far toward managerialism.⁹⁶

Also in 2005, Leo E Strine, Jr, Vice Chancellor of Delaware's Court of Chancery, set out to "take some of the mystery out of Delaware's role in the governance of American public corporations."⁹⁷ When discussing the politics of state competition, however, Strine was noticeably reserved. He alluded to the fact that Delaware was and will be in the lead for some time to come in the state race for corporate law.⁹⁸ In defining the boundaries of state competition, he stated that the

⁹⁴ Mark J Roe, "Delaware's Politics" (2005) 118 Harv L Rev 2491 at 2494 [Roe, "Delaware's Politics"].

⁹⁵ *Ibid.*

⁹⁶ *Ibid* at 2542.

⁹⁷ Leo E Strine, Jr, "The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face" (2005) 30 Del J Corp L 673 [Strine, "The Delaware Way"].

⁹⁸ *Ibid* at 673-74.

issues of competition, labor, trade, and disclosures to public investors were generally regulated federally, while Delaware governed the “internal affairs of the corporation.”⁹⁹ He never more than tacitly acknowledged that the federal government had full authority to regulate in this area as well.¹⁰⁰ In other words, Strine failed to directly acknowledge that Delaware’s power was a privilege granted to the state, not a constitutional right. Accordingly, Strine does not elaborate on this federal power other than to say that present interventions like SOX and the amendments to listing requirements were suboptimal reforms.

In an exchange in the Harvard Law Review, the issue of federal intervention in the Delaware caucus was raised once again. Bebchuk argued that managers were too powerful and were blocking shareholders from maximizing shareholder value.¹⁰¹ Accordingly, he asserted that, since managers dominated state law, the federal government had to intervene.¹⁰² In response, Strine entertained Bebchuk’s proposal,¹⁰³ but emphasized that such reform “must emanate from state policymakers;”¹⁰⁴ Delaware (and not the federal government) ought to be “the

⁹⁹ *Ibid* at 674.

¹⁰⁰ *Ibid* at 686.

¹⁰¹ Bebchuk, “Increasing Shareholder Power”, *supra* note 65.

¹⁰² *Ibid* at 874.

¹⁰³ Strine, “True Corporate Republic”, *supra* note 65 at 1775.

¹⁰⁴ *Ibid* at 1777.

primary source of substantive corporate law” reform.¹⁰⁵ Bainbridge, in his response to Bebchuk, did not exhibit any of the potential flexibility that Strine did. He flatly rejected Bebchuk’s call for greater shareholder empowerment by arguing that if Bebchuk’s proposal could really enhance the value of the firm, why did it not already exist? In challenging Bebchuk in this manner, Bainbridge employed a classic Winteresque race-to-the-top argument.¹⁰⁶ Bainbridge rejected any changes to Delaware’s law and lawmaking capacity.

In reply, Bebchuk was somewhat encouraged by Strine’s opinions (although he believed they did not extend far enough).¹⁰⁷ Bebchuk attacked Bainbridge’s race-to-the-top argument by referencing a Winteresque argument from 1983, which advocated against federal intervention to better regulate insider trading. The 1983 article argued there was nothing wrong with the existing standards since charter competition would have already corrected them if they were suboptimal. This example illustrated the error of assuming that state competition already provided optimal corporate governance arrangements as Bainbridge suggested.¹⁰⁸ In an

¹⁰⁵ *Ibid* at 1780.

¹⁰⁶ Stephen M Bainbridge, “Director Primacy and Shareholder Disempowerment” (2006) 119 Harv L Rev 1735 at 1737-42 [Bainbridge, “Shareholder Disempowerment”].

¹⁰⁷ Lucian A Bebchuk, “Reply: Letting Shareholders Set the Rules” (2006) 119 Harv L Rev 1784 at 1796 [Bebchuk, “Reply”].

¹⁰⁸ *Ibid* at 1805.

interesting twist, Bebchuk pointed out that the innovative nature of state competition implied state law was subject to improvement in an evolving context.¹⁰⁹ Thus, even if one assumed Delaware produced optimal corporate law, it did not mean his proposition ought to be rejected outright.

The recent Bebchuk–Strine–Bainbridge debate helps to confirm Roe’s observation that the true motivator for shaping corporate governance is the threat of federal intervention. Bebchuk’s call for such intervention caused a defense of Delaware from both Strine and Bainbridge, and also a willingness on Strine’s part to seriously entertain various shareholder empowerment initiatives. This reflects what is at stake in these debates over Delaware: the spectrum of embedded relationships between public and private power in American society.

VI. WHAT PLACE DOES DELAWARE RESERVE FOR THE CORPORATION IN AMERICAN SOCIETY? A REFLECTION OF BAINBRIDGE

A. The Delaware Status Quo

Delaware attempts to enshrine managerialism within American corporate governance. Delaware’s defenders have made good use of the race-to-the-top argument,¹¹⁰ but recent history challenges whether favoring managerialism is the

¹⁰⁹ *Ibid* at 1808.

¹¹⁰ Bainbridge, *New Corporate Governance*, *supra* note 65 at 98-99, 103-04, 192-94, 200, 233.

optimal strategy for regulating the corporation. Amidst corporate scandal and economic downturns over the past decade, managerialism has garnered much scrutiny and created agency issues. The solutions for these agency relationship problems, which were inspired by the work of Michael Jensen and William Meckling,¹¹¹ appear insufficient to cope with managerial opportunism as well as responsible risk management.

This section explores the writing of one of Delaware's most loyal defenders: Stephen Bainbridge. Bainbridge defends Delaware while simultaneously distancing himself from managerialism. Bainbridge claims that American directors are undergoing a transformation, becoming more than de facto rubber stamps for managerial power.¹¹² He has developed a theory he calls "director primacy," which re-invents the managerialist position in a way that can appeal to both managerialists and anti-managerialists.¹¹³ By taking the shareholder–manager dichotomy and splitting it into a shareholder–director–manager trichotomy, Bainbridge places corporate directors firmly in the middle of the struggle between ownership and control. The brilliance of this position is that it personifies what Delaware's corporate law has de jure attempted to enforce since the rise of the modern corporation. The

¹¹¹ See Michael C Jensen & William H Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure" (1976) 3 J Fin Econ 305.

¹¹² See Bainbridge, *New Corporate Governance*, *supra* note 65.

¹¹³ *Ibid.*

weakness in Bainbridge's argument, however, is that history proves that American directors have not always lived up to the model of corporate governance.

If American directors are becoming more loyal to shareholder concerns, then director primacy is the driving force in a coup d'état in American corporate governance. However, those skeptical of Bainbridge will argue that this shift is not occurring and that his director primacy argument is no more than managerialism with a twist, albeit a clever twist that distances his position from the criticism of managerialism, while still sustaining the status quo in American corporate governance. And to a degree this criticism is fair – the ends of Bainbridge's director primacy position are still the same as those of managerialism in one important respect: both empower managers, at least until such time as the boards of America's large public corporations start behaving in the manner that Bainbridge projects they will.

Even with federal initiatives to bolster director independence, Bainbridge himself acknowledges the *Panglossian* nature of being optimistic about the present potential for director primacy. For example, he fully recognizes the problem of directors side-stepping their accountability to important constituents, such as shareholders.¹¹⁴ And yet, just under the surface of American corporate law may be

¹¹⁴ *Ibid* at 98-99, 103-04, 192-94, 200, 233.

another managerial revolution¹¹⁵ which will blur the classic distinctions between shareholder–manager and managerialist–anti-managerialist by encouraging the board of directors to take their duties more seriously. The director primacy norms may cause directors to start standing up to the special interests of managers and protecting shareholder interests more diligently. As a result, this may foster a better relationship between ownership and control and help resolve some of the serious agency issues that exist today.

B. Bainbridge's Director Primacy

The necessary shift in corporate governance, which can make director primacy transcend from theory into business reality and become the dominant model, will occur when boards of directors become more than mere rubber stamps for CEOs and other top executives. Bainbridge claims that this shift has commenced, arguing that directors are finally about to seize the mantle of power that corporate law has for so long reserved for itself.¹¹⁶ However, until this time, directors have rarely been

¹¹⁵ The first Managerialist revolution occurred with the contractarian shift to “the Market” in the 1970s, which resulted in managers shifting their focus away from balancing the constituent interests of the firm and towards maximizing shareholder value. For an explanation of the evolution of corporate governance by dividing it into historical paradigms, see Peer Zumbansen, “The Evolution of the Corporation: Organization, Finance, Knowledge and Corporate Social Responsibility” (Osgoode Hall L Sch Comp Res in L & Pol Econ Res Paper Series, Paper No 6/2009, 2009) online: <http://ssrn.com/abstract=1346971>.

¹¹⁶ See Bainbridge, *New Corporate Governance*, *supra* note 65. For examples of the development of director primacy, see Stephen M Bainbridge, “The Board of

separated from “managers” in the managerialist forum, and for good reason since directors are rarely distinguishable from corporate executives in their decision making choices.¹¹⁷ For this reason, beneath Bainbridge’s director primacy lays a contentious theory that a functional revolution is occurring in American corporate governance. This functional revolution may or may not be happening and is difficult to substantiate, but if Bainbridge is correct, then director primacy will mark a historic shift in governance away from Chandler’s model of managerialism toward the board-centered fiat model, which director primacy endorses.

Directors as Nexus of Contracts” (2002) 88 Iowa L Rev 1 (this is an introduction to the conceptual foundation for his theory of director primacy) [Bainbridge, “Nexus of Contracts”]; see also Stephen M Bainbridge, “Director Primacy: The Means and Ends of Corporate Governance” (2003) 97 Nw UL Rev 547 (revisiting director primacy, including: decision-making by fiat; the primacy of the board of directors over shareholders and managers; the relationship between the director primacy model and the nexus of contracts model; and the importance of centralized decision-making for efficient corporate governance by balancing the need for balancing authority and accountability within corporate regulation) [Bainbridge, “Director Primacy”].

¹¹⁷ For instance, read *The Economist’s* claim that directors are the lapdogs of managers on the critical issue of executive compensation: “[M]any bosses in other industries are overpaid because weak boards have allowed them to dictate the terms of their compensation. As a result, pay bears little relationship to performance and tends to rise inexorably. A chief critic of the supposed corporate gravy-train is Warren Buffett. At the annual meeting of his holding company, Berkshire Hathaway, on May 2nd the legendary investor railed against a system that lets chief executives choose the members of remuneration committees. This, he claimed, allows them to select compliant directors prepared to wave through pay proposals. ‘These people aren’t looking for Dobermans,’ he complained. ‘They’re looking for cocker spaniels.’” “Restraints on Executive Pay: Attacking the Corporate Gravy Train”, *The Economist*, 391:8633 (30 May 2009) 71 at 72.

In promoting director primacy, Bainbridge strongly advocates Delaware's off-the-rack default statutory model of corporate governance which protects the board's authority against direct shareholder influence in day-to-day decision making. In fact, it has even been suggested that Bainbridge advocates a more pro-board position than even Delaware dares.¹¹⁸ He describes how Delaware's corporate law protects the primacy of the directors to govern the corporation, asserting that this doctrinal position sits well with prevailing corporate theory.¹¹⁹ In particular, he contends that Delaware's director primacy fits nicely with the contractarian concept of the firm.¹²⁰ Bainbridge explains that decision making by fiat, which the board represents, is where the nexus of contracts meet and where the decision making power about how to manage this nexus is most efficiently allocated.¹²¹

Bainbridge explains that there will always be a need to balance the authority and accountability of directors, but the complexities and demands of managing this nexus suggest that careful consideration must be taken before limiting the authority of

¹¹⁸ For more detail on this argument, see Brett H McDonnell, "Professor Bainbridge and the Arrowian Moment: A Review of *The New Corporate Governance in Theory and Practice*" (2009) 34 Del J Corp L 139.

¹¹⁹ Bainbridge, *New Corporate Governance*, *supra* note 65 at IX–XII.

¹²⁰ See Bainbridge, "Nexus of Contracts", *supra* note 116.

¹²¹ Bainbridge, *New Corporate Governance*, *supra* note 65 at 32-35.

the board.¹²² Bainbridge offers a number of arguments for broad directorial discretion,¹²³ possibly providing his best defense of Delaware's allocation of authority to directors (which may be at the expense of greater shareholder empowerment). However, if what he contends is true, this broad discretion is ultimately in the shareholder's best interest.

Although Bainbridge argues that corporate boards do (and should) have final authority over decision making, his arguments also align with the shareholder primacy position: that such decision making authority must be for the sole benefit of shareholders. He justifies this position normatively by using the majoritarian default model. This model suggests that the shareholder wealth maximization norm is what all stakeholders of the firm ultimately want because default rules that pander to management are inefficient, increasing the cost of capital, creating greater vulnerability to hostile takeover, and negatively affecting the overall health of the corporation. The distinction that Bainbridge makes between director primacy and shareholder primacy is that the advocates of shareholder primacy extend their backing of shareholder power beyond the shareholder wealth maximization norm by pushing

¹²² See Stephen M Bainbridge, "The Business Judgment Rule as Abstention Doctrine" (2004) 57 Vand L Rev 83 [Bainbridge, "Business Judgment Rule"].

¹²³ For more details on Bainbridge's relevant arguments, see Bainbridge, *New Corporate Governance*, *supra* note 65 at 45-75.

for shareholders to have more direct control over the day-to-day affairs of the firm. Director primacy advocates argue only the shareholder wealth maximization norm.

Putting the collective action problems of a widely dispersed shareholder class aside, Bainbridge suggests that directors will more vigilantly care for the firm's wellbeing for the benefit of shareholders than direct shareholder empowerment.¹²⁴ One reason for this is the ease with which shareholders can exit the firm. Such unattached shareholder influence can shift the firm's focus to short-term, ill-informed, and/or self-serving goals that can possibly corrupt prudent corporate strategy over the long-term. Another reason for endorsing director primacy is that such direct shareholder empowerment would serve only to endorse the special interests of those who have power within the shareholder class: institutional investors.

Bainbridge justifies why authority ought to rest with the board of directors within the corporate governance structure by arguing that a governance group (that acts collegially) is superior to a single autocrat at the apex of the corporate governance hierarchy.¹²⁵ In making this argument, he offers evidence from the behavioral economics literature which explains why group decision making is of higher quality than individual decision making.¹²⁶ This leads Bainbridge to conclude

¹²⁴ *Ibid* at 55-57.

¹²⁵ *Ibid* at 78-79.

¹²⁶ For more details on Bainbridge's relevant arguments, see *ibid* at 82-104; see also Stephen M Bainbridge, "Why a Board? Group Decisionmaking in Corporate

that corporate boards are more effective at monitoring corporate governance than a single autocrat, and thus the fiat model is generally the best option.¹²⁷

The main problem with the fiat model remains: who watches the watchers? In other words, who keeps the board of directors from being poisoned by groupthink and/or other forms of collective action failure? And who keeps the board of directors from social loafing and/or other serious opportunistic behavior? Bainbridge's answer is the board itself.¹²⁸ The arguments justifying this answer are at best hopeful. The optimism of his answer may make some hardened anti-managerialists smile cruelly at the lack of realism that one must embrace to whole-heartedly be at ease with the potential of directors self-monitoring.

To be fair, this is a serious problem with no easy answer; and to his credit, Bainbridge attacks it directly. Ultimately, though, his arguments are more sound regarding the avoidance of collective action failure than they are regarding the avoidance of opportunistic behavior. Albeit, the group dynamic makes opportunism less attractive for one individual within the group than it would for an all-powerful autocrat with no equals. That said, the suggestion that social norms (like reputational

Governance" (2002) 55 Vand L Rev 1 (exploring why the default statutory model of corporate governance promotes a governance group that acts collegially, using evidence from the behavioral sciences to help explain why group decision-making is generally superior to individual decision-making) [Bainbridge, "Why a Board?"].

¹²⁷ Bainbridge, *New Corporate Governance*, *supra* note 65 at 104.

¹²⁸ *Ibid* at 75-78.

cost and the virtues of the communal life within the boardroom) will prevent the board from acts of opportunism at the expense of all other constituents of the firm may be too sweet for some intimate observers of director politics to swallow.

Bainbridge suggests that a key problem for corporate governance is locating the appropriate balance between providing enough authority for the board to govern the firm in an efficient manner, while not providing so much discretion that authority becomes unreviewable, uncorrectable, and ultimately unaccountable.¹²⁹ Therefore, at one extreme, efficiency demands that board decisions are shielded from shareholders and courts; otherwise, optimal risk-taking will be discouraged and the internal team governance structure could be seriously compromised by the fear of hindsight review.

What about the courts protecting shareholders from extensive director discretion? Bainbridge reasons that shareholders are protected from “optimal” risk-taking by the dual functioning of limited liability and portfolio diversity.¹³⁰ At the other extreme, if directors flagrantly violate their obligation to maximize shareholder wealth, the threat of judicial accountability must come out as a deterrent for corporate irresponsibility. However, this is not an easy balance to strike. Bainbridge warns that judges must use caution because they are not business experts, and because hindsight

¹²⁹ *Ibid* at 153.

¹³⁰ *Ibid* at 115.

can make decision making look more irresponsible when the consequences of those decisions are known to have been negatively magnified.

In determining the balance to be struck between authority and accountability, Bainbridge sides with the *Unocal Corp v. Mesa Petroleum Co* case, which provides a conservative interpretation of the application of the business judgment rule.¹³¹ The *Unocal* interpretation views the business judgment rule through the lens of the doctrine of abstention. This interpretation suggests that the business judgment rule allows the courts to go no further than to assess whether a board was disinterested and independent in their decision-making process (good faith) and that the decision-making process was reasonable (sans gross negligence).¹³² Thus, Bainbridge endorses a presumption in favor of strong judicial deference to board decisions as long as there is some evidence of good faith and competence. He ultimately justifies this position by reasoning that directors cannot be made more accountable without compromising their authority, leading to less-than-optimal risk-taking.¹³³

The key to director primacy, therefore, is establishing that directors are becoming agents of change by: 1) severing their loyalty to “managers;” 2) championing the rights of all shareholders; and 3) forging further corporate

¹³¹ *Unocal Corp v Mesa Petroleum Co*, 493 A 2d 947 (Del 1985).

¹³² For a full analysis of the *Unocal* test, see Bainbridge, *New Corporate Governance*, *supra* note 65 at 137-40.

¹³³ *Ibid* at 153.

governance. It is here that director primacy either lives or dies by the sword, for when Bainbridge attacks managerialism as inadequate he is indirectly challenged to establish how the distinction drawn between managerialism and his director primacy is in fact defensible.

Before Bainbridge, most traditional managerialists assumed that their readers understood that directors were included in the term “managers” because no clear distinction between the decision making outcomes of directors and senior executives was thought to exist. One major reason for this pre-determination was that the CEO was generally the office where actual power consolidated in public corporations. In practice, the CEO had tremendous control over: 1) who would be on the ballot for board elections; and 2) the flow of information from corporate operations to the board. Many times, the CEO was on the board (if not the chairman of the board), making frank discussions about managerial performance during board meetings difficult at best. Thus, the CEO accumulated a great deal of power to manage the corporation. So much that if there was one individual that Bainbridge had in mind in his comparison between group decision making and individual decision making, the CEO would likely be that individual as he or she has historically been the corporation’s best approximation of the single autocrat at the apex of the corporate governance hierarchy. In fact, it is not always clear how much the influence of the CEO has changed in the day-to-day function of the corporation.

When Bainbridge looks to the future of corporate governance in America, he sees two competing models: shareholder primacy and director primacy.¹³⁴ He petitions for greater vigilance in the face of today's pressure to extend the shareholder franchise.¹³⁵ Bainbridge notes that there is very good reason why shareholder power is so limited.¹³⁶ He argues that shareholder primacy is a flawed account of American corporate governance and, accordingly, in appreciating the reasons for this, director

¹³⁴ See Stephen M Bainbridge, "Director v. Shareholder Primacy in the Convergence Debate" (2002) 16 *Transnat'l Law* 45 [Bainbridge, "Director v. Shareholder Primacy"].

¹³⁵ *Ibid* (clarifying that most scholars in the convergence debate assume that American corporate law primarily promotes shareholder primacy, when it actually promotes director primacy, warning that such confusion may have serious consequences when transplanting the American model into recipient jurisdictions); see also Stephen M Bainbridge, "Shareholder Activism and Institutional Investors" (UCLA Sch of L Law-Econ Research Paper Series, Research Paper No. 05-20, 2005) online: <<http://ssrn.com/abstract=796227>> (warning of the dangers of greater institutional investor activism, arguing that such investors are motivated by narrow interests that may undermine passive investors and compromise the effectiveness of the board to make decisions in the best interest of the firm) [Bainbridge, "Shareholder Activism"]; Stephen M Bainbridge, "The Case for Limited Shareholder Voting Rights" (2006) 53 *UCLA L Rev* 601 (petitioning for greater prudence before extending the shareholder franchise, defending why only shareholders have voting rights and then defending why such voting rights are so limited) [Bainbridge, "Limited Shareholder Voting Rights"]; Bainbridge, "Shareholder Disempowerment", *supra* note 106 (responding to Lucian A Bebchuk's article entitled, "The Case for Increasing Shareholder Power," and rejecting Bebchuk's proposals for allowing shareholders to have greater voting power so that they can change a firm's basic corporate governance arrangements, defending existing regime of limited shareholder voting rights).

¹³⁶ Bainbridge, *New Corporate Governance*, *supra* note 65 at 233-35.

primacy emerges from the cries that proclaim greater shareholder primacy is the enlightened path for corporate governance.¹³⁷

Bainbridge contends that no shareholder empowerment amendments are needed in order to ensure that the American corporate governance model optimizes shareholder protection.¹³⁸ He argues that director primacy satisfies this objective by ensuring that corporate governance abides by the shareholder wealth maximization norm.¹³⁹ He warns that shareholder primacy urges policy-makers to grant shareholders additional powers to exercise direct control over the corporation, but this will prove to be detrimental to the shareholder class as a whole.¹⁴⁰ This is because special interests (institutional investors), which have consolidated power within the shareholder class, will exploit these additional powers at the expense of weaker shareholders.¹⁴¹

Within the existing corporate governance order, Bainbridge suggests that shareholders are happy to be rationally apathetic because it is easier to exit than it is to fight.¹⁴² He contends that this is true even for institutional investors because of: 1)

¹³⁷ *Ibid* at 235.

¹³⁸ *Ibid* at 234-35.

¹³⁹ *Ibid* at 234.

¹⁴⁰ *Ibid* at 228-32.

¹⁴¹ *Ibid* at 228-30.

¹⁴² *Ibid* at 202.

the costs of monitoring corporate activities and engaging in activism; 2) the frequency of free riding on such efforts; and 3) the marginal gains that result from such activism.¹⁴³ Bainbridge asserts that the apathy of shareholders is normally a good thing because when institutional investors are motivated to interfere with corporate governance, they usually do so in order to champion their narrow interests which undermine shareholders' interests as a whole and hamper the ability of directors to make decisions in the best interest of the firm.¹⁴⁴

There are a number of existing vehicles for shareholder activism including: 1) exit; 2) proxy contests; 3) withholding votes in director elections; 4) shareholder proposals; and 5) private negotiations between institutional investors and corporate management. Bainbridge asserts that shareholder primacy advocates view these vehicles as inadequate and that they promote expansion of the shareholder franchise by: 1) reforming the director nomination process; 2) reforming the mechanics of the voting process; and 3) expanding the substance of what shareholders can vote upon.¹⁴⁵ Bainbridge flatly rejects that the expansion of shareholder voting rights would be prudent, reinforcing his main argument which calls for adherence to the status quo. Ultimately, he reminds his reader that one should not take lightly the dangers of interfering with board authority for the sake of greater accountability

¹⁴³ *Ibid* at 208.

¹⁴⁴ *Ibid* at 209.

¹⁴⁵ For more detail on these mechanisms of shareholder voice, see *ibid* at 209-22.

because “the preservation of managerial discretion should always be [the] default presumption.”¹⁴⁶

The biggest test for the canonization of director primacy is whether it is simply a semantic technique to maintain the defense of the professional bureaucracy that runs the corporation or whether the function of the board can be established as changing. If the behavior of “managers” (excluding directors) is what shareholder primacy advocates are up in arms about, and if directors are really the true champions of the whole of the shareholder class, then director primacy might be the “Third Way” of corporate governance. However, if the distinction between managerialism and director primacy cannot stand the test of the Devil’s Advocate, and directors cannot be established to be different than “managers,” this theory will fail to be convincing as a new path for corporate governance.

For this reason, the stakes are at their highest when Bainbridge makes the case for the distinction between directors and managers in the post-Enron function of the American board of directors. Although Bainbridge argues that director empowerment started much earlier than the enactment of SOX¹⁴⁷ and other amendments to the listing requirements of various American stock exchanges, his position is that these legal changes have finally tipped the scales as directors are now starting to enjoy

¹⁴⁶ *Ibid* at 235.

¹⁴⁷ *The Sarbanes-Oxley Act of 2002*, Pub L No 107-204, 116 Stat 745, (codified at 15 USC § 7201 et seq).

enough freedom from executive officers to be able to independently exercise authority over the corporation.¹⁴⁸

Bainbridge's narrative of the shift from managerialism to director primacy is persuasive to read. He discusses the director's evolving role from being the rubber stamps of CEOs to potentially having a legitimate monitoring function.¹⁴⁹ He explains how starting in the 1970s, the pressure mounted to improve what was seen at that time as the board's failure to rein in the excesses of executive officers and improve management's performance.¹⁵⁰ From this arose the recognition of the important role that independent directors could play within the corporate governance structure. He explains how post-Enron developments have bolstered a director's ability to police managers for shareholders by: 1) improving best-practice norms; 2) strengthening the threats to a director's reputation for turning a blind eye to managers running roughshod over shareholder interests; 3) increasing judicial pressure for better information flow from management to directors; and 4) increasing requirements for more independent directors on boards.¹⁵¹

¹⁴⁸ Bainbridge, *New Corporate Governance*, *supra* note 65 at 198-200.

¹⁴⁹ *Ibid* at 198-200.

¹⁵⁰ See e.g. Melvin A Eisenberg, *The Structure of the Corporation: A Legal Analysis* (Boston: Little, Brown, 1976) [Eisenberg, *Structure of the Corporation*].

¹⁵¹ Bainbridge, *New Corporate Governance*, *supra* note 65 at 176-87.

Bainbridge's argument is weaker when he fails to provide strong empirical evidence that these changes are creating "strong, active independent directors with little tolerance for negligence or culpable conduct."¹⁵² Again, there is little empirical evidence to support his claims that this functional shift is, in fact, occurring.¹⁵³ In the end, Bainbridge sounds like E Merrick Dodd, Jr who, in his reply to Adolf A Berle, Jr, merely employed optimism for the new generation of managers.¹⁵⁴ They are both very optimistic about the potential of a bureaucratic revolution, an event which would transform the ruling fiats of the great American corporations into group decision making centers and, thereby, helping manage the economy in a manner that is more beneficial to society.¹⁵⁵ Both arguments are inspiring, but also lack substance and amount to no more than corporate futurism.

In the end, even in his best argument for director primacy to date, Bainbridge makes quite a weak statement arguing that the "real world practice" of directors is still "supine," but is "closer to the director primacy model than it was in earlier

¹⁵² *Ibid* at 198.

¹⁵³ *Ibid*.

¹⁵⁴ E Merrick Dodd, Jr, "For Whom Are Corporate Mangers Trustees?" (1932) 45 Harv L Rev 1145 at 1146, 1148, 1151-53, 1165-67.

¹⁵⁵ *Ibid* at 1148.

periods.”¹⁵⁶ One must respect Bainbridge’s candor on this point, but it does lay bare the weakness of his argument.

VII. REFLECTIONS ON THE BATTLE FOR DELAWARE: FORM OR SUBSTANCE?

Strine was obviously opposed to more federal meddling within Delaware’s national corporate law regime and Bainbridge was clearly a defender of the Delaware status quo. But by encouraging greater federalization of corporate law, Bebchuk appeared willing to risk Delaware’s caucus and the American corporate law status quo in order to gain greater shareholder engagement. Although Bebchuk did not appear to want to open the Delaware arrangement to the flood of other interests that might follow the federal government into the internal affairs of the corporation, he was willing to risk it.

In “The Case for Increasing Shareholder Power,” Bebchuk used empirical evidence to establish that the power between directors and shareholders of larger American corporations with dispersed ownership was too unbalanced, as it blocked shareholders from maximizing shareholder value when management refused to cooperate.¹⁵⁷ Bebchuk argued that allowing shareholders to be directly involved in corporate decision making would enhance corporate governance by motivating management to be more cooperative because shareholders had the power to directly

¹⁵⁶ Bainbridge, *New Corporate Governance*, *supra* note 65 at 200.

¹⁵⁷ Bebchuk, “Increasing Shareholder Power”, *supra* note 65.

intervene. With respect to the reformation process, Bebchuk predictably stated that it should be through federal intervention.¹⁵⁸

Bebchuk's writing indicated that he did not want to open the floodgates beyond shareholders and managers to other interests that influenced the federal government.¹⁵⁹ If he did not want these populous interests to start meddling in the internal affairs of the corporation, what was he doing? Doubtless, he was familiar with Roe's position on the matter, so maybe he: 1) did not believe that his petition for federal involvement seriously threatened the Delaware caucus; 2) did not care if the Delaware caucus was threatened (if managers monopolized it); or 3) maybe he was using the Cary card as leverage to up the stakes and, perhaps, make Delaware concede without federal intervention. Regardless, the Cary card caused different reactions which were interesting to observe. In response to Bebchuk's proposal, Strine suggested that the traditionalist investor would prefer the status quo to what Bebchuk proposed.¹⁶⁰ This was because the traditionalist investor would fear that Bebchuk's proposal might subvert their interests by compromising managerial authority.¹⁶¹ If managerial authority was undermined, institutional intermediaries with no interests to serve but their own would further compromise the corporate

¹⁵⁸ *Ibid* at 874.

¹⁵⁹ See e.g. *ibid*.

¹⁶⁰ Strine, "True Corporate Republic", *supra* note 65 at 1775.

¹⁶¹ *Ibid*.

governance structure. Strine suggested that the traditionalist investor would thus “leave things where they [stood] even if the status quo [was] not ideal.”¹⁶² But Strine still entertained Bebchuk’s proposal (with some slight reframing) in order to be “open-minded” to the idea that the traditionalist investor “might embrace reform that [was] consistent with Bebchuk’s call for greater managerial accountability.”¹⁶³ Strine bit Bebchuk’s bait, but why? The answer came when Strine asserted: “Therefore, if reform attractive to the traditionalist is to come, it must emanate from state policymakers who can implement a reform that coheres with an overall approach to corporate law.”¹⁶⁴ Strine longwindedly made this argument, but he reinforced his key point: whatever amendments needed to be made, Delaware and not the federal government needed to make them.¹⁶⁵

Strine offered hope to Bebchuk that there might be flexibility on the issue of shareholder empowerment but Delaware needed to be the innovator, not the federal government, because state competition must be preserved. It made sense that, if the choice was between Delaware (form) and the status quo (substance), Strine would advocate sacrificing some substance and managerial power and protect Delaware’s de facto preeminence. If this situation was to arise it would be ideal for Bebchuk because

¹⁶² *Ibid.*

¹⁶³ *Ibid.*

¹⁶⁴ *Ibid* at 1777.

¹⁶⁵ *Ibid* at 1780.

it would maintain Delaware's influence while increasing shareholder influence within the political caucus.

As one might expect, Bainbridge opposed Bebchuk's proposal by employing the race-to-the-top argument.¹⁶⁶ He argued that existing corporate law was optimal because it survived the competitive forces of the charter market.¹⁶⁷ He then made his director primacy argument defending why this model was the appropriate model to protect shareholder interests.¹⁶⁸ He concluded that, since director primacy was the superior model and since Delaware's default rules already enshrined director primacy, no reform was necessary.¹⁶⁹ The bottom line was that Bainbridge rejected any changes to the form or the substance of Delaware's law and lawmaking capacity.

In sum, within the battle over corporate governance, there appears to be an impasse which allows managers to have the luxury of a heavy hand in shaping its evolution. Bebchuk, champion of the shareholder and, to a lesser degree, of Cary, is unhappy with this state of affairs and is petitioning federal intervention to shake things up. Strine, champion of Winter and, to a lesser degree, managerialism, is happy with Delaware's position as the manufacturer of "national" corporate law but appears willing to negotiate with Bebchuk's position. And Bainbridge is the warrior of the

¹⁶⁶ Bainbridge, "Shareholder Disempowerment", *supra* note 106 at 1737-42.

¹⁶⁷ *Ibid.*

¹⁶⁸ *Ibid.*

¹⁶⁹ *Ibid.*

Delaware status quo and is deeply entrenched in his position. Or is he? For, although he initially attacked creeping federalism, he now uses the provision of SOX and the amendments to listing requirements to support his director primacy argument.¹⁷⁰ This might suggest that his race-to-the-top argument gives way at times to pragmatism, as does Strine's defense of the Delaware status quo.

VIII. CONCLUSION

The power to influence the development of the corporate charter within the Delaware caucus is the power to potentially influence Granovetter's actual and ongoing social networks inside and outside of the corporation and, hence, underscore its embeddedness. The above narrative highlights the levels of contention between managers and shareholders for control over future reforms. To date, managers have dominated the caucus, marginalizing efforts by shareholder advocates who want other shareholders to have greater direct participation within America's corporate governance structures. Historically, the Delaware caucus has weathered tremendous economic transformations, remaining relatively unchanged when compared to the reforms Britain and Australia took over the last twenty-five years.¹⁷¹ Delaware has been less prone to amendment partly because its corporate law regime is regarded to

¹⁷⁰ Bainbridge, *New Corporate Governance*, *supra* note 65 at 176-87.

¹⁷¹ For more on this, see Jennifer G Hill, "Regulatory Show and Tell: Lessons From International Statutory Regimes" (2008) 33 *Del J Corp L* 819 at 823.

be the result of an innovative and inspirational regulatory lab that harnesses the power of state competition.¹⁷²

With a view to the still-open questions regarding state competition, Bebchuk petitioned for more federal intervention, challenging whether the market for charters inspires the optimal lawmaking which is claimed to exist. He called for greater power-sharing between the federal and state governments in this process, hoping this would crack open the Delaware caucus and result in more direct shareholder influence over corporate decision making. In response to Bebchuk, Vice Chancellor Strine argued that greater power-sharing with the federal government would be a mistake because Delaware's regulatory machinery was not influenced by managers to a degree that would prevent greater shareholder participation within corporate governance (if such reforms were what shareholders really wanted and what American corporate governance really needed). Meanwhile, this dialogue between two highly regarded and influential discourse participants – the Vice Chancellor of Delaware's Court of Chancery and America's top legal academic advocate of shareholder empowerment – has been unsettling to the avid champions of Delaware's present status quo.

Confidence in Delaware, like that heralded by Professor Bainbridge, has made some American corporate observers less likely to look beyond national borders for

¹⁷² *Ibid* at 821-29.

inspiration in corporate reforms and also less likely to assume that such reforms are necessary.¹⁷³ In this way, the charter competition argument has been very successful at maintaining a status quo in which corporate managers have greater control over corporate governance policy than similar managers have in either Britain or Australia – countries that have both seen an increase in the participatory rights of shareholders.¹⁷⁴ However, American corporate governance can be said to be in transition as there has clearly been a shift of power away from the Delaware caucus in response to its “modest and incremental” approach to reform.¹⁷⁵ Starting with the post-scandal regulatory responses (such as SOX), the federal government has been more willing to interfere with the presumed preeminence of the charter market.¹⁷⁶ This may prove to be the harbinger of the demise of the monopoly which Delaware has enjoyed for the past century,¹⁷⁷ providing new opportunities to increase the participatory rights of shareholders.

Today, corporate managers are under attack for having failed to provide for adequate monitoring and oversight of their firms’ investments before the credit crisis. The situation has called into question the balance between managerial authority and

¹⁷³ *Ibid* at 819-20.

¹⁷⁴ *Ibid* at 826.

¹⁷⁵ *Ibid* at 823.

¹⁷⁶ *Ibid* at 824-25.

¹⁷⁷ *Ibid* at 841.

managerial accountability. Eyes are on the capacity of state-level legal mechanisms (in particular Delaware) to deal with these corporate governance failures.¹⁷⁸ Meanwhile, federal reforms (such as “say on pay” and other shareholder empowerment initiatives) have either been established,¹⁷⁹ or are in the works.¹⁸⁰ Such federal interventions demonstrate a continued willingness to intercede in corporate regulatory development at the state level.

It is difficult to foretell the long-term impact of such federal interventions in the area of corporate governance. If this attitude prevailed, the federal government would likely face increased pressures from a number of interest groups – not just shareholder groups – pushing for further corporate governance reform. But is this a Pandora’s Box in the making? Alternatively, Delaware may want to answer to the sort of pressures that prompted the federal government’s activity in the first place. It seems that, either way, more shareholder participation rights in American corporate governance is a likely outcome.

The likelihood of such an outcome brings this argument full circle. As noted in the beginning, the British corporate governance expert Simon Deakin observed

¹⁷⁸ Anne Tucker Nees, “Who’s The Boss? Unmasking Oversight Liability Within The Corporate Power Puzzle” (2010) 35 Del J Corp L 199.

¹⁷⁹ “Rewarding American Bosses: Nay on Pay”, *The Economist* 395:8682 (15 May 2010) 70.

¹⁸⁰ “The Rewards of Virtue”, *The Economist* (26 April 2010) online: <<http://www.economist.com/node/15993202>>.

how Polanyi's double movement had in recent times been off-set to favor market interests to the detriment of society, driven predominantly by the power exercised by investors in this era of financialization. Now, with the regulatory responses against the crisis still forthcoming, one of the questions arising out of the foregoing is whether increases in shareholder participatory rights are likely to further increase the movement toward the financialization of the firm in the American context? While only a few years ago we would have found it hard to see how it would not, the current crisis and the emerging regulatory responses might suggest otherwise.¹⁸¹ This uncertainty hints at the political stakes in the Delaware debate and beyond.

Of course, the issue is more complex. Greater shareholder participation may not be a bad thing. As Berle argued in response to Dodd in the classical American debate over managerialism, although shareholder empowerment may not be an adequate solution to managerial opportunism, enforcement of property rights is the only legal tool available to safeguard against it.¹⁸² But how much has changed almost eighty years later? In 1932, Berle was hopeful that new theories in sociology would

¹⁸¹ Julia Black & Robert Baldwin, "Really Responsive Risk-Based Regulation" (2010) 32 *Law & Pol'y* 181.

¹⁸² See AA Berle, Jr, "For Whom Corporate Managers are Trustees: A Note" (1932) 45 *Harv L Rev* 1365.

soon provide the support for legal innovations which would better regulate corporate governance¹⁸³ . . . the law is still waiting.

¹⁸³ Adolf A Berle, Jr & Gardiner C Means, *The Modern Corporation and Private Property*, 2d ed (New York: Harcourt, Brace & World, 1968) 219-20.

CHAPTER 5: THE CORPORATION, NEW GOVERNANCE, AND THE POWER OF NARRATIVE

I. INTRODUCTION

In *Regulatory Capitalism: How it Works, Ideas for Making it Work Better*, John Braithwaite wrote an eye-catching phrase: regulatory capitalism represents the “reality of hybridity between the privatization of the public and publicization of the private.”¹ The privatization of the public had been well documented,² but the idea of publicization of the private appeared to hold new promise.³ I had spotted this new optimism of Braithwaite earlier in a 2006 working paper, when he admitted that he had been concerned about the “neoliberal” shift toward privatization,⁴ even though, for some time, he had been endorsing the self-governance of private actors.⁵ But now

¹ John Braithwaite, *Regulatory Capitalism: How it Works, Ideas for Making it Work Better* (Cheltenham, UK: Edward Elgar,) at 8 [Braithwaite, *Regulatory Capitalism*].

² See e.g. Daniel Yergin & Joseph Stanislaw, *The Commanding Heights: The Battle for the World Economy*, revised ed (New York: Simon & Schuster, 2002).

³ For the origins of the concept, see Jody Freeman, “Extending Public Law Norms Through Privatization” (2003) 116 Harv L Rev 1285 at 1285 [Freeman, “Extending Public Law”].

⁴ See generally John Braithwaite, “Neoliberalism or Regulatory Capitalism” (RegNet Occasional Paper No 5, 2005) online: <https://www.anu.edu.au/fellows/jbraithwaite/_documents/Articles/Neoliberalism_Regulatory_2005.pdf> [Braithwaite, “Neoliberalism”].

⁵ See Ian Ayres & John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (New York, Oxford University Press, 1992).

(as of 2006), he was convinced that his fears over “neoliberalism” were excessive and that it was merely a stage of “regulatory capitalism.”⁶

In April of this year, Braithwaite released a new working paper that further extrapolates upon publicization, explaining that it means “the percolation of public law values into private law and into corporate self-regulation, [including] the most critical public law values such as transparency, accountability, stakeholder voice and separations of powers.”⁷ Jody Freeman, the originator of this idea, described publicization as a process by which “private actors increasingly commit themselves to traditionally public goals as the price of access to lucrative opportunities...that might otherwise be provided directly by the state.”⁸

For the past decade since Freeman hypothesized that this publicization would occur, the evidence of this transformation has not been convincing.⁹ For better or worse, business actors do not appear to be any more or less imbued with the spirit of public service than in the past, leaving questions as to whether or not endorsing recent regulatory experimentation has not been at the expense of the long-term integrity of governance. Both the collapse of Enron and the Credit Crisis have been, in large part,

⁶ Braithwaite, *Regulatory Capitalism*, *supra* note 4 at 8, 18.

⁷ John Braithwaite, “Strategic Socialism, Strategic Privatization and Crises” (2013) [unpublished, archived at <http://ssrn.com/abstract=2249544>] at 4 [Braithwaite, “Strategic Socialism”].

⁸ Freeman, “Extending Public Law”, *supra* note 3 at 1285.

⁹ See e.g. Braithwaite, “Strategic Socialism”, *supra* note 7 at 5.

attributable to the regulatory failures caused by the decisions of for-profit “gatekeepers,”¹⁰ such as Arthur Anderson¹¹ and Standard & Poor's,¹² who were enjoying the sort of lucrative opportunities that Freeman had envisioned, but who failed to adequately *publicize*.

In light of the continued interest in the idea of publicization, this chapter offers some considerations that might be taken into account when attempting to

¹⁰ John C Coffee, Jr, *Gatekeepers: The Professions and Corporate Governance* (Oxford: Oxford University Press, 2006) at 1-6 [Coffee, Gatekeepers].

¹¹ See e.g. Kristen Hays, “Enron at Eye Level: A Reporter’s View of the Trials” in Nancy B Rapoport, Jeffrey D Van Niel & Bala G Dharan, eds, *Enron and Other Corporate Fiascos: The Corporate Scandal Reader*, 2d ed (New York: Foundation Press, 2009); Theodore Eisenberg & Jonathan R Macey, “Was Arthur Andersen Different? An Empirical Examination of Major Accounting Firm Audits of Large Clients” (2004) 1 J Empirical Legal Stud 263 (concluding that after controlling for client size, region, time, and industry, there was no evidence that Andersen’s performance significantly differed from other large accounting firms).

¹² For how investment banks exploit new governance regulations in order to more than double the maximum leverage (15:1) allowable under regulatory requirements, see John C Coffee, Jr, “What Went Wrong? An Initial Inquiry into the Causes of the 2008 Financial Crisis” (2009) 9 J Corp L Stud 1 at 10-13 [Coffee, “What Went Wrong?”]. Frank Partnoy argues that credit rating agencies have “little incentive to ‘get it right,’” which “pose[s] a systemic risk.” Frank Partnoy, “Rethinking Regulation of Credit Rating Agencies: An Institutional Investor Perspective” (Legal Studies Research Paper Series, Research Paper No. 09-014, 2009) at 3, online: <<http://ssrn.com/abstract=1430608>>. Timothy Sinclair identifies that the issue is conventionally conceived as that the way that credit rating agencies are remunerated generates a conflict of interest. He suggests that this conflict of interest is overblown and that focus should be upon the challenges rating agencies (and similar gatekeepers) face, more generally, in a market system. Timothy J Sinclair, “Credit Rating Agencies and the Global Financial Crisis” (2010) 12 Econ Soc 4 at 4.

evaluate its potential. To do so, this chapter in part takes a second look at the literatures supporting “new governance” initiatives.

New governance is an umbrella term for theories of governance that encourage regulatory architects to marry the best of both the public and private orderings.¹³ It celebrates a “blurring” of public and private functions within areas of regulation.¹⁴

The publicization dimension of new governance rhetoric invokes an out of focus image of the democratic delegation of power to for-profit agents, who, it is assumed, will exercise this power in a benevolent and competent manner. For many regulatory scholars, with market failure to their left and regulatory failure to their right, publicization of the private represents a best-case metaphor in which governance enjoys the optimal balance between the functional efficiencies of decentered actors,¹⁵ and the integrity of idealized public servants. But again, the

¹³ See generally David Trubek & Louise Trubek, “The World Turned Upside Down: Reflections on New Governance and the Transformation of Law” (2010) 2010 Wis L Rev 719; William H Simon, “New Governance Anxieties: A Deweyan Response” (2010) 2010 Wis L Rev 727; Lisa T Alexander, “Reflections on Success and Failure in New Governance and the Role of the Lawyer” (2010) 2010 Wis L Rev 738.

¹⁴ See generally Jason M Solomon, “New Governance, Preemptive Self-Regulation, and the Blurring of Boundaries in Regulatory Theory and Practice” (2010) 2010 Wis L Rev 591.

¹⁵ See e.g. Julia Black, “Critical Reflections on Regulation” (2002) 27 Austl J Leg Phil 1 [Black, “Critical Reflections”]; see also Friedrich A Hayek, “The Use of Knowledge in Society” (1945) 35 Am Econ Rev 519 [Hayek, “Use of Knowledge”].

vision of publicization is out of focus, lacking detail, and this may be a serious problem if it is creating a false promise of a Panacea for the social ills attributed to privatization—such as the “democratic deficit” it creates.¹⁶

This chapter invites other scholars to reconsider whether or not such blurring of public and private functions is to be encouraged. It will be argued that the publicization of for-profit activities is a goal that is unlikely to be achieved. As a result, this chapter suggests that the best-case scenario for new governance may be merely the privatization of the public—without the publicization of the private. And if this is the case, then new governance, and its call for a further blurring of public and private functions, may merit a critical re-evaluation.

Part II of this chapter provides an introduction to some of the literatures that inform new governance. Part III explores the normative strength of corporate governance to resist publicization. Part IV looks at the challenges that technocratic narratives pose to publicization within both public and private governance. Part V concludes by suggesting that, based on the arguments presented, for-profit actors will not publicize as the literature suggests. This conclusion invites further discussion as

¹⁶ Alfred C Aman, Jr, “Law, Markets and Democracy: A Role for Law in the Neo-Liberal State” (2007) 51 NYL Sch L Rev 801 at 810-11 [Aman, “Law, Markets and Democracy”]. Of course, the concerns over the “democratic deficit” exist beyond privatization issues and are considered by those who are concerned about the entire project of new governance. See e.g. Victor Bekkers et al, eds, *Governance and the Democratic Deficit: Assessing the Democratic Legitimacy of Governance Practices*, (Burlington, Vt: Ashgate Publishing, 2007) at 307-11.

to the possibility of a more directed process that engineers a reconstitution of the public and private in light of the challenges facing modern governance, rather than just leaving it to the fortunes of market-driven “spontaneous evolution.”

II. THE FOUNDATION FOR NEW GOVERNANCE

It is yet to be determined how new governance will play out.¹⁷ Thus, its merits are difficult to assess. The literature—if it is a single literature—is fragmented: collaborative,¹⁸ incentive-based,¹⁹ reflexive,²⁰ responsive,²¹ and decentered²² notions

¹⁷ For reflection upon the present transformation, see Lisa Blomgren Bingham, “The Next Generation of Administrative Law: Building the Legal Infrastructure for Collaborative Governance” (2010) 2010 Wis L Rev 297; Mark Dawson, “Transforming into What? New Governance in the EU and the ‘Managerial Sensibility’ in Modern Law” (2010) 2010 Wis L Rev 389; Poul F Kjaer, “The Metamorphosis of the Functional Synthesis: A Continental European Perspective on Governance, Law, and the Political in the Transnational Space” (2010) 2010 Wis L Rev 489; Trubek & Trubek, *supra* note 100.

¹⁸ See e.g. Jody Freeman, “Collaborative Governance in the Administrative State” (1997) 45 UCLA L Rev 1 [Freeman, “Collaborative Governance”]; Philip J Harter, “Collaboration: The Future of Governance” (2009) 2009 J Disp Resol 411.

¹⁹ See e.g. Richard B Stewart, “A New Generation of Environmental Regulation?” (2001) 29 Cap U L Rev 21 at 94-127; Daniel H Cole & Peter Z Grossman, “When is Command-and-Control Efficient? Institutions, Technology, and The Comparative Efficiency of Alternative Regulatory Regimes in Environmental Protection” (1999) 1999 Wis L Rev 887 at 887-894, 935-938; Lily N Chinn, “Can the Market Be Fair and Efficient - An Environmental Justice Critique of Emissions Trading” (1999) 26 Ecology LQ 80 at 80-88, 102-125.

²⁰ See e.g. Peer Zumbansen, “Law After the Welfare State: Formalism, Functionalism, and the Ironic Turn of Reflexive Law” (2008) 56 Am J Comp L 769 [Zumbansen, “Law After the Welfare State”]; Ulrich Beck, Wolfgang Bonss & Christoph Lau, “The Theory of Reflexive Modernization: Problematic, Hypotheses

of governance are not necessarily mindful of each other and appear not to be moving toward a single cohesive position. Attempts to synthesize the new governance literature²³ have been charged with being “overzealous,”²⁴ because to do so invites a level of generalization, which threatens to ignore important differences between the literatures. In this way, new governance is like critical legal theory,²⁵ and legal realism for that matter,²⁶ in the sense that, although a number of authors can be

and Research Programme” (2003) 20 *Theory, Culture & Soc’y* 1; Ulrich Beck, *Risk Society: Towards a New Modernity* (London: Sage Publications, 1992).

²¹ See e.g. Ayres & Braithwaite, *supra* note 5; David Levi-Faur, “The Global Diffusion of Regulatory Capitalism” (2005) 598 *Annals Am Acad Pol & Soc Sci* 12 [Levi-Faur, “The Global Diffusion”]; Braithwaite, *Regulatory Capitalism*, *supra* note 1.

²² See e.g. Julia Black, “Decentering Regulation: Understanding the Role of Regulation and Self Regulation in a ‘Post-Regulatory’ World” (2001) 54 *Current Probs* 103 [Black, “Decentering Regulation”].

²³ See e.g. Orly Lobel, “The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought” (2004) 89 *Minn L Rev* 342 [Lobel, “The Renew Deal”].

²⁴ See Bradley C Karkkainen, “New Governance in Legal Thought and in the World: Some Splitting as Antidote to Overzealous Lumping” (2004) 89 *Minn L Rev* 471.

²⁵ For a discussion of the nature of the movement and its fragmentation, see generally Mark Tushnet, “Critical Legal Studies: An Introduction to Its Origins and Underpinnings” (1986) 36 *J Legal Educ* 505.

²⁶ Joseph Singer discusses the competition notion of legal realism and the idea that “we are all legal realists now.” Joseph William Singer, “Legal Realism Now” (1988) 76 *Cal L Rev* 465 at 467.

identified as being under the conceptual umbrella, the nature of the movement as a whole defies an all-inclusive definition.²⁷

That being said, it is safe to assert that new governance is the study of the ways in which governments release their authority to regulate, or to enforce regulation, within regulated spaces,²⁸ allowing non-government organizations to share in providing administrative functions traditionally associated with government.²⁹ New governance may be the replacement of the command-and-control model of the welfare state. If so, it may become the replacement of the welfare state as the ideological³⁰ binary pole to a pure free market,³¹ within the spectrum of “models of

²⁷ See e.g. *ibid.*; Tushnet, *supra* note 25.

²⁸ A prime example of this is regulatory capitalism. See generally Braithwaite, *Regulatory Capitalism*, *supra* note 1. Although this does not bring additional clarity to the distinction between the sphere of new commerce and the locus of new governance, it is significant to note the distinctions that Braithwaite makes between understandings of neoliberalism, privatization, and regulatory capitalism. See Braithwaite, “Neoliberalism”, *supra* note 4.

²⁹ See Colin Scott, “Private Regulation of the Public Sector: A Neglected Facet of Contemporary Governance” (2002) 29 *JL & Soc’y* 56 at 57-60 [Scott, “Private Regulation”].

³⁰ Cukierman emphasizes the importance of ideology, among other forms of rationality, for its influence on economic policies, and thus the impact that ideology, for better or worse, has on macroeconomic developments. Alex Cukierman, “The Roles of Ideology, Institutions, Politics, and Economic Knowledge in Forecasting Macroeconomic Developments: Lessons from the Crisis” (2010) 56 *CESifo Econ Stud* 575 at 575-79. Thus, to reject ideology, when your opponents use it effectively as a tool for policy, is a disadvantage, pragmatically speaking, if the end goal is to influence policy development.

capitalism.”³² Accordingly, new governance may become the newest champion of “embedded liberalism.”³³

Most new governance literature today appears to be hopeful of the “reassertion of the public interest” within governance.³⁴ Instead of framing the issue just³⁵ within the context of the “turn to the market,”³⁶ the “withdrawal of the welfare

³¹ See Yergin & Stanislaw, *supra* note 2; Canadian Broadcasting Corporation. “Markets and Society: The Life and Thought of Karl Polanyi, Part 5: The Legacy” (webcast) (Posted 8 August 2006, 9:53 pm) (interviewing Fred Block), online: Canadian Broadcasting Corporation <<http://www.insidethecbc.com/ideas-series-markets-and-society-available-for-download/>>.

³² See generally Colin Crouch, “Models of Capitalism” (2005) 10 *New Pol Econ* 439; see also Richard Deeg & Gregory Jackson, “Towards a More Dynamic Theory of Capitalist Variety” (2007) 5 *Socio-Econ Rev* 149.

³³ Ruggie coined this term. John Gerard Ruggie, “International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order” (1982) 36 *Int’l Org* 379 at 392. However, Ruggie was inspired to coin the term because of Karl Polanyi work on “embedded” and disembedded” economic orders. See Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, 2d ed (Boston: Beacon Press, 2001) at 79.

³⁴ See generally David Levi-Faur, “Regulatory Capitalism and the Reassertion of the Public Interest” (2009) 27 *Pol’y & Soc’y* 181 [Levi-Faur, “Reassertion of the Public Interest”].

³⁵ Of course, this is not to take away from these debates because they are important. It is only to say that different debates ought to also continue to emerge. Furthermore, the distinction drawn here is a precarious one in the sense that many of the authors of the privatization literature will also have voice in these other literature. Thus, although Braithwaite, in particular, is drawing a similar distinction when he distinguishes between neoliberalism and regulatory capitalism, see Braithwaite, “Neoliberalism”, *supra* note 4, such distinctions are not embraced by many and are to some degree artificial. However, it has been drawn presently in order to see what follows.

state,³⁷ or the “welfare state retrenchment,”³⁸ new governance provides a place to imagine the “reconstituting,”³⁹ “restructuring,”⁴⁰ “reasserting,”⁴¹ or the “rise”⁴² of the public dimension of governance function. This appears to be the essential promise of new governance: to provide an alternative, which is not antibusiness,⁴³ yet still attempts to balance the demands of markets with the interests of society in a way that generates sustainable and balanced policy options, and a governance mechanism that stabilizes wealth creation, protects human dignity, and ensures a habitable natural

³⁶ Bob Jessop, “Governance Failure” in Gerry Stoker, ed, *The New Politics of British Local Governance* (New York: St. Martin’s Press, 2000) at 11.

³⁷ Vito Tanzi, *Government Versus Markets: The Changing Economic Role of the State* (New York: Cambridge University Press, 2011) at 273.

³⁸ See e.g. Judith Treas, “Can Families Compensate for Welfare State Retrenchment?” (2012) 41 *Contemp Soc* 33; Nathalie Giger & Miora Nelson, “The Electoral Consequences of Welfare State Retrenchment: Blame Avoidance or Credit Claiming in the Era of Permanent Austerity?” (2011) 50 *Eur J Pol Res* 1.

³⁹ See e.g. Suzanne Mettler, “Reconstituting the Submerged State: The Challenges of Social Policy Reform in the Obama Era” (2010) 8 *Persp Pol* 803; Braithwaite, *Regulatory Capitalism*, *supra* note 1; David Levi-Faur & Jacint Jordana, “The Rise of Regulatory Capitalism: The Global Diffusion of a New Order” (2005) 598 *Annals Am Acad Pol & Soc Sci* 200; Black, “Decentring Regulation”, *supra* note 22.

⁴⁰ Lobel, “The Renew Deal”, *supra* note 23.

⁴¹ Levi-Faur, “Reassertion of the Public Interest”, *supra* note 103.

⁴² Colin Scott, “Regulation in the Age of Governance: The Rise of the Post-Regulatory State” in Jacint Jordana & David Levi-Faur, eds, *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (Cheltenham, UK: Edward Elgar, 2005) 145 at 148-49 [Scott, “Age of Governance”].

⁴³ Braithwaite, *Regulatory Capitalism*, *supra* note 1 at vii-x.

environment for future generations. As a result, new governance's boundaries, like those of corporate governance, are assumed to be "blurred and porous,"⁴⁴ and in a state of disequilibrium,⁴⁵ which allows for a high level of pragmatic "experimentalism"⁴⁶ within new governance's learning processes.⁴⁷ Again, all of this points to the hopefulness of publicization—hopefulness this chapter wishes to temper.

Below, a number of literatures on governance are introduced, which help to construct a greater appreciation of some of the thoughts that have influenced the form new governance appears to be taking.

⁴⁴ John R Boatright, "The Implications of the New Governance for Corporate Governance" in Ingo Pies & Peter Koslowski, eds, *Corporate Citizenship and New Governance: The Political Role of Corporations* (New York: Springer, 2011) 133 at 141. Ball and Junemann discusses how governance, by its nature, deconstructs or transcends organizational boundaries and not these networks are changes alluding to the understanding of regulated spaces that a governmentality approach might offer, creating "overlap and confusion." Stephen J Ball & Carolina Junemann, *Networks, New Governance and Education* (Bristol, UK: Policy Press, 2012) at 1-7; see also Simon, *supra* note 100.

⁴⁵ Dewey believed that learning occurred by facing an experience of disequilibrium and then finding a "more extensive balance," arguing "equilibrium comes...out of, and because of, tension." In this sense, life and learning to Dewey was a constant cycle of equilibrium and disequilibrium. John Dewey, *Art as Experience* (New York: Capricorn Books, 1934) at 14 [Dewey, Art as Experience].

⁴⁶ For more on the issues related to new governance and experimentalism, see generally Grainne de Burca, "New Governance and Experimentalism: An Introduction" (2010) 2010 Wis L Rev 227.

⁴⁷ See Solomon, *supra* note 101 at 593-97. In the European context, democratic experimentalism is occurring within the European Union in relation to the coordination of top-down, as well as bottom-up, learning processes. See generally Erika Szyszczak, "Experimental Governance: The Open Method of Coordination" (2006) 12 Eur LJ 486.

A. Deregulation

The deregulation literature portrays governments as removing regulations from areas of society, allowing markets to operate “freely.”⁴⁸ This notion of deregulation, although still persistent in the imagination of some, has been largely debunked.⁴⁹ Not only has the administrative state grown in its size (and expense),⁵⁰ but there has also been a vast geographical expansion of regulations in previously unregulated, or less regulated, spaces.⁵¹ Thus, the term “deregulation,” which framed

⁴⁸ For more on this idea and the regulation literature, see, for example, Milton Friedman, *Capitalism and Freedom* (Chicago: Chicago University Press, 1962); see also Paul L Joskow, *Deregulation: Where Do We Go from Here* (Washington, DC: AEI Press, 2009); Daniel Immergluck, *Foreclosed: High-Risk Lending, Deregulation, and the Undermining of America’s Mortgage Market* (Ithaca, NY: Cornell University Press, 2009); Yergin & Stanislaw, *supra* note 2; Paul S Dempsey & Andrew R Goetz, *Airline Deregulation and Laissez-Faire Mythology* (Westport, Conn: Quorum Books, 1992); Martha Derthick & Paul J Quirk, *The Politics of Deregulation* (Washington, DC: Brookings Institution, 1985). Additionally, consider the quote of Mark Weisbrot, an economist at the progressive Center for Economic and Policy Research: “[Friedman] had an enormous impact on the shape of most economies in the world in the last 25 to 35 years...If you go back to his book *Capitalism and Freedom*, it wasn’t even reviewed by major reviewers like [the] *New York Times*. By the end of Reagan’s last term, most of his policies were implemented...Friedman fought a counterrevolution in the 1950s against Keynesianism...” “Nobel Economist Milton Friedman Dead at 94”, *CNN Money* (16 November 2006) online” <<http://money.cnn.com/2006/11/16/news/newsmakers/friedman/>>.

⁴⁹ See Ayres & Braithwaite, *supra* note 5 at 7-12; Levi-Faur, “The Global Diffusion”, *supra* note 21 at 13-14; Braithwaite, *Regulatory Capitalism*, *supra* note 1 at 4-12.

⁵⁰ See Braithwaite, “Neoliberalism”, *supra* note 4 at 8, 18.

⁵¹ See Levi-Faur, “The Global Diffusion”, *supra* note 21 at 12-13.

much of the conversation about the shift from the welfare state for so long,⁵² has been inaccurate as a description of the evolution of government and governance.⁵³ So the literature is worth mentioning, but not worth much more.

B. Privatization

The privatization literature⁵⁴ describes the “withdrawal of the state” as a provider of public services, and in particular, various forms of social insurance.⁵⁵ The narrative of privatization is more dramatic and self-apparent in countries such as the United Kingdom (which, during the “Golden Age,” had a more robust welfare state than the United States),⁵⁶ but it still strongly shapes how many understand this regulatory shift in America.⁵⁷

⁵² See generally Ayres & Braithwaite, *supra* note 5.

⁵³ See Braithwaite, “Neoliberalism”, *supra* note 4 at 8-12.

⁵⁴ See generally Yergin & Stanislaw, *supra* note 2; Maxim Boycko, Andrei Shleifer & Robert W Vislny, “A Theory of Privatisation” (1996) 106 *Econ J* 309; Thomas Clarke & Christos Pitelis, eds, *The Political Economy of Privatisation* (New York: Routledge, 1995); Kate Ascher, *The Politics of Privatisation: Contracting Out Public Services* (Basingstoke, UK: MacMillan Education, 1987); Friedman, *supra* note 48.

⁵⁵ Scott, “Age of Governance”, *supra* note 42 at 148-49.

⁵⁶ *Ibid.*

⁵⁷ Paul R Verkuil, *Outsourcing Sovereignty: Why Privatization of Government Functions Threatens Democracy and What We Can Do About It* (New York: Cambridge University Press, 2007) at 2-8.

Privatization generally refers to the outsourcing of government services⁵⁸—“essential services”⁵⁹—that were provided traditionally under welfare state programs to for-profit or nonprofit organizations.⁶⁰

The rationale for privatization is, in essence, that it improves the efficiency of social services provided by allowing private, usually for-profit, organizations to manage them.⁶¹ By delegating responsibility, governments achieve more at a

⁵⁸ For more on privatization in this sense, see Dru Stevenson, “Privatization of Welfare Services: Delegation by Commercial Contract” (2003) 45 *Ariz L Rev* 83 at 83-85; Damian Grimshaw, Steve Vincent & Hugh Willmott, “Going Privately: Partnership and Outsourcing in UK Public Services” (2002) 80 *Pub Admin* 475 at 475-76; see also Andrew Kakabadse & Nada Kakabadse, “Outsourcing in the Public Services: A Comparative Analysis of Practice, Capability and Impact” (2001) 21 *Pub Admin & Dev* 401.

⁵⁹ For the challenge of how to govern privatized essential services, see generally Greg Palast, Jerrold Oppenheim & Theo MacGregor, *Democracy and Regulation: How the Public can Govern Essential Services* (London: Pluto Press, 2003). These authors have a broader definition of essential services than the definition of essential services in which the right to strike is highly limited. See A Pankert, “Settlement of Labour Disputes in Essential Services” (1980) 119 *Int’l Lab Rev* 723.

⁶⁰ Stevenson, *supra* note 58 at 86-94; see also Aman, “Law, Markets and Democracy”, *supra* note 16. For a more in depth discussion of the appropriate role for nonprofits and for-profits in programs that are social services that have been outsourced by government, see generally Eric Werker & Faisal Z Ahmed, “What Do Nongovernmental Organizations Do?” (2008) 22 *J Econ Persp* 73; William P Ryan, “The New Landscape for Nonprofits” in Victor Futter, Judith A Cion & George W Overton, eds, *Nonprofit Governance and Management* (Chicago: American Bar Association, 2002) 13.

⁶¹ See William L Megginson & Jeffry M Netter, “From State to Market: A Survey of Empirical Studies on Privatization” (2001) 39 *J Econ Literature* 321; Catherine C Eckel, Doug W Eckel & Vijay Singal, “Privatization and Efficiency: Industry Effects of the Sale of British Airways” (1997) 43 *J Fin Econ* 275 at 297. However, this assertion is contested. See e.g. Shinichi Nishiyama & Kent Smetters, “Does Social

decreased expense to the public by allowing free market capitalism to shoulder much of the load.⁶² The main claim is that the consumers of these services receive better quality and variety of products, as well as potentially lower prices generated by the efficiency gains from market competition.⁶³ These efficiency gains increase the profitability of providing services and boost economic growth, ultimately leading to more financially stable economies.⁶⁴ Economic growth increases the tax base, and these gains made by governments are then passed down to taxpayers, reducing the overall tax burden.⁶⁵ Low taxes leave more money in the economy, further increasing economic growth.⁶⁶ In the end, taxpayers enjoy lower tax burdens, consumers enjoy

Security Privatization Produce Efficiency Gains?” (2007) 122 QJ Econ 1677; George Yarrow et al, “Privatization in Theory and Practice” (1986) 1 Econ Pol’y 323 (arguing the benefits of privatization can often be achieved through better means).

⁶² Yergin & Stanislaw, *supra* note 2 at 372-74.

⁶³ See e.g. *ibid* at 373-74; see also Eckel, Eckel, & Singal, *supra* note 61.

⁶⁴ For a more detailed understanding, see, for example, Yergin & Stanislaw, *supra* note 2 at 372-74. Additionally, consider the “Washington Consensus.” See John Williamson, “What Washington Means by Policy Reform” in John Williamson, ed, *Latin American Adjustment: How Much has Happened?* (Washington, DC: Institute for International Economics, 1989) 5.

⁶⁵ For a more detailed understanding of this in a modern context, as well as an analysis of whether such a policy truly works, see Hang Nguyen et al, *How Hard is it to Cut Tax Preferences to Pay for Lower Tax Rates?* (Urban Institute and Urban-Brookings Tax Policy Center, 2012) online: <<http://www.taxpolicycenter.org/UploadedPDF/412608-Base-Broadening-to-Offset-Lower-Rates.pdf>>.

⁶⁶ Generally, “[c]orporate taxes are most harmful for growth, followed by personal income taxes, and then consumption taxes.” Asa Johansson et al, “Taxation

better services, employees benefit from a better economy, and governments can channel resources with more focus upon a narrower range of functions.⁶⁷

Unfortunately, this theory has already proven to be too good to be true, and policies have modified privatization by applying it in a more incremental, experimental, and responsive manner⁶⁸ than the initial enthusiasm the “Washington Consensus” encouraged.⁶⁹ Still, skepticism remains.⁷⁰

C. Risk

During the time of the welfare state (approximately from the first Roosevelt Administration in 1933–1937 until between the Carter Administration in 1977–1981

and Economic Growth” (OECD Economics Department Working Papers, No. 620, 2008), online: <<http://dx.doi.org/10.1787/241216205486>>.

⁶⁷ For a more detailed understanding, see Yergin & Stanislaw, *supra* note 2.

⁶⁸ See generally John Bennett, Saul Estrin & Giovanni Urga, “Privatization Methods and Economic Growth in Transition Economies” (2007) 15 *Econ Transition* 661; *Economic Growth in the 1990s: Learning from a Decade of Reform* (Washington, DC: World Bank, 2005) at 165-95, online: <<http://www1.worldbank.org/prem/lessons1990s/>>.

⁶⁹ See Dani Rodrik, “Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank’s Economic Growth in the 1990s: Learning from a Decade of Reform” (2006) 44 *J Econ Literature* 973; see also Yergin & Stanislaw, *supra* note 2 at 237; Williamson, *supra* note 64 (of additional note are the comments to Williamson’s article included in the book).

⁷⁰ See Rodrik, *supra* note 69 at 986.

and the first Reagan Administration in 1981–1985),⁷¹ a prevailing assumption, at least in the earlier years, was that an effective regulatory architecture could be modeled upon command-and-control style regulation.⁷² It was predicted that government experts could employ science in order to determine what the law ought to be, while administrative and judicial technologies could enforce the regulatory architecture devised.⁷³ There were also assumptions made about the nature of natural hazards and manufactured risks and how they related to science and its technologies. However, these proved to be overly optimistic and simplistic,⁷⁴ and more problematic than anticipated.⁷⁵

Anthony Giddens suggests that it was the manufacturing of uninsurable risk by progress, and not the financial cost of the welfare state, which led to state retrenchment.⁷⁶ There was an inability to devise a way to use regulatory architecture

⁷¹ Salamon argues that “the Carter administration began in the latter 1970s to restrain the growth of government social welfare spending” in response to increased fiscal deficits. See Lester M Salamon, “The Marketization of Welfare: Changing Nonprofit and For-Profit Roles in the American Welfare State” (1993) 67 Soc Serv Rev 16 at 20-21.

⁷² See e.g. Adolf A Berle, Jr, “Government Function in a Stabilized National Economy” (1943) 33 Am Econ Rev 27.

⁷³ See e.g. *ibid.*

⁷⁴ See generally Beck, Bonss, & Lau, *supra* note 20; Beck, *supra* note 20.

⁷⁵ See generally Robert L Rabin, “Federal Regulation in Historical Perspective” (1986) 38 Stan L Rev 1189.

⁷⁶ Anthony Giddens, “Risk and Responsibility” (1999) 62 Mod L Rev 1 at 4-10.

to solve the problems created by progress.⁷⁷ Faced with this, governments were caught between a rock and a hard place: the social experiment of using the welfare state to mitigate the dangers of progress was unworkable, and the prospect of reverting to a pre-progress, pre-industrial society was similarly impractical. Thus the social contract, which obliged the state to mitigate the social and environmental risks caused by industrialization, was in breach.⁷⁸ The state could not meet these lofty commitments. As a result, the first project of “embedded liberalism”⁷⁹ was a failure, and the state retreated. From this perspective, the welfare state model proved unable to adequately identify risks, or adequately devise solutions that did not manufacture new risks and greater complexity.⁸⁰ This inability left “the path of progress”⁸¹ highly

⁷⁷ *Ibid.*

⁷⁸ See e.g. Beck, *supra* note 20.

⁷⁹ For more on the idea of “embedded liberalism,” see Andrew TF Lang, “Reconstructing Embedded Liberalism: John Gerard Ruggie and Constructivist Approaches to the Study of the International Trade Regime” in John Gerard Ruggie, ed, *Embedding Global Markets: An Enduring Challenge* (Burlington, Vt: Ashgate, 2008) 13; Jeffrey A Hart & Aseem Prakash, “The Decline of ‘Embedded Liberalism’ and the Rearticulation of the Keynesian Welfare State” (1997) 2 *New Pol Econ* 65; John Gerard Ruggie, *supra* note 33.

⁸⁰ Giddens, *supra* note 76 at 9-10.

⁸¹ For the phrase’s origin, see Michael J Trebilcock & Ronald J Daniel, *Rule Of Law Reform And Development: Charting the Fragile Path of Progress* (Cheltenham: Edward Elgar, 2008).

uncertain.⁸² It was this uncertainty, then which ultimately led to the demise of the welfare state.⁸³

With no way back and no way forward, the state retrenched, resulting in what Ulrich Beck, Giddens's colleague, calls "reflexive modernization."⁸⁴ Mitchell Dean uses the term "reflexive government" as an alternative term for "reflexive modernity."⁸⁵ Dean writes that reflexive government is "a folding back of the objectives...upon its means."⁸⁶ In other words, government legitimacy is now measured by the efficiency of how it provides services (means), not what services it provides (objectives), because, as Giddens explained, the calculus of determining what services ought to exist has been exposed as unworkable. In other words, governments are at a loss as to how to solve the challenges they face. As a result, they outsource responsibilities to the private sector and focus squarely upon improving the efficiency of the remaining regimes of practice within its purview of power in order to maintain legitimacy.⁸⁷ As long as governments do what they do within a

⁸² See Beck, Bonss, & Lau, *supra* note 20 at 10-13.

⁸³ See e.g. *ibid*; see also Giddens, *supra* note 76.

⁸⁴ Beck, *supra* note 20 at 10.

⁸⁵ Mitchell Dean, *Governmentality: Power and Rule in Modern Society*, 2d ed (London: Sage Publications, 2010).

⁸⁶ *Ibid* at 207.

⁸⁷ *Ibid* at 207-08.

legitimated measure of accountability (a calculus of risk management and economic efficiency),⁸⁸ the larger issues of whether such government initiatives promote the long-term sustainability of society can be shadowed by technocratic narratives.⁸⁹ Thus, governments limit their function, and fixate upon the efficiency of their internal control systems as a measure of performance.

Before ending this section it is important to at least reference Michael Power, who details how these technocratic narratives “have filtered into regulatory organizations [providing] a blueprint for the governance and accountability of the regulatory decision process.”⁹⁰ Power also agrees with the above-mentioned thinkers in this area that such patterns of reflexive government are leading to a new and potentially dangerous political economy.⁹¹

D. Decentered Regulation

The decentered literature covers a broad spectrum of ideology from the thought of neoclassical economist thinkers, such as Milton Friedman⁹² and Friedrich

⁸⁸ Michael Power, *Organized Uncertainty: Designing a World of Risk Management* (Oxford: Oxford University Press, 2007) at 2-7, 91 [Power, *Organized Uncertainty*].

⁸⁹ See Part IV *supra* for more on technocratic narratives.

⁹⁰ *Ibid* at 91.

⁹¹ *Ibid* at 91–92.

⁹² See generally Milton Friedman & Rose Friedman, *Free to Choose: A Personal Statement* (New York: Harcourt Brace Jovanovich, 1980).

Hayek,⁹³ to governance scholars with roots in responsive law, such as John Braithwaite⁹⁴ and David Levi-Fair,⁹⁵ to those with roots in systems theory and reflexive law, such as Julia Black⁹⁶ and Colin Scott.⁹⁷

Friedman and Hayek, in particular, have become synonymous with predicting the failures of the welfare state.⁹⁸ Historical narratives focused upon their work have explained that governments, with the United States and United Kingdom leading the way, privatized and deregulated their regulatory models.⁹⁹ Top-down, command-and-control regulatory techniques were abandoned, and “free markets” were unleashed.¹⁰⁰ “Free markets,” rhetoric aside, means regulators create more discretionary, process-based regulation of markets and society, which allows private actors, generally for-profit actors, to exercise more discretion within regulated spaces.¹⁰¹

⁹³ See generally Hayek, “Use of Knowledge”, *supra* note 99.

⁹⁴ Braithwaite, *Regulatory Capitalism*, *supra* note 1.

⁹⁵ Levi-Fair & Jordana, *supra* note 39.

⁹⁶ Black, “Decentring Regulation”, *supra* note 22.

⁹⁷ Scott, “Age of Governance”, *supra* note 42.

⁹⁸ See Yergin & Stanislaw, *supra* note 2 at 80-81, 126-27.

⁹⁹ *Ibid* at 96-103.

¹⁰⁰ See e.g. Milton Friedman, “Free Markets and Free Speech” (1987) 10 Harv J L & Pub Pol’y 1.

¹⁰¹ Yergin & Stanislaw, *supra* note 2 at 406-08.

One of the foundational claims of this neoclassical academic and political movement was that the “man on the spot” enjoyed the most intimate vantage point that helped him understand complex society.¹⁰² For this reason, it was assumed that, with the aid of the price mechanism, the “man on the spot” was in the best position to make decisions in regulated spaces.¹⁰³ For instance, Hayek would likely suggest that Goldman Sachs does not need a centralized public bureaucracy to operate within the global economy. Goldman Sachs is the “man on the spot,” having the most intimate knowledge of the ever-changing information it must balance in its decision-making processes. What about the knowledge Goldman Sachs lacks? Hayek would argue that no actor enjoys perfect knowledge, but the price mechanism adequately supplements these limits to be informed about other market actors.¹⁰⁴

The “man on the spot” is plugged into the knowledge of the facts on the ground. As such, groups of these actors are collectively, from various decentralized locations, in the best positions to exercise governance discretion, since each has an intimate knowledge of the small segment of the regulated space in which each operates.¹⁰⁵ Consequently, by exploiting the power of information exchange

¹⁰² Hayek, “Use of Knowledge”, *supra* note 99 at 524-25.

¹⁰³ *Ibid.*

¹⁰⁴ *Ibid.*

¹⁰⁵ Of course, this extends beyond what Hayek was suggesting, but imagine how this applies to Hayek’s knowledge theory. See Hayek, “Use of Knowledge”, *supra* note 99.

technologies (such as the price mechanism,¹⁰⁶ knowledge brokers, and auditing and reporting processes¹⁰⁷), regulators can create “knowledge networks,”¹⁰⁸ which provide decentered actors the additional information they need to coordinate activities, and accordingly govern society.

This sort of thinking emphasizes that an important dimension of an effectively regulated space is the willingness of the regulated to respect, follow, and actively participate (to the best of their ability) as partners in the regulatory process.¹⁰⁹ In fact,

¹⁰⁶ See *ibid* at 524.

¹⁰⁷ Knowledge brokers are people or organizations, who/which act as intermediaries between the different manufacturers of knowledge, providing linkages and resources. They are conduits for channeling information through a social network (like a regulated space). For more on knowledge brokers, see, for example, Gianmario Verona, Emanuela Prandelli & Mohanbir Sawhney, “Innovation and Virtual Environments: Towards Virtual Knowledge Brokers” (2006) 27 *Org Stud* 765; Andrew B Hargadon, “Brokering Knowledge: Linking Learning and Innovation” (2002) 24 *Res Org Behav* 41; Andrew B Hargadon, “Firms as Knowledge Brokers: Lessons in Pursuing Continuous Innovation” (1998) 40 *Cal Mgmt Rev* 209.

¹⁰⁸ The use of the term “knowledge network” is as an analogy to other literatures that use the term. For instance, some have explored the idea of a “knowledge network” for coordinating and management at the organization level. See generally William Swan et al, “Viewing the Corporate Community as a Knowledge Network” (2000) 5 *Corp Comm* 97; Andreas Seufert, Georg von Krogh & Andrea Bach, “Towards Knowledge Networking” (1999) 3 *J Knowledge Mgmt* 180. Others think of it in a most literal sense as a bank of knowledge, and yet, it still has coordinating and management application potential, but not so much in the classical regulatory sense. See generally Martin Doerr & Dolores Iorizzo, “The Dream of a Global Knowledge Network—A New Approach” (2008) 1 *J Computing & Cultural Heritage* 1; Sandy J Andelman et al, “Understanding Environmental Complexity through a Distributed Knowledge Network” (2004) 54 *BioScience* 240.

¹⁰⁹ See Braithwaite, *Regulatory Capitalism*, *supra* note 1 at 88-97.

such governance strategies are regarded as dependent upon the information that exchanges between regulators and the regulated in order to learn of and respond to complex regulatory challenges in a timely and effective manner¹¹⁰ or, more dramatically, simply to avoid regulatory failure.

Since such information exchanges between actors within a regulated space need to be effective, maintaining non-adversarial relationships is given a top priority in order to facilitate communication, coordination, and learning.¹¹¹ The problem is that this priority can hamper meaningful enforcement mechanisms in some cases, as the regulator becomes fearful that paternalistic punishment of the regulated may undermine their partnership, and thus may also compromise the information exchanges within the regulated space.¹¹² This places the regulator in a dilemma: if it wishes to have effective information exchanges so as to have the best possible knowledge about a regulated space, then it must not enforce such regulation with vigor, because it may alienate the regulated, upon whom it relies to inform it about changes in the regulated space.¹¹³ On the other hand, if a regulator does not enforce its regulations, or has regulations without “real teeth,” then the regulated may not take

¹¹⁰ See *ibid* at 65, 70, 79.

¹¹¹ See *ibid* at 88-97.

¹¹² See *ibid*.

¹¹³ See *ibid*.

the “law” of the regulated space seriously,¹¹⁴ creating new informal norms, which can actually dictate how the regulated space functions and can thus compromise the regulator’s intentions.¹¹⁵

From this perspective, governance is a channeling of discretionary authority from government agencies to more hybrid and decentered public–private governance processes,¹¹⁶ in the hope of establishing social relationships with “the man on the spot.”¹¹⁷ This channeling is deemed necessary to exploit decentered decision-making,¹¹⁸ by using information exchange technologies. This results in the replacement of substance-based, state-imposed regulation with process-based, public–private co-regulation and co-governance.¹¹⁹

Governments restrict their function to devising strategic plans for regulated spaces (called steering), leaving a large portion of the application, monitoring, and

¹¹⁴ See e.g. Clark J Lee, “Federal Regulation of Hospital Resident Work Hours: Enforcement with Real Teeth” (2006) 9 J Health Care L & Pol’y 162.

¹¹⁵ This is what Coffee suggested happened with the Credit Crisis and the shift in leverage regulation of banks. See Coffee, “What Went Wrong?”, *supra* note 12 at 1-2.

¹¹⁶ See Braithwaite, *Regulatory Capitalism*, *supra* note 1 at 7-8.

¹¹⁷ Hayek, “Use of Knowledge”, *supra* note 99 at 524.

¹¹⁸ See Black, “Decentring Regulation”, *supra* note 22.

¹¹⁹ See generally Jordana & Levi-Faur, *supra* note 42. For the dangers this results in, see Philip Alston, “Facing Up to the Complexities of the ILO’s Core Labour Standards Agenda” (2005) 16 EJIL 467.

enforcement of these strategies (called rowing) to non-state actors.¹²⁰ As a result, regulation is becoming intimately linked to other ordering processes, such as markets, civil society networks, and the internal control and risk management mechanisms of corporate governance.¹²¹ In theory, the steering rules are created by the state, but in practice this is only partly true, since private participation in strategic rule making is becoming more common in regulated spaces.¹²² Consequently, the distinction between steering and rowing is blurred.¹²³

For instance, when focusing upon The California Occupational Safety and Health Act Cooperative Compliance Plan,¹²⁴ it is not so easy to draw a distinction between the Act's regulations (steering) and the rules emerging from the regulated (rowing).¹²⁵ Many of the rowing norms are also strategic and steering in nature. The

¹²⁰ Levi-Faur, "The Global Diffusion", *supra* note 21 at 15-16.

¹²¹ To be clear, although state law will always be present within post-statist regulatory processes, it becomes a question of whether the law is steering these regulatory processes or whether these regulatory processes are steering themselves.

¹²² Harter, *supra* note 18 at 414-22.

¹²³ *Ibid.*; Power, *Organized Uncertainty*, *supra* note 88 at 41-42.

¹²⁴ For more details on the plan, see Brian Friel, "OSHA: Cooperative Compliance" (8 December 1997), online: Government Executive <<http://www.govexec.com/federal-news/1997/12/osha-cooperative-compliance/5176/>>.

¹²⁵ For a general understanding of the situation, see Power, *Organized Uncertainty*, *supra* note 88 at 36-42. For an analysis of the benefits and pitfalls of the strategy of the Occupational Safety and Health Act, see Orly Lobel, "Interlocking Regulatory and Industrial Relations: The Governance of Workplace" (2005) 57

blurring between external institutional norms (strategic steering regulations) and internal organizational norms (operational rowing norms) demonstrates that the differentiation between who is steering and who is rowing is not so clear.¹²⁶ In such heterarchically-regulated spaces, assumptions cannot be made regarding which norms, control mechanisms, and regulatory participants are, in fact, directing the evolution of regulatory norms at any given time.¹²⁷

Regulatory architects within these heterarchically-regulated spaces are experimenting with reflexive,¹²⁸ responsive,¹²⁹ decentered,¹³⁰ and collaborative¹³¹ techniques to harness incentive mechanisms, many times market-based ones.¹³² The

Admin L Rev 1071 [Lobel, “The Governance of Workplace”]; Marius Aalders & Ton Wilthagen, Moving Beyond Command-and-Control: Reflexivity in the Regulation of Occupational Safety and Health and the Environment” (1997) 19 Law & Pol’y 415.

¹²⁶ Braithwaite notes the “reality of hybridity between the privatization of the public and publicization of the private.” Braithwaite, *Regulatory Capitalism*, supra note 1 at 8.

¹²⁷ See Scott, “Age of Governance”, supra note 42 at 146, 154.

¹²⁸ See e.g. Zumbansen, “Law After the Welfare State”, supra note 20; Gunther Teubner, “Substantive and Reflexive Elements in Modern Law” (1983) 17 Law & Soc’y Rev 239.

¹²⁹ See e.g. Ayres & Braithwaite, supra note 5.

¹³⁰ See e.g. Black, “Decentering Regulation”, supra note 22.

¹³¹ See e.g. Freeman, “Collaborative Governance”, supra note 18.

¹³² See e.g. Richard B Stewart & Jonathan B Wiener, “Models for Environmental Regulation: Central Planning Versus Market-Based Approaches” (1992) 19 BC Envtl Aff L Rev 547.

umbrella term, “regulatory capitalism,” captures many of these dimensions of decentered governance.¹³³ Looking forward, future regulated spaces may host co-governance mechanisms in which the state, although present, plays a minor role. Such spaces of the future have been associated with an understanding of the “post-regulatory state.”¹³⁴ Many elements of this post-regulatory state exist today, including auditing and reporting mechanisms¹³⁵ and the incorporation of private monitoring of regulated spaces by non-state gatekeepers.¹³⁶ These gatekeepers can dwell in civil society, such as People for the Ethical Treatment of Animals does,¹³⁷ or in the

¹³³ See e.g. David Levi-Faur, “Regulatory Architectures for a Global Democracy: On Democratic Varieties of Regulatory Capitalism” in Tony Porter & Karsten Ronit, eds, *The Challenges of Global Business Authority: Democratic Renewal, Stalemate, or Decay?* (Albany: State University of New York Press, 2010) 205 [LeviFaur, “Regulatory Architectures”]; David Levi-Faur, “Varieties of Regulatory Capitalism: Sectors and Nations in the Making of a New Global Order” (2006) 19 *Governance* 363 [LeviFaur, “Varieties of Regulatory Capitalism”]; Levi-Fair & Jordana, *supra* note 39.

¹³⁴ Scott, “Age of Governance”, *supra* note 42 at 146.

¹³⁵ Power, *Organized Uncertainty*, *supra* note 88 at 53, 90, 152-81; see also Michael Power, *The Audit Society: Rituals of Verification* (Oxford: Oxford University Press, 1997) [Power, *Audit Society*].

¹³⁶ See John C Coffee, Jr, “Brave New World?: The Impact(s) of the Internet on Modern Securities Regulations” (1997) 52 *Bus Law* 1195 [Coffee, “Brave New World?”]; John C Coffee, Jr, “Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms” (2004) 84 *BUL Rev* 301 at 305-07, 334-35 [Coffee, Jr, “Gatekeeper Failure”].

¹³⁷ *How Is a Company Certified as Cruelty-Free?* (last visited 28 August 2012) online: People for the Ethical Treatment of Animals <<http://www.peta.org/about/faq/how-is-a-company-certified-as-cruelty-free.aspx>>.

business sector, such as Moody's Investors Services does.¹³⁸ This proliferation of these mechanisms is the most obvious sign of this emerging decentered order.¹³⁹ But the question remains: Will these private actors have the requisite public spiritedness to sacrifice self-interest when called upon to do so?

E. Conclusion

As already suggested, faith in the reassertion of the public interest within governance appears in a spectrum of governance literatures. It suggests that a counterbalance to privatization is occurring.¹⁴⁰ The hope is that, as the bright-line distinction between public and private blurs further, some of the rationalities that legitimate profit making on the cusp of legality¹⁴¹ will be brought under more "unwieldy" public,¹⁴² and more careful academic,¹⁴³ scrutiny resulting in for-profit actors becoming more socially minded.

¹³⁸ Moody's, online: <<http://www.moodys.com/>>.

¹³⁹ See generally Power, *Audit Society*, *supra* note 135; see also Power, *Organized Uncertainty*, *supra* note 88; Michael Power, *The Risk Management of Everything: Rethinking the Politics of Uncertainty* (London: Demos, 2004) [Power, *Risk Management of Everything*].

¹⁴⁰ See generally Freeman, "Extending Public Law", *supra* note 3; Braithwaite, "Neoliberalism", *supra* note 4 at 8, 18; Braithwaite, *Regulatory Capitalism*, *supra* note 1; Braithwaite, "Strategic Socialism", *supra* note 7.

¹⁴¹ See Frank H Easterbrook & Daniel R Fischel, *The Economic Structure of Corporate Law* (Cambridge: Harvard University Press, 1991) at 38-39.

¹⁴² "Talking about a Revolution: A Fascinating and Unwieldy Movement in Search of a Narrative", *The Economist* (7 April 2012) online: 258

Linguistically, the language of “public-private partnership”¹⁴⁴ and “governance”¹⁴⁵ has been introduced more frequently into the lexicon of regulatory

<<http://www.economist.com/node/21552179>> [“Talking about a Revolution”]; “Rage Against the Machine: People are Right to be Angry. But it is Also Right to be Worried about Where Populism Could Take Politics”, *The Economist* (22 October 2011) online: www.economist.com/node/21533400 [“Rage Against the Machine”].

¹⁴³ See e.g. David Vogel, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Washington, DC: Brookings Institution Press, 2005); see also Peer Zumbansen, “Rethinking the Nature of the Firm: The Corporation as a Governance Object” (2012) 32 *Seattle UL Rev* 1469; Aaron K Chatterji & Barak D Richman, “Progressive Visions of the Corporation: Understanding the ‘Corporate’ in Corporate Social Responsibility” (2008) 2 *Harv L & Pol’y Rev* 33; Ruth V Aguilera et al, “Putting the S Back in Corporate Social Responsibility: A Multi-Level Theory of Social Change in Organizations” (2007) 32 *Acad Mgmt Rev* 836; Doreen McBarnet, Aurora Voiculescu & Tom Campbell, eds, *The New Corporate Accountability: Corporate Social Responsibility and the Law* (New York: Cambridge University Press, 2007).

¹⁴⁴ See generally Aidan R Vining & Anthony E Boardman, “Public-Private Partnerships: Eight Rules for Governments” (2008) 13 *Pub Works Mgmt Pol’y* 149; Chris Skelcher, “Public-Private Partnerships and Hybridity” in Ewan Ferlie, Laurence E Lynn, Jr & Christopher Pollitt, eds, *The Oxford Handbook of Public Management* (Oxford: Oxford University Press, 2005) 347; Akintola Akintoye, Matthias Beck, Cliff Hardcastle, *Public-Private Partnerships: Managing Risks and Opportunities* (Oxford: Blackwell, 2003); Wolfgang Kleinwachter, “From Self-Governance to Public-Private Partnership: The Changing Role of Governments in the Management of the Internet’s Core Resources” (2003) 36 *Loy LA L Rev* 1103 ; Stephen Osborne, ed, *Public-Private Partnerships: Theory and Practice in International Perspective* (London: Routledge, 2000); ES Savas, *Privatization and Public-Private Partnerships* (New York: Chatham House Publishers, 2000); Gerry Stoker, “Public-Private Partnerships and Urban Governance” in Jon Pierre, ed, *Partnerships in Urban Governance: European and American Experience* (Basingstoke, UK: Macmillan Press, 1998) 34.

¹⁴⁵ See generally Lester M Salamon, ed, *The Tools of Government: A Guide to the New Governance* (New York: Oxford University Press, 2002); Jody Freeman, “The Private Role in Public Governance” (2000) 75 *NYUL Rev* 543; B Guy Peters & John

discourse. Politically, a “double movement”¹⁴⁶ against privatization and deregulation has increased support globally for greater accountability of for-profit actors.¹⁴⁷ Vocationally, a strong corporate social responsibility discourse has entered into many top American business schools.¹⁴⁸ But functionally, are for-profit actors assuming the role of public servants? There is scant evidence to support the claim, but faith in the publicization of for-profit activities within governance remains strong.¹⁴⁹

So, is this faith in publicization misplaced? Jody Freeman’s account of publicization assumes some particular conditions need to be present. She describes private actors promising to uphold “traditionally public goals,” because this is “the price” governments demand in order for these private actors to have access to these

Pierre, “Governance Without Government? Rethinking Public Administration” (1998) 8 J Pub Adm Res Theory 223.

¹⁴⁶ Polanyi, *supra* note 33 at 79, 136.

¹⁴⁷ “Talking about a Revolution”, *supra* note 142; “Rage Against the Machine”, *supra* note 142.

¹⁴⁸ Top US business schools with a new emphasis on Corporate Social Responsibility include: University of Michigan (Ross), Yale School of Management, Stanford Graduate School of Business, Notre Dame (Mendoza), University of California Berkeley (Haas), New York University (Stern), Columbia Business School, University of Virginia (Darden), Cornell (Johnson), and George Washington University School of Business. Cindy Hoots, “The Aspen Institute’s Top 10 Business Schools Integrating Corporate Social Responsibility” (21 October 2009) online: <<http://inspiredeconomist.com/2009/10/21/the-aspen-institutes-top-10-business-schools-focused-on-corporate-social-responsibility/>>.

¹⁴⁹ Braithwaite, “Strategic Socialism”, *supra* note 7 at 4.

¹⁴⁹ Freeman, “Extending Public Law”, *supra* note 3 at 1285.

“lucrative opportunities.”¹⁵⁰ Does privatization play out under these conditions? Are governments generally in the position to make such demands? Short of having to cope with a crisis of catastrophic political proportions, are governments willing and able to reverse privatization initiatives merely because they are disappointed with the performance of private actors?

Some suggest not, arguing that the state withdrew from being a service provider because it could not afford to provide such services.¹⁵¹ This is a story of governments amassing debt in a manner that no financially prudent and socially conscious citizen with an eye to the welfare of the next generation could tolerate,¹⁵² so they were forced to privatize. This would not appear to be a situation in which private actors would be fearful that a government might reverse privatization, if private actors failed to uphold traditionally public goals.

That said, this financial justification for state withdrawal may not be altogether convincing, considering that, in the American context, every

¹⁵⁰ *Ibid.*

¹⁵¹ For a historical perspective post-Bretton Woods, see Thomas L Friedman, *The Lexus and the Olive Tree* (New York: Farrar, Straus and Giroux, 2000). For a more contemporary rationality of the fiscal pressures facing the state, see Reuven S Aviyonah, “Globalization, Tax Competition and the Fiscal Crisis of the Welfare State” (2000) 113 Harv L Rev 1573.

¹⁵² Office of Management and Budget, *Historical Tables: Budget of the U.S. Government* (2013) online: <<http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/hist.pdf>>, at 5-10, 21-23.

administration, both Democratic and Republican, since the Reagan Administration has increased the national debt.¹⁵³ In fact, the Reagan Administration, which to many represents the model for fiscal responsibility, did not decrease the overall national debt over its two terms.¹⁵⁴ Either way, considering the massive amount of national debt in the United States, it appears unlikely that private actors need be too fearful that the government will reverse privatization—at least in the American context.

Placing the issue of financial capacity to one side, both the risk and decentered regulation literatures suggest that governments cannot reverse privatization, because government experts alone cannot determine how to regulate society. In short, governments need privatization. Thus, the idea that publicization is the price that governments demand in order for private actors to have access to “lucrative opportunities” may not be accurate. The more frightening possibility, and possibly the more accurate one, is precisely the opposite: privatization is the price that private actors demand in order for governments to be able to govern adequately.

¹⁵³ *Ibid* at 22-23 (charting the budget deficit from Reagan up to present).

¹⁵⁴ Braithwaite notes the financial analysis of Tramontozzi and Chilton, writing: “Overall, real business regulatory spending increased 10 per cent during the Reagan years.” See Braithwaite, “Neoliberalism”, *supra* note 4 at 8 (citing PN Tramontozzi & KW Chilton, *US Regulatory Agencies Under Reagan, 1960-1988* (St. Louis, Missouri: Center for the Study of American Business, Washington University, 1989)).

III. THE GATES OF CORPORATE GOVERNANCE

There are a number of rudimental ideas that have become anchors for how judges, lawyers, and corporate legal scholars understand the corporation and the law that regulates it. This section introduces a number of them. Although each of these ideas is presented in a largely uncontested manner in this section, of course, there are minority voices that contest them.¹⁵⁵ That said, corporate legal scholars in the American context tend to be more conservative than their European counterparts, and thus, many of the ideas presented below are seen by many as commonsense positions in the American academy.

A. The Free Market and Lex Mercatoria

At its core, free market ideology suggests that if societies strive toward the ideal free market, many of today's social problems would be closer to being alleviated.¹⁵⁶ Although many accept this without much investigation, the notion is

¹⁵⁵ See e.g. William Kline, "Criteria for Good Laws of Business Associations" (2005) 2 Berkeley Bus LJ 13; William Bratton, "Welfare, Dialectic, and Mediation in Corporate Law" (2005) 2 Berkeley Bus LJ 59.

¹⁵⁶ See Friedman, *supra* note 48 at 201-02 ("I believe that we shall be able to preserve and extend freedom...But we shall be able to do so...only if we persuade our fellow men that free institutions offer a surer...route to the ends they seek than the coercive power of the state."); Murray N Rothbard, *Economy, and State with Power and State*, 2d ed (Auburn, Ala: Ludwig von Mises Institute, 2009) ("The more the market principle prevails in a society, therefore, the greater will be that society's freedom and its prosperity.").

rooted in the story of the medieval European merchant order.¹⁵⁷ This order existed beyond state law.¹⁵⁸ Accordingly, it was developed through custom and best practice.¹⁵⁹ Merchants developed and administered their own laws, and the state rarely interfered.¹⁶⁰ To many, it is a shining example of a period of a purer private ordering, in which market mechanisms and social norms governed and society flourished.¹⁶¹ This story of *lex mercatoria* (merchant law) celebrates the past prowess and future potential of the free market.

¹⁵⁷ López Rodríguez argues that, during the middle ages, which for hundreds of years, at uniform commercial rules, which were enforced through “the market tribunals of the various European trade centers.” Ana M López Rodríguez, *Lex Mercatoria and Harmonization of Contract Law in the EU* (Copenhagen: DJØF, 2003) at 87.

¹⁵⁸ It is suggested that these medieval uniform rules did not “benefit of state enforcement of contracts,” but solely “evolved their own private code of laws,” which was enforced by “local official or a private merchant.” Paul R Milgrom, Douglass C North & Barry R Weingast, “The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs” (1990) 2 *Econ & Pol* 1 at 2.

¹⁵⁹ This medieval merchant law, which developed privately through best practice, provides a model for how law should be constructed and implemented today. Robert D Cooter, “Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant” (1996) 144 *U Pa L Rev* 1643 at 1647; see also Milgrom, North & Weingast, *supra* note 158 at 2.

¹⁶⁰ *Ibid.*

¹⁶¹ See e.g. Cooter, *supra* note 159 at 1647; see also Friedman, *supra* note 48 (applying this idea in a more general and obvious way).

Although this story is not historically accurate, it still establishes a “common ground” for the proponents of the free market.¹⁶² It is used as the model solution to solve social problems.¹⁶³ Free market champions hold this image of the free market in their minds—and hearts—when they advocate for the protection of the freedom of contract, the inalienability of property, and minimal government intervention.¹⁶⁴ Their arguments hint that a world without government is possible and desirable.¹⁶⁵ Their views reflect a deep mistrust of government,¹⁶⁶ and a conviction that market function can spontaneously order complex society effectively.¹⁶⁷ This faith in free market ideology loosely underpins much of corporate governance thinking.

¹⁶² Ralf Michaels, “Legal Medievalism in Lex Mercatoria Scholarship” (2012) 90 *Tex L Rev* 259 at 264.

¹⁶³ *Ibid.*

¹⁶⁴ See Friedman, *supra* note 48; Rothbard, *supra* note 156 at 1337-47.

¹⁶⁵ See Bruce L Benson, “Enforcement of Private Property Rights in Primitive Societies: Law without Government” (1989) 9 *J Libertarian Stud* 1; Rothbard, *supra* note 156.

¹⁶⁶ See e.g. FA Hayek, *Road to Serfdom*, 50th Anniversary ed (Chicago: University of Chicago Press, 1994) [Hayek, *Road to Serfdom*].

¹⁶⁷ See Hayek, “Use of Knowledge”, *supra* note 99 at 519-20. Hayek claimed that markets lead to “a more efficient allocation of societal resources than any design could achieve.” Christina Petsoulas, *Hayek’s Liberalism and Its Origins: His Idea of Spontaneous Order and the Scottish Enlightenment* (London: Routledge, 2001) at 2 (2001) (citing Hayek).

B. Corporate Law as Merely Protector of the Market Mechanism

Much of corporate legal scholarship regards corporate law as the protector of the freedom of contract and the alienability of property. It is thought that by simply protecting these fundamentals of market function, corporate law ensures that corporate management will be driven by competition to constantly strive for lower transaction costs and, as a result, greater efficiency within the corporation.¹⁶⁸

Frank Easterbrook and Daniel Fischel explained that unlike administrative law, in which the discretion of administrative officials needs to be tightly constrained, corporate law does not have to police corporate managers in the same way.¹⁶⁹ The reason is that there is already an enforcement mechanism in place—the market.¹⁷⁰ If corporate managers do not do their jobs, then corporate profits decrease, which affects share price and results in ex ante contractual penalties for the managers.¹⁷¹ These penalties potentially include a decrease in the value of stock options, termination of employment, damage to reputation, and acquisition.¹⁷²

¹⁶⁸ Easterbrook & Fischel, *supra* note 141 at 35.

¹⁶⁹ *Ibid.*

¹⁷⁰ *Ibid* at 2-3, 35.

¹⁷¹ *Ibid* at 6.

¹⁷² *Ibid.*

For the market mechanism to enforce efficient internal order within corporate governance, corporate law need only address the issues related to agency between shareholders and management—to be clear, corporate law need only ensure that corporate managers have one “master:” shareholders.¹⁷³ The market mechanism will do the rest. Otherwise, if corporate law directs corporate managers to have loyalties to both the investor and the community, the law would free managers from the discipline of the market, opening up the opportunity for them to serve neither.¹⁷⁴

An idea that accompanies this thinking is that, for regulators to police corporate behavior, they need only harness the market. For instance, if a regulator imposes a large enough fine for a violation of a regulation, the regulator will have made effective use of the firm’s strength. According to Easterbrook and Fischel, the firm’s strength is its ability to calculate risks and rewards, and thus, imposing such a fine will effectively prevent violation of the said regulation.¹⁷⁵

Of course, this regulatory solution is not nuanced, effectively enforcing large fines against corporations, but it does provide an adequate rationality to protect the operation of the market mechanism within corporate governance, which is what is really at stake for corporate legal scholars like Easterbrook and Fischel—economic accountability not social responsibility. With this solution to regulatory challenges,

¹⁷³ *Ibid.*

¹⁷⁴ *Ibid.*

¹⁷⁵ *Ibid.*

the status quo corporate structure remains. In theory, the corporation is still encouraged to “maximize wealth” creation,¹⁷⁶ while regulators have an effective mechanism to alter behavior without reforming corporate law.¹⁷⁷ This arrangement leaves “managers free to maximize the wealth of the residual claimants [shareholders] subject to the social constraints.”¹⁷⁸

Upon reflection, Easterbrook and Fischel clearly established the public/private distinction within corporate law, constructing precisely where the iron gates against government intervention within corporate law ought to be constructed—at its very border. Most corporate legal scholars agree with Easterbrook and Fischel that corporate law best serves society as an economizing device, which facilitates wealth creation and encourages corporate management to keep transaction costs low and profits high.¹⁷⁹

C. Corporate Law as the Product of the Market Mechanism

In 1974, William Cary argued that states were competing to attract incorporations to increase state revenues.¹⁸⁰ He thought that this was creating a

¹⁷⁶ *Ibid* at 38.

¹⁷⁷ For instance, fines or other sanctions by laws other than corporate law.

¹⁷⁸ Easterbrook & Fischel, *supra* note 141 at 38.

¹⁷⁹ *Ibid* at 35-39.

¹⁸⁰ William L Cary, “Federalism and Corporate Law: Reflections Upon Delaware” (1974) 83 Yale LJ 663.

dangerous “race-to-the-bottom” for corporate governance standards.¹⁸¹ He suggested that Delaware, in particular, created corporate governance standards that favored managerial interests, because corporate managers tended to be the incorporators, and the state’s budget was dependent upon revenues from incorporations.¹⁸² As a consequence, state competition for incorporations was resulting in managers enjoying broad and unchecked authority, resulting in less-than-optimal corporate performance.¹⁸³

In 1977, Ralph Winter wrote a reply to Cary, rejecting his position by arguing that state competition should “tend toward optimality so far as the shareholders’ relationship to the corporation is concerned” and, thus, corporate governance standards, like those of Delaware, “are optimal legal arrangements.”¹⁸⁴ He agreed with Cary that corporate management ultimately had the consumer power over incorporation, but argued that managers would select corporate law that reduce transaction costs and led to more profitable business organizations.¹⁸⁵ Thus, this state

¹⁸¹ *Ibid* at 666.

¹⁸² *Ibid*.

¹⁸³ *Ibid* at 668-69.

¹⁸⁴ Ralph K Winter, Jr, “State Law, Shareholder Protection, and the Theory of the Corporation” (1977) 6 J Legal Stud 251 at 254.

¹⁸⁵ *Ibid* at 255.

competition produced an optimal corporate law regime.¹⁸⁶ Put differently, what Cary regarded as a “race-to-the-bottom” Winter regarded as a “race-to-the-top.”¹⁸⁷

This debate has had a number of reincarnations,¹⁸⁸ and Winter’s position has consistently won the debate, creating the impression that corporate law is not a product of politics, but the product of market forces.¹⁸⁹ Even though recent empirical evidence suggests that there is no competition at all and that other states simply do not compete with Delaware for its primacy over incorporations for publicly held corporations in America,¹⁹⁰ the perception that US corporate law is the product of market demands and competition between states still persists.¹⁹¹

When combined with the other normative messages address above, one can appreciate that many corporate legal thinkers are convinced that a corporate law shaped by market forces would lead to an optimal corporate law regime, and that any

¹⁸⁶ *Ibid* at 254.

¹⁸⁷ See *ibid*.

¹⁸⁸ Fenner L Stewart, Jr, “The Place of Corporate Lawmaking in American Society” (2010) 23 Loy Consumer L Rev 147 at 155-57 [Stewart, “Place of Corporate Lawmaking”].

¹⁸⁹ *Ibid* 157-64.

¹⁹⁰ See Lucian A Bebchuk & Assaf Hamdani, “Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters” (2002) 112 Yale LJ 553 at 556; Marcel Kahan & Ehud Kamar, “The Myth of State Competition in Corporate Law” (2002) 55 Stan L Rev 679 at 684.

¹⁹¹ See generally Stewart, “Place of Corporate Lawmaking”, *supra* note 188.

political meddling, such as an attempt to publicize corporate governance, would be rejected out of hand as, at best, suboptimal, and as, at worst, radical, unworkable, and blindly naïve.

D. The Corporation as a Nexus of Contracts

As regards corporate legal theory, it is important to stress from the outset that the concession theory, the entity theory, and the aggregate contractarian theory¹⁹² always inform the legal understanding of the corporation,¹⁹³ because the modern corporation has always been¹⁹⁴ a group of aggregate constituents¹⁹⁵ connected

¹⁹² The concession theory asserts that corporations are merely creatures of statute. Fenner L Stewart, Jr, “Indeterminacy and Balance: A Path to a Wholesome Corporate Law” (2012) 9 Rutgers Bus L Rev 81 [Stewart, “Indeterminacy and Balance”]. The entity theory asserts that the corporation is something that exists beyond its aggregate parts. For more, see *ibid*. The aggregate contractarian theory argues that the corporation is the sum of the contractual obligations that each of its constituents (labor, management, shareholders, creditors, the community-at-large, etcetera) owe to each of its other constituents. For more, see *ibid*.

¹⁹³ *Ibid*.

¹⁹⁴ For an historical account of the rise of the modern corporation at the end of the 19th century, see Stewart, “Place of Corporate Lawmaking”, *supra* note 188 at 151-55.

¹⁹⁵ Thomas W Joo, “Theories and Models of Corporate Governance” in H Kent Baker & Ronald Anderson, eds, *Corporate Governance: A Synthesis of Theory, Research, and Practice* (Hoboken, NJ: John Wiley & Sons, 2010) 157 at 159 [Joo, “Theories and Models”]; see also *Santa Clara County v Southern Pacific Railroad Co*, 118 US 394 (1886).

through contract,¹⁹⁶ while at the same time the corporation is an entity with personhood that only exists because of a concession made by the state.¹⁹⁷ Today, in the American legal context, the corporation is generally thought of in terms of a version of a theory overbalanced¹⁹⁸ with a contractarian understanding of the corporation, which is captured by the nexus-of-contracts theory.¹⁹⁹ This chapter calls this the aggregate contractarian theory.

This imbalance within American corporate theory²⁰⁰ conveys an understanding of the corporation as a set of consensual and efficient contracts that bind corporate constituents.²⁰¹ This version of corporate theory suggests that a high

¹⁹⁶ Armen Alchian & Harold Demsetz, “Production, Information Costs, and Economic Organization” (1972) 62 *Am Econ Rev* 777 at 783-84.

¹⁹⁷ For more on the historical roots of the concession theory, see William W Bratton, Jr, “The New Economic Theory of the Firm: Critical Perspectives from History” (1989) 41 *Stan L Rev* 1471 at 1502-05 [Bratton, “The New Economic Theory”].

¹⁹⁸ Stewart, “Indeterminacy and Balance”, *supra* note 192.

¹⁹⁹ William W Bratton, Jr, “The ‘Nexus of Contracts’ Corporation: A Critical Appraisal” (1989) 74 *Cornell L Rev* 407 at 458 (arguing that “the nexus of contracts concept places the corporation on a foundation of contractual consent”) [Bratton, “‘Nexus of Contracts’”]. For an example of a “real adherent,” see Stephen M Bainbridge, *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at 30-31 (Bainbridge’s application of “The Hypothetical Bargain Methodology”) [Bainbridge, *New Corporate Governance*].

²⁰⁰ Stewart, “Indeterminacy and Balance”, *supra* note 192.

²⁰¹ Joo, “Theories and Models”, *supra* note 28 at 170 (arguing that “incorporating efficient-market assumptions, contractarianism makes two claims: that governance is consensual and that it is efficient”).

level of efficiency occurs between corporate constituents because relaxed legal requirements allow market forces to inspire them to optimally negotiate contracts to satisfy their own interests.²⁰² Since this arrangement is regarded as the best option for the corporation as an economizing device,²⁰³ it follows that corporate law must remain permissive, rejecting mandatory legal rules as generally suboptimal.²⁰⁴

Upon closer inspection of corporate governance, this theory suggests that large sophisticated investors play a central role in making corporate governance work within this legal-market framework.²⁰⁵ In theory, professional investors and their consultants provide analysis of corporate management, governance structures, debt/equity ratios, and relative prowess when compared to competitors,²⁰⁶ which supplies the price mechanism with enough information for debt and equity markets to

²⁰² Thomas W Joo, “Contract, Property, and the Role of Metaphor in Corporations Law” (2002) 35 UC Davis L Rev 779 at 800 (arguing that the contractarian vision of contract is a laissez-faire one, which justifies the assumption that “economic relationships are the product of individual free will and rational deliberation, and the law respects them for this reason”) [Joo, “Role of Metaphor”]. For an excellent example of an adherent to this theory, see Bainbridge, *New Corporate Governance*, *supra* note 5 at 30-31 (Bainbridge’s application of “The Hypothetical Bargain Methodology”).

²⁰³ Easterbrook & Fischel, *supra* note 141 at 35-39.

²⁰⁴ Joo, “Theories and Models”, *supra* note 28 at 171.

²⁰⁵ See John C Coffee, Jr, “Liquidity Versus Control: The Institutional Investor As Corporate Monitor” (1991) 91 Colum L Rev 1277 at 1291-93 [Coffee, “Liquidity versus Control”].

²⁰⁶ Easterbrook & Fischel, *supra* note 141 at 17-19, 23-24.

reward good corporate practice and punish poor performance.²⁰⁷ Thus, just as Easterbrook and Fischel suggested, what emerges is a corporate law that allows markets to function competently, encouraging “what is optimal for the firm and investors.”²⁰⁸

Within this aggregate contractarian theory, fair treatment of corporate constituents is rationalized as follows. If a corporate constituent does not like the terms upon which it is about to contract with a corporation, it can negotiate for new terms, demand a higher price for contracting, or choose not to enter into a contract with the corporation in question.²⁰⁹ It is a consensual relationship.²¹⁰ If a constituent (shareholder) is unhappy and there are highly liquid markets, the constituent can “exit” the relationship. If enough shareholders exit, this will decrease share value and trigger a reason for management to prevent further exits,²¹¹ thereby policing managerial opportunism.

²⁰⁷ *Ibid* at 19.

²⁰⁸ *Ibid* at 7.

²⁰⁹ For an excellent example of an adherent to this theory, see Bainbridge, *New Corporate Governance*, *supra* note 5 at 30-31 (Bainbridge’s application of “The Hypothetical Bargain Methodology”).

²¹⁰ See Joo, “Theories and Models”, *supra* note 28.

²¹¹ For the classic text, see Albert O Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge: Harvard University Press, 1970).

Furthermore, the cost of contracting will encourage corporate managers to make choices that balance the transaction costs of making a decision between all of the constituents affected.²¹² In this way, contract enforces a balance of power between constituents, for although corporate managers have much of the ex ante authority,²¹³ the contractual ex post consequences discipline such discretionary behavior.²¹⁴ For instance, efficient, rational incorporators will select rules when incorporating that balance the transaction costs of deviating from the off-the-rack default rules of incorporation with the perceived benefit of doing so.²¹⁵ Such freedom of rule selection allows the corporate form to have greater flexibility to respond to market demands and opportunities.²¹⁶

That said, some mandatory obligations are imposed upon directors and management in an attempt to counter the inherent potential for power and/or information asymmetries between actors within corporate hierarchies.²¹⁷ But

²¹² Easterbrook & Fischel, *supra* note 141 at 91-93, 217-18

²¹³ See e.g. Bainbridge, *New Corporate Governance*, *supra* note 5 at 67-68.

²¹⁴ Easterbrook & Fischel, *supra* note 141 at 91-93, 217-18.

²¹⁵ Charles RT O'Kelley & Robert B Thompson, *Corporations and Other Business Associations: Cases and Materials*, 6th ed (New York: Aspen Publishers, 2010) at 8-20.

²¹⁶ Easterbrook & Fischel, *supra* note 141 at 34-35.

²¹⁷ For instance, a director may have a personal interest in the approval of a particular contract, and in such cases, strict procedural obligations are imposed upon

generally speaking, such mandatory rules are discouraged, since most are deemed to be unnecessary, because the cost of electing to adopt choices that obviously disadvantage, for instance, shareholders or creditors is so high that these choices become de facto mandatory; the market disciplines, while still leaving discretion for dynamic, entrepreneurial decision-making options.²¹⁸

This aggregate contractarian perspective also discourages courts from attempting to compensate ex post facto for any ex ante errors in negotiating. If constituents of the corporation fail to negotiate for the risks involved in a particular contractual relationship, courts should just leave it to the market to police.²¹⁹ Thus, from this perspective, the role of the courts ought to be as follows: “The courts may not rewrite [corporate contracts] under the guise of relieving one of the parties from the hardship of an improvident bargain. The Court cannot protect the parties from a bad bargain and it will not protect them from bad luck.”²²⁰ In this light, corporate law, and its judicial application, appears somewhat insensitive to the inequalities between contracting parties, because it is hesitant to impose a stricter standard than freedom of

that director. O’Kelley & Thompson, *supra* note 215 at 277; see also *Broz v Cellular Information Systems, Inc*, 673 A 2d 148 at 154-56 (Del Sup Ct 1996).

²¹⁸ See Easterbrook & Fischel, *supra* note 141 at 34-35.

²¹⁹ See *Concord Auto Auction, Inc v Rustin*, 627 F Supp 1526 at 1531–32 (Dist Mass 1986).

²²⁰ *Ibid.*

contract, since doing so might inadvertently undermine market discipline and, therefore, the corporation as an economizing device.²²¹

E. Corporate Social Responsibility and Corporate Law

In the classic corporate social responsibility of the Berle–Dodd debate of the 1930s, the issue was whether corporate power ought to be in the hands of shareholders as public interest representatives or managers as stewards of society.²²² In the 1980s and 1990s, the shift from corporate social responsibility (direct social obligation) to corporate responsibility (indirect social obligation through wealth creation) is captured by Easterbrook and Fischel’s classic one master theory: if managers are only accountable to shareholders as investors, the market will force corporate responsibility (profitmaking).²²³ If managers are burdened by split loyalties, the door is open for managerial opportunism, and accordingly wealth production is compromised.²²⁴ It was claimed that such interference could easily jeopardize profits, which will have a net negative impact upon all constituents within these

²²¹ See Easterbrook & Fischel, *supra* note 141 at 31-38.

²²² See Adolf A Berle, Jr., “Corporate Powers as Powers in Trust” (1931) 44 Harv L Rev 1049 [Berle, “Corporate Powers”]; E Merrick Dodd, Jr, “For Whom Are Corporate Managers Trustees?” (1932) 45 Harv L Rev 1145; AA Berle, Jr, “For Whom Corporate Managers are Trustees: A Note” (1932) 45 Harv L Rev 1365 [Berle, “A Note”].

²²³ Easterbrook & Fischel, *supra* note 141 at 38.

²²⁴ *Ibid.*

organizations, because the capacity to generate wealth is sacrificed in a blind attempt to achieve fairness.²²⁵ From this perspective, by producing wealth, managers are most responsible to society.²²⁶

The Easterbrook and Fischel position has been so important in shaping the American position that it deserves some further explanation. As mentioned, they suggested that using regulations, other than corporate law, to cultivate markets that better deal with price uncertainties²²⁷ would be the best way to circumscribe corporate for-profit activities without undermining the corporation as an economizing device.²²⁸ For instance, if a regulator wants to prevent a corporation from releasing pollutants into a river, do not try to change corporate function through reforming corporate law, but create a regulatory mechanism within the Environmental Protection Act for monitoring and fining potential river polluters. If the enforcement mechanism is sound, then no rational market actor will attempt to violate this law, because the potential risk grossly outweighs the potential profit. In other words, if regulators

²²⁵ *Ibid.*

²²⁶ Easterbrook & Fischel, *supra* note 141 at 35-38.

²²⁷ For an understanding of the relationship between the price mechanism and uncertainty, consider that case of “transfer pricing,” which is an accounting term for the transfer of goods or services from one division or company (within the same group) to another in order to distribute revenue in a more efficient manner. See Joshua Ronen & Kashi R Balachandran, “An Approach to Transfer Pricing Under Uncertainty” (1988) 26 J Acct Res 300 at 301-02.

²²⁸ See e.g. Easterbrook & Fischel, *supra* note 141 at 37-39.

understand that corporate actors will violate the law if it is profitable to do so, then regulators can create the appropriate regulatory incentives to manipulate corporate behavior.

This was a game changer in American corporate legal scholarship; corporate social responsibility of the Berle–Dodd debate shifted to a corporate responsibility debate in mainstream corporate legal scholarship. Shareholders were no longer characterized as proxies of the public interest, as Berle suggested,²²⁹ but as investors.²³⁰ Directors were no longer characterized as stewards of society, as Dodd suggested,²³¹ but as champions of investors as a class.²³² As a result, the corporation is understood as a tool, which best serves society when it solely focuses upon profit making, creating the wealth necessary for other segments of society to cope with the world’s problems.

²²⁹ See Berle, “Corporate Powers”, *supra* note 222; Berle, “A Note”, *supra* note 222.

²³⁰ See Lucian A Bebchuk, “Reply: Letting Shareholders Set the Rules” (2006) 119 Harv L Rev 1784; Lucian Arye Bebchuk, “The Case for Increasing Shareholder Power” (2005) 118 Harv L Rev 833.

²³¹ See Dodd, *supra* note 222.

²³² See Stephen M Bainbridge, “Director Primacy and Shareholder Disempowerment” (2006) 119 Harv L Rev 1735 [Bainbridge, “Director Primacy”].

F. Conclusion

From the corporate legal perspective today, corporations are not expected, nor encouraged, to be imbued with public spiritedness. They are profit-making organizations that are encouraged to act in a self-interested manner. There are a number of interconnected assumptions that legitimate this perspective. First, the corporation can best serve society by being an efficient wealth creation device.²³³ Second, direct legal intervention in corporate governance undermines the efficiency of corporate wealth creation.²³⁴ Third, if managers serve one master—shareholders—then markets can police corporate managers and preserve the efficiency of corporate wealth creation.²³⁵ Fourth, corporate law must therefore enforce shareholder interests within corporate governance.²³⁶ Fifth, corporate law then must almost exclusively engage in agency issues between shareholders and management.²³⁷ Sixth, if regulators want to circumscribe the profit-making function of corporations, then areas of law other than corporate law must be employed to change the price of doing business that

²³³ See *supra* notes 223–226 and accompanying text.

²³⁴ See *supra* notes 228 and accompanying text.

²³⁵ See *supra* notes 223–232 and accompanying text.

²³⁶ See Berle, “A Note”, *supra* note 222.

²³⁷ See *supra* notes 223–228 and accompanying text.

corporations face.²³⁸ As a result, most corporate legal scholars view corporate law as legitimate when it serves as a conservative mechanism to avoid public interference and regulatory reform.

This is the mindset that dominates American corporate legal culture. Although there are always dissenting opinions, this is the commonsense position in the business world. Regulators would face serious resistance if they attempted to experiment with corporate law in ways that might compromise the corporation as an economizing device.²³⁹

So, what about new governance's hope of "publicization of the private?" If the normative claims suggested above are accurate, then publicization might have traction as a marketing campaign if there is money in it; otherwise...well...it is a bit naïve. Publicization stands in the face of what is deemed to be the common sense position within corporate governance thinking.

IV. THE NARRATIVE OF ENTRENCHED PRIVATIZATION

From a different perspective than what was outlined in the last section, this section reconnects to the idea of technocratic narratives, which were mentioned earlier, suggesting that there is an additional quality that governance narratives possess, which tends to discourage publicization. This quality is a lack of humanistic

²³⁸ See *supra* notes 227–228 and accompanying text.

²³⁹ Easterbrook & Fischel, *supra* note 141 at 35-39.

narratives, which can divorce decision-making from what is at stake, namely the violent consequences of that particular decision upon a segment of society.²⁴⁰

To explain this quality, this chapter draws a distinction between two types of narrative: humanistic narratives and technocratic narratives. This chapter defines humanistic narratives as storylines with identifiable characters and a time sequence, which reveals the causes and consequences of characters' actions. Humanistic narratives grant the readers/listeners a digestible message, which mirrors life experience. On the other side of the distinction are technocratic narratives, which this chapter defines as accounts used by technical experts and professionals, who are attempting to employ a spectrum of scientific methodologies, but most predominately economic ones, in order to attempt to resolve governance issues.

Mae Kuykendall, in her article about the lack of strong narrative in corporate governance, chooses to label technocratic narrative as “discourses,” and humanistic narratives has just narrative.²⁴¹ She argues that corporate law lacks the sort of narratives “that attract human interest,” even though the corporation is a significant site for “human activity.”²⁴² Accordingly, although one might expect humanistic narratives, they are rarely present or employed within corporate governance.

²⁴⁰ See Robert M Cover, “Violence and the Word” (1986) 95 Yale LL 1601 at 1601.

²⁴¹ Mae Kuykendall, “No Imagination: The Marginal Role of Narrative in Corporate Law” (2007) 55 Buff L Rev 537 at 541.

²⁴² *Ibid.*

Kuykendall further notes that technocratic narratives in corporate governance generally rely upon economic analysis of corporate interactions, which has the sanitizing effect of obscuring the social costs of particular choices.²⁴³ David Westbrook agrees,²⁴⁴ adding that such lack of humanistic narrative also fails to provide corporate governance with heroes that inspire virtue.²⁴⁵

One can clearly appreciate that this lack of humanistic narrative is damaging to the hope of publicization. Yet, the situation may be even more alarming when one takes into account the effects of technocratic narratives upon governance more broadly. For instance, Kerry Rittich suggests that the problems identified by corporate scholars, such as Kuykendall and Westbrook, might reach beyond corporate governance to impact public administrative agencies as well.²⁴⁶

To digress for a moment, by the twentieth century, enlightened modern thinkers were painfully aware of the loss of normative certainty that accompanied accepting Nietzsche's thesis that the understanding of good was historically

²⁴³ *Ibid* at 547-548.

²⁴⁴ See Mae Kuykendall & David Westbrook, "Introduction: Unsettling Questions, Disquieting Stories" (2009) 2009 Mich St L Rev 817.

²⁴⁵ David A Westbrook, *City of Gold: An Apology for Global Capitalism in a Time of Discontent* (New York: Routledge, 2004) at 112.

²⁴⁶ See generally Kerry Rittich, "Functionalism and Formalism: Their Latest Incarnations in Contemporary Development and Governance Debates" (2005) 55 UTLJ 853.

contingent.²⁴⁷ Without normative certainty, decision makers grasped for the scientific method, which promised to reveal the “real issues at stake” by providing social facts upon which sound regulatory frameworks could be constructed.²⁴⁸ This legitimated decision-making functions in a manner that mere power or politics could not. The employment of social sciences by administrative agencies to solve social problems in this manner has been called functionalism.

Reflecting on the work of John Willis, Rittich argues that functionalism was successful in the New Deal Era, because it provided “a way to depoliticize the process of adjudication and diffuse the conflicts among the courts, the executive and the legislature.”²⁴⁹ During the interwar period in England, functionalists, such as Willis, defended the expansion of the modern administrative state, which was striving to meet the public's demands for greater state involvement in English society.²⁵⁰ As Martin Loughlin explains:

The functionalist style offered an alternative way of addressing the issues that were presenting themselves for resolution as matters of public law. It was therefore a practical, reformist approach, offering solutions to a variety of legal challenges facing modern government

²⁴⁷ See Frederick, Nietzsche. *Beyond Good and Evil*, translated by RJ Hollingdale (New York: Penguin Books, 1990).

²⁴⁸ Rittich, *supra* note 246 at 855.

²⁴⁹ *Ibid.*

²⁵⁰ See generally Peter L Lindseth, “Reconciling with the Past: John Willis and the Question of Judicial Review in Inter-War and Post-War England” (2005) 55 UTLJ 657.

and spanning the range from institutional reforms to alternative modes of interpretation and methods of legal reasoning. This practical program of law reform was directly tied to the broader political movement encompassed under the broad heads of new liberalism, social democracy, progressivism, or democratic socialism.²⁵¹

The British functionalist movement paralleled that of American Legal Realists, embracing governance by teams of experts, who could use their mastery of science to determine what was best for society.²⁵²

John Dewey rejected this expert paternalism, which subsequently made his ideas unfashionable at the time, but he pressed on, insisting that if a “government by experts” did not earnestly consult citizens, then such government could amount to no more than “an oligarchy managed in the interests of the few.”²⁵³ He insisted “[T]he enlightenment must proceed in ways which force the administrative specialists to take account of the needs [of the masses].”²⁵⁴ But progressives, such as Willis, believed such administrative expertise could determine what was best for citizens, legitimating their authority in the modern world by paving the path to progress with their technical knowledge.

²⁵¹ Martin Loughlin, “The Functionalist Style in Public Law” (2005) 55 UTLJ 361 at 362-63.

²⁵² See generally Robert W Gordon, “Willis’s American Counterparts: The Legal Realists’ Defence of Administration” (2005) 55 UTLJ 405.

²⁵³ John Dewey, “The Public and Its Problems” in Jo Ann Boydston, ed, *The Later Works of John Dewey, 1925-1953*, vol 2 (Carbondale, Ill: Southern Illinois University Press, 1984) 365 [Dewey, “The Public and Its Problems”].

²⁵⁴ *Ibid.*

Today, the technocratic mindset of functionalism remains the same; however, as Rittich suggests, its use has changed, supporting the conservative interests it once rivaled.²⁵⁵ Rittich argues that regulators now measure the performance of their institutions “by the extent to which they further efficient transactions and encourage private-sector activity.”²⁵⁶ She continues, “[T]hese objectives, in turn, are typically understood to involve creating the legal infrastructure that furthers the interests of investors and capital holders through, inter alia, enhanced protection for property and contract rights.”²⁵⁷ Rittich describes an emerging power structure for governance in which “[c]adres of technocrats and professionals...set the terms and conditions under which states, markets, civil society groups, and individuals interact.”²⁵⁸ This has led some to agree, in retrospect, that Dewey’s rejection of expert paternalism²⁵⁹ may have deserved greater credence at the time.

The dangers of technocratic narratives have been clearly echoed by other scholars. On the more radical end of the spectrum is David Harvey. Harvey regards this problem of technocratic narrative as reaching far beyond legal discourse. He views such narratives as part of a conscious campaign over communication to create a

²⁵⁵ Rittich, *supra* note 246 at 855.

²⁵⁶ *Ibid.*

²⁵⁷ *Ibid.*

²⁵⁸ *Ibid* at 856.

²⁵⁹ Dewey, “The Public and Its Problems”, *supra* note 253 at 365.

“hegemonic discourse,” which is propagated through mass media, in particular the entertainment industry.²⁶⁰ In Harvey’s opinion, this hegemonic discourse has already corrupted “ways of thought and political economic practices to the point where it is now part of the commonsense way we interpret, live in, and understand the world.”²⁶¹ Thus, from his Marxian perspective, such narratives are powerful examples of how Capitalists have adapted and reasserted their ideology so as to once again lure the Proletariats into undermining their own interests. Harvey believes this to be one of the central achievements of the neoliberal movement.²⁶²

Like Harvey, Rittich suggests that ideology is corrupting governance, using a scientific and technical language, which appears depoliticized but in fact limits choices within the “regulatory calculus” to those that embrace “efficiency, expertise, and cost-containment.”²⁶³ In this way, humanistic narratives are regarded as unsuitable, and are thus marginalized, within decision-making. Rittich’s argument demonstrates how technocratic narratives depoliticize, and dehumanize, social conflicts by divorcing them from the personal, and necessarily political humanistic narratives in the name of the scientific method. What is dangerous about this

²⁶⁰ David Harvey, “Neoliberalism as Creative Destruction” (2007) 610 *Annals Am Acad Pol & Soc Sci* 22 at 34.

²⁶¹ *Ibid* at 22.

²⁶² See *ibid*.

²⁶³ Rittich, *supra* note 246 at 867.

dehumanization of narrative is that social conflicts can be abstractified, practically concealing the connection between particular choices and the violent consequences of that particular course of action upon a segment of society. Thomas Nagel brings home this last point when he wrote: “Once the door is opened to calculations of utility..., the usual speculations... can be brought to bear to ease the consciences of those responsible for a certain number of charred babies.”²⁶⁴

What the positions of Kuykendall, Harvey, and Rittich all have in common is the lament over the underlying ideology that has presently captured technocratic narratives. They each highlight, in different ways, how technocratic narratives guide their users to prioritize economic needs over social needs when it is necessary to choose between the two. As Harvey pointed out, the normative message that economic needs must always be the priority over all others presents itself as commonsense, radicalizing any suggestion to the contrary.²⁶⁵

Kuykendall’s approach inspires meaningful discourse between ideological adversaries, since it allows for a critical reflection upon particular communication without heightening the distinction between such adversaries. One can imagine that approaching such a discourse like an embattled Proletariat would probably prove to be less than successful. Kuykendall approaches sensitive issues with tact, so as not to

²⁶⁴ Thomas Nagel, *Mortal Questions* (Cambridge: Cambridge University Press, 1979) at 59.

²⁶⁵ Harvey, *supra* note 260 at 22-23.

alienate a corporate legal audience, which usually tends to be conservative. Consider Kuykendall's tact in the following passage:

The absence of [humanistic] narrative from corporate law is substantially explained by the nature of the undertaking of producing wealth and by the social formation of business. The absence of [such] narrative is not a nefarious scheme to undermine critique, although it tends to have that effect. Rather, the underlying project of generating wealth does not produce rich human stories.²⁶⁶

Kuykendall's approach does not point fingers at Capitalists and the cadres of technocrats, who Harvey would suggest are operating behind the scenes to control societies. As a result, the chance of constructive bipartisan debate, as well as the potential emancipation from a particular mindset, becomes more likely, since criticism can be deftly directed at a normative level rather than a more personal one. In fact, her article sparked broad debate in the corporate legal community, resulting in a symposium at Michigan State University College of Law entitled the *Business Law and Narrative Symposium*.²⁶⁷

In conclusion, the problem of a lack of humanistic narrative appears not to be isolated to private governance (corporate governance), but also appears to seriously threaten public governance (administrative agencies) as well. Again publicization

²⁶⁶ Kuykendall, *supra* note 241 at 555.

²⁶⁷ Michigan State University College of Law, News Release, "Michigan State Law Review to Host Business Law and Narrative Symposium" (10 Sep 2009) online: <<http://www.law.msu.edu/news/2009/releases/business-narrative.html>>.

suggests that there will be the “percolation”²⁶⁸ of values from public governance to private governance. So, if this percolation process transports values from public to private, what happens when there needs to be a publicization of the public as well? The above account suggests that this might be the case. And if this is the case, then the project of new governance might be even more dangerously optimistic than this chapter suggests.

V. CONCLUSION

This chapter has attempted to dash the hopes of those who quell their fear of privatization with the faith that the clouds shall part and corporate doves imbued with the twin virtues of benevolent kindness and efficiency shall save us all from the woes of modern governance. Based on the literatures reviewed, there is little merit in hoping that this will occur. The blurring of public and private in governance today will not lead to the publicization of corporations in some spontaneous way—to think otherwise amounts to magical thinking.

That said, magical thinking has an important role in the cultivation of ideology. Those that champion privatization have the “foundation myth” of the medieval *lex mercatoria*²⁶⁹—the promise of a pure free market, which can shepherd

²⁶⁸ Braithwaite, “Strategic Socialism”, *supra* note 7 at 4.

²⁶⁹ For more on how such “foundation myths” function, see Nicholas HD Foster, “Foundation Myth as Legal Formant: The Medieval Law Merchant and the New Lex Mercatoria” (2005) *Forum Historiae Juris*, online:

a commoditized humanity through the wonders of the price mechanism.²⁷⁰ If this is so, then does the myth of publicization create an appropriate counterview of social order, adequately challenging the vision of a pure free market, and legitimating opposition to it? A better myth is possible.

There needs to be more of a stress on social justice,²⁷¹ equality,²⁷² and the socioeconomic impacts of privatization.²⁷³ Maybe there needs to be a louder campaign that stresses an understanding of privatization through the lens of human rights,²⁷⁴ which asserts that international customary law obliges²⁷⁵ governments to

<<http://www.forhistiur.de/zitat/0503foster.htm>>; see also Michaels, *supra* note 162 at 264-65, 267.

²⁷⁰ See e.g. Hayek, “Use of Knowledge”, *supra* note 99.

²⁷¹ See e.g. Demetrius S. Iatridis, “The Social Justice and Equality Contexts of Privatization” in Demetrius S Iatridis, ed, *Social Justice and The Welfare State in Central and Eastern Europe: The Impact of Privatization* (Westport, Conn: Praeger, 2000) 3.

²⁷² See e.g. *ibid.*

²⁷³ See e.g. Danwood Mzikenge Chirwa, “Water Privatisation and Socio-Economic Rights in South Africa” (2004) 8 *Law, Democracy & Dev* 181.

²⁷⁴ See e.g. William W Felice, *The Global New Deal: Economic and Social Human Rights in World Politics* (Lanham, Md: Rowman & Littlefield, 2010); Alana Klein, “Judging as Nudging: New Governance Approaches for the Enforcement of Constitutional Social and Economic Rights” (2008) 39 *Colum HRL Rev* 351.

²⁷⁵ Although some argue that the Universal Declaration of Human Rights “is not binding,” they argue that “most of its rights have been incorporated into the domestic legal systems of most countries...especially...the rights in the Declaration’s first ‘column’ [namely civil and political rights].” Mary Ann Glendon, “The Rule of Law

ensure that each of their citizens has the rights to dignity, an adequate standard of living, housing, social services, and education.²⁷⁶ Maybe there also needs to be further declarations that these rights are binding upon all nations,²⁷⁷ and thus, are “not negotiable!”²⁷⁸ Of course, this is only one of many options, which could coordinate and galvanize the fragmentation of social reaction that Polanyi predicted in his theory of the double movement.

in *The Universal Declaration of Human Rights*” (2004) 2 Nw U J Int'l Hum Rts 5. Hannum takes the broader view that, in principle, the Universal Declaration of Human Rights may be invoked as a source of customary international law and is, in its entirety, binding (again stressing in principle). Hurst Hannum, “The Status of the Universal Declaration of Human Rights in National and International Law” (1995) 25 Ga J Int'l & Comp L 287. In accordance with Hannum’s view, it can be argued that there is a legal and moral obligation upon all nations to enforce not only civil and political rights, but also social and economic rights. For more on the differences, compare the *International Covenant on Civil and Political Rights*, 19 December 1966, 999 UNTS 171; Can TS 1976 No 47, 6 ILM 368, with the *International Covenant on Economic, Social and Cultural Rights*, 16 December 1966, GA Res 2200A (XXI), UN Doc A/6316; 993 UNTS 3; 6 ILM 368 [ICESCR].

²⁷⁶ *Universal Declaration of Human Rights*, GA Res 217A (III), UN Doc A/810 at 71 (1948) articles 22, 25-26.

²⁷⁷ See Hannum, *supra* note 275 at 289, 319, 323-25, 330-34.

²⁷⁸ Irina Bokova (Director-General), *Message from the Director-General of UNESCO*, online: UNESCO <<http://www.un.org/en/events/humanrightsday/2011/unesco.shtml>> (“Whatever the circumstances or complexity of the challenges that we face, the observance of human rights is not negotiable.”); Titus Edjua & Antony Crockett, “Human Rights Not Negotiable” (2009) 28 Int'l Fin L Rev 50 at 50-51; John Ruggie, *Stabilization Clauses and Human Rights* (Geneva: International Finance Corporation, 2008) at 10, 39-43, online: <[http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/\\$FILE/Stabilization+Paper.pdf](http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/$FILE/Stabilization+Paper.pdf)>.

That said, the human rights framing may also be inadequate. In the face of how countries observe human rights,²⁷⁹ the hope that states will meet these human rights obligations (in particular social, cultural, and economic rights²⁸⁰) is probably as close to becoming reality as a reincarnation of the medieval *lex mercatoria*.²⁸¹ Yet, this human rights framing of the privatization issue provides a stronger “foundation myth” than publicization, providing a better counter to the present spin of the free-marketeters. Either way, there is more work to be done in Nietzsche’s Dark Workshop.

²⁷⁹ To better appreciate human rights conditions on a country-by-country basis, see Human Rights Watch’s Regional Reports. Human Rights Watch, *Regions*, online: Human Rights Watch <<http://www.hrw.org/regions>>.

²⁸⁰ *ICESCR*, supra note 275.

²⁸¹ See e.g. Emily Kadens, “The Myth of the Customary Law Merchant” (2012) 90 *Tex L Rev* 1153 at 1159-60, 1181-96, 1205-06 (questioning the validity of claims concerning the existence of custom in the form of *lex mercatoria*).

CHAPTER 6: CONCLUSION

The frame of reference for this book has been the intermingling of potentialities and circumstances, which over time has led to today's American corporation and its corporate governance. As the chapters demonstrate, this path to the present has not been a straightforward progression towards an ideal.

Before the hangover from the heady 1990s, many believed that the global economy and its central unit of organization—the publically traded corporation—were back on the heroic track to a pure capitalism,¹ and society was finally making forward progress toward the liberal ideal.² However a succession of scandals and crises in the years that followed shook this confidence.³ That said, although most today acknowledge that there is still work to be done, most American corporate legal scholars remain steadfast in their belief in the fundamentals of this liberal dream.

This resilient confidence has done much to preserve contractarianism as the central ideology that drives much of American corporate governance practice.⁴ This is

¹ See e.g. Jeffrey D Sachs, “Twentieth-Century Political Economy: A Brief History of Global Capitalism” (1999) 15 *Oxford Rev of Econ Pol* 90.

² See Francis Fukuyama, *The End of History and the Last Man* (New York: Free Press, 1992); see also Roberta Romano, *The Genius of American Corporate Law* (Washington, DC: AEI Press, 1993).

³ See Nancy B Rapoport, Jeffrey D Van Niel & Bala G Dharan, eds, *Enron and Other Corporate Fiascos: The Corporate Scandal Reader*, 2d ed (New York: Foundation Press, 2009).

⁴ Stephen M Bainbridge, *The New Corporate Governance in Theory and Practice* (New York: Oxford University Press, 2008) at 55-57.

good in the sense that the routines and rituals, which follow this contractarian perspective, are now hardwired into governance processes. This creates a high degree of predictability within market transactions, which in turn provides opportunities for more precise determinations of the risks associated with profitmaking over the short term. It is also bad because this embedding of routines and rituals retards the potential for responsiveness to the needs of markets and society when either, or both, demands an evolution in business practices. In other words, the resilience of contractarianism helps corporations sustain profitability for now, but also creates a kind of shortsightedness, and possibly social blindness, over the long term.

At the beginning of this research project, I assumed that corporate governance might be the site to initiate the sort of social reforms necessary to alleviate this shortsightedness. But as my research and study of American corporate governance progressed, this assumption no longer appeared as self-evident as I once assumed.

The present American capitalist culture creates a highly incentivized, profit-driven rationality, which fuels a decentered functional capacity. Such decentered functional capacity, in turn, allows for complex social interactions in centers, such as New York City, to occur with a relative degree of ease. The secret is the promise of wealth, which incentivizes market actors to aggressively identify demands in society and then devise cost-effective strategies to satisfy these demands in a manner that is competitive and profitable. And thus, it is hard to refute that Hayek was correct in the

sense that complex social coordination could not exist as it does without the price mechanism.⁵

This capitalist culture provides the context within which the corporation flourishes. The publically traded corporation is like a steroid for markets, allowing business to attract massive amounts of capital, while dispersing risk, in order to organize complex distributions of resources—not only in highly populated areas, but also transnationally, even in spaces international law cannot tame.

The market for control holds American corporate governance together.⁶ Key to the market for control is that directors and managers are tied to shareholder expectations. If such bonds between ownership and control are not strong, the market for control within American corporate governance does not work.⁷ If the market for control does not function, the permissive nature of American corporate law cannot ensure that there will be the control mechanism available to police managerial opportunism. Thus, directors and managers must be tied to shareholder interests.⁸ It follows from this that in order to institute an alternative would require dramatic

⁵ Friedrich A Hayek, “The Use of Knowledge in Society” (1945) 35 Am Econ Rev 519 at 528-529.

⁶ See generally, Henry G Manne, “Mergers and the Market for Corporate Control” (1965) 73 J Pol Econ 110.

⁷ Frank H Easterbrook & Daniel R Fischel, *The Economic Structure of Corporate Law* (Cambridge: Harvard University Press, 1991) at 2-3.

⁸ See generally AA Berle, Jr, “Corporate Powers as Powers in Trust” (1931) 44 Harv L Rev 1049.

reform—American corporate law would need a complete overhaul. This will not happen in the foreseeable future.

There are very real dangers in not accepting this pessimism as factual. For instance, with the blurring of public and private,⁹ corporate managers are being asked to take on more public roles.¹⁰ From a corporate governance perspective, if taken seriously, this is highly problematic. If corporate managers were permitted by corporate law to split their loyalties between shareholders and the wider polity, this would create opportunities that could undermine the American system of corporate governance.¹¹ If it is not taken seriously, and the new governance agenda is pushed forward and corporate actors continue to assume more public roles without real accountability to the broader polity, the survival of public spaces, as historically conceived, will be jeopardized.¹² This creates a Catch-22, which plays out so that when corporate managers are used as quasi-public servants, the result is that either corporate governance suffers or society suffers.

⁹ See generally Jason M. Solomon, “New Governance, Preemptive Self-Regulation, and the Blurring of Boundaries in Regulatory Theory and Practice” (2010) 2010 Wis L Rev 591.

¹⁰ See generally Jody Freeman, “Extending Public Law Norms Through Privatization” (2003) 116 Harv L Rev 1285; John Braithwaite, “Strategic Socialism, Strategic Privatization and Crises” (2013) [unpublished, archived at <http://ssrn.com/abstract=2249544>].

¹¹ See generally Easterbrook & Fischel, *supra* note 7.

¹² See Morton J. Horwitz, “The History of the Public/Private Distinction” (1982) 130 U Pa L Rev 1423.

If one looks to this book for an answer to this dilemma, one finds contestation. The first three chapters, which focus upon the potentialities for change within corporate legal discourses, appear to indicate that change in corporate governance is possible and needed. However, the final substantive chapter of this book reflects pessimism toward publicization, and also the potential for meaningful reform within American corporate governance in the foreseeable future.

In fact, I even flirt with the idea of whether the American status quo is not the best outcome presently. If one accepts the corporation as an economizing device, it should always respond effectively to whatever incentives, understood as prices, it confronts.¹³ If this is correct, then the corporation, as a highly responsive mechanism to price signals, might be a very effective measure of regulatory performance without reform. In other words, if new governance can calibrate markets to properly price the social cost of production within society, then the corporation, in theory, will effectively adjust its function to the new price signals without reform.

However, this hypothesis, although attractive to some, is problematic. If one uncritically accepts the corporation as an economizing device, corporate governance can remain in the almost exclusive domain of economic thought. That is not to say that scholars from the fields of economics and finance ought not to have a strong voice, just that more voices need to be heard from the fields of behavioral

¹³ Bainbridge, *supra* note 4 at 55-57.

psychology, sociology, anthropology, and others, which are presently underrepresented. Without reintroducing the whole argument here, this point dovetails nicely with the arguments made about the dangers of the lack of humanistic narratives within corporate governance mentioned in the previous chapter.

Either way, corporate governance study needs to branch into a whole new area. Traditional corporate governance scholars will continue to do what they do—ensuring that the regulatory mechanisms, which are internal to corporate governance function, are facilitating efficient low-cost transactions between contractual actors. However, a new study of corporate governance must also emerge that observes the impact of the incentive structures created by regulatory mechanisms, which are external to corporate governance, but which still impact upon its function. By observing how corporate governance reacts to these new conditions, the broader governance of society, and the corporation's roles within that governance, can be measured.

In the end, research on this project has deconstructed much of my pre-existing biases about markets and society, while adding layers of complexity and nuance to my understanding of the tensions between them. It appears to have generated more questions, and fewer answers. Accordingly, this modest conclusion no more than suggests a programme of study moving forward.

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