Corporate Power in the Public Eye: Reassessing the Implications of Berle's Public Consensus Theory

Marc T. Moore and Antoine Rebérioux†

I. Introduction

Adolf A. Berle, Jr. is widely regarded as the intellectual pioneer of corporate governance. Amongst Berle's numerous legacies is the contemporary status of corporate governance as a distinct, multi-disciplinary field of academic inquiry. The seminal text which he co-authored with Gardiner Means in 1932, *The Modern Corporation and Private Property* (*TMC*),[1] is still recognized by many scholars as the most influential conceptual account of the area of social science we today refer to as corporate governance. On a descriptive level, Berle[2] is credited with identifying the separation of ownership and control within public companies that is a consequence of widely held stock ownership. Furthermore, in view

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† Lecturer in Laws, University College London, UK (marc.moore@ucl.ac.uk); Assistant Professor in Economics, University Paris Ouest Nanterre La Défense, EconomiX, France (antoine.reberioux@u-paris10.fr). This article was written for the symposium "In Berle's Footsteps" in celebration of the launch of the Adolf A. Berle, Jr. Center on Corporations, Law and Society held at Seattle University School of Law on November 6–8, 2009. We are grateful to Chuck O'Kelley and the Berle family for the honor of being invited to participate in this exciting and memorable initiative. We are also thankful for comments received on our article at this event, in particular from William Bratton, Michael Wachter, and Cynthia Williams. An earlier version of this article was presented at an Oxford-UCL-LSE Corporate and Financial Law Reading Group seminar held at University College London on October 29, 2009. Thanks to Arad Reisberg for organizing and chairing this event, and also to John Lowry, David Kershaw, Tim Swanson, Wolf-Georg Ringe, and Edwin Mkwananzi for their constructive comments in relation to the article. This article was also presented at the Collège des Bernardins Seminar on Corporate Social Responsibility, on January 28, 2010. Thanks in particular to Olivier Favereau and Jean-Philippe Robé for valuable discussion and comments. In respect of all the above named individuals, we stress that the views expressed in this article are those of the authors alone and no attribution whatsoever is intended.

1. Adolf A. Berle & Gardiner C. Means, The Modern Corporation and Private Property (Harcourt, Brace & World, Inc. rev. ed. 1968) (1932) [hereinafter TMC].

2. In our discussion of *TMC* in this article, we refer to the ideas and conclusions presented in the book as those of Berle individually. This is partly for the purpose of authorial convenience, and partly also in acknowledgement of the fact that Berle has been individually accredited with expounding the bulk of the work's doctrinal and normative arguments. This is not to deny, however, the invaluable empirical insights provided by Gardiner Means into prevailing ownership structures in US corporations, without which Berle's propositions would almost certainly have been impossible.

of his famous 1932 exchange with contemporary E. Merrick Dodd in the *Harvard Law Review* journal,[3] Berle became known as the original defender of the shareholder wealth maximization norm in corporate governance. This is the principle that directors (and, indirectly, officers) should exercise their discretion exclusively in the collective interest of the firm's equity holders, as measured by share price and underpinned by the fiduciary concept in corporate law.[4] In response to Dodd's apparently enlightened exhortation that managers should have "some degree of legal freedom" to depart from their perceived responsibility to promote the shareholder interest exclusively,[5] Berle famously affirmed corporate law's normative orthodoxy with this warning:

> [Y]ou can not abandon emphasis on 'the view that business corporations exist for the sole purpose of making profits for their stockholders' until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else.[6]

As a result of his perceived position on the above issues, Berle is frequently regarded to be the original intellectual precursor of the "agency costs" paradigm of corporate governance that attained prominence within corporate law and finance scholarship from the 1970s onwards.[7] This is in spite of the fact that many of the normative ideas ad-

3. *See* Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932) [hereinafter FWCMAT]; E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932). On this debate, see William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and "The Modern Corporation,"* 34 J. CORP. L. 99, 122–35 (2008); C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 KAN. L. REV. 77 (2002).

4. For a more detailed academic exposition of this principle, including an explanation of the difference between the dual tenets of "shareholder wealth maximization" and "shareholder primacy" (on which, see *infra* notes 94–95 and accompanying text), see Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003), especially Part III. Note that the shareholder wealth maximization norm is also distinct from the (more limited) concept of "shareholder democracy," on which see *infra* note 104 and accompanying text.

5. Dodd, *supra* note 3, at 1161.

6. FWCMAT, *supra* note 3, at 1367.

7. The "agency costs" paradigm of corporate governance scholarship essentially distills the subject down to a problem of aligning the conflicting incentive patterns of different corporate participants. On this basis, its proponents suggest a collection of both market-based and contingent legal-institutional devices (for example, the hostile takeover mechanism and independent boards of directors), which together have the effect of mitigating the tendency of managerial "agents" to appropriate or otherwise diminish the wealth of their shareholder "principals." The formal autonomy and independent personhood of the corporation in law, and also the quasi-public decision-making power which large corporate enterprises are commonly alleged to exercise within society, are both elided by reference to the fundamentally *private* bargaining dynamics involved in the formation and internal constitution of companies. At the same time, the logic of the agency costs approach leads in general to an acceptance of equity holders as the sole legitimate claimant to residual profit and governance rights under corporate law, in view of their unique status as superior economic risk-bearers amongst the general set of "inputs" constituting the business firm. Hence, agency costs approaches

vanced by Berle, both in *TMC* itself and in his (more normatively developed) future writing, appear to run starkly against the grain of many of the fundamental tenets of this later school of thought. Therefore in studying Berle's work through a contemporary lens, it is customary to view Berle as having ideologically changed course over his scholarly career, from his initial position as a conservative shareholder wealth maximization advocate to his later position as a reformist communitarian theorist.[8] Orthodox interpretations of Berleian theory would suggest that the allegedly "conservative" dimension of Berle's thinking is characterized by the majority of his earlier inter-war work, principally the doctrinal (middle) chapters of *TMC* (1932),[9] Berle's contemporaneous article *For Whom Corporate Managers Are Trustees: A Note* (1932) ("FWCMAT"),[10] and his formative doctrinal article on corporate law entitled *Corporate Powers as Powers in Trust* (1931).[11] The more "reformist" dimension of Berle's scholarship, on the other hand, is felt to be exemplified by the concluding book of *TMC* (titled "Reorientation of Enterprise") along with Berle's later post-war works *The 20th Century Capitalist Revolution* (1954),[12] *Power Without Property* (1959),[13] and *The American Economic Republic* (1963).[14]

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to corporate governance tend to provide ideological support for the shareholder wealth maximization norm in corporate law, not as a moral-proprietary imperative but rather as a functional precondition for engendering efficient and socially beneficial outcomes from a corporation's productive and wealth-generating activities (for more on this, see *infra* note 94–95 and accompanying text). The path-breaking articles in the construction of the agency costs approach are: Michael C. Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); and Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301 (1983). For an influential application of the agency costs paradigm in rationalizing the structure and rules of corporate law, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW, (Harvard, Cambridge, MA paperback ed. 1996) (1991); BRIAN R. CHEFFINS, COMPANY LAW: THEORY, STRUCTURE AND OPERATION (1998) (dealing with the US and UK systems of corporate law respectively). For a critical perspective on the conceptual relevance of agency costs theory to US corporate governance and law today, see Marc T. Moore & Antoine Rebérioux, *From Minimization to Exploitation: Re-Conceptualizing the Corporate Governance Problem* (Reflexive Governance in the Public Interest, Working Paper No. REFGOV-CG-32), *available at* http://ssrn.com/abstract=1324127.

8. For analysis stressing the ambiguity or duality of *TMC* and Berle's thinking, see, for example, Bratton & Wachter, *supra* note 3; J.A.C. Hetherington, *Redefining the Task of Corporation Law*, 19 U.S.F. L. REV. 229 (1985); Allan C. Hutchinson, *Public Policy and Private Cupidity: Berle and Means Re-Visioned* 3 (CLPE Research Paper No. 3/2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=961292.

9. TMC, *supra* note 1.

10. *See* FWCMAT, *supra* note 3.

11. Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931).

12. ADOLF A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION (1954).

13. ADOLF A. BERLE, JR., POWER WITHOUT PROPERTY: A NEW DEVELOPMENT IN AMERICAN POLITICAL ECONOMY (1959) [hereinafter PWP].

14. ADOLF A. BERLE, THE AMERICAN ECONOMIC REPUBLIC (1963) [hereinafter AER].

The convenience of interpreting Berle in this way is that it allows the reader to link the majority of Berle's earlier thinking on corporate governance to the later agency costs paradigm,[15] while at the same time compartmentalizing those aspects of his (mainly later) work that do not support this purported connection. In this way, the more radical, communitarian strand of Berle's normative thought can be regarded mainly as the historically-specific product of America's peculiar postwar politico-economic climate,[16] thus meriting it being analyzed in distinction from Berle's more "mainstream" positive insights into the structure of American public companies. Thus, Berle's *prescriptive* ideas regarding re-appraisal of the rightful beneficiaries of the corporate wealth-creation process have now fallen by the intellectual wayside. However, his primarily *descriptive* insights revealed in *TMC* about the structure of the dual ownership and control relation in public companies have undoubtedly retained considerable influence over the ensuing decades.[17]

This article takes issue with such bipolar understandings of Berle's work—the various strands of which we believe are too tightly interlinked to be separated into constituent positive and normative elements. In particular, we argue that, on a normative level, *TMC* is most appropriately viewed not as a *sui generis* project, but rather as one (early) part of a wider continuum of ideas advanced by Berle over the course of the following three decades. By reading *TMC* in this contextual sense, it becomes possible to regard it as one aspect of a wider lifelong inquiry by Berle into the whole panoply of civil society pressures shaping the course of corporate-managerial decision-making, as opposed to a primarily empirical or doctrinal study into corporate law and ownership structures whose core descriptive conclusions can be extrapolated from the above and viewed in their own terms. Accordingly, *TMC*'s more radical normative propositions, especially those in the final chapter of the work, assume a more dynamic and time-robust character.

We accordingly present one such contextual and integral understanding of Berle's ideas; we aim at both highlighting and analyzing this wider institutional quality of his corporate governance scholarship. For this purpose, we rely principally on the two Berleian texts which are most heavily associated with his work on corporate governance; namely, *TMC* (1932) itself (notably including Berle's 1968 updates to the original

15. On this, see *supra* note 7.

16. For an analysis of the peculiarity (at least by contemporary standards) of the corporatist politico-economic context in which Berle's ideas were developed, see Bratton & Wachter, *supra* note 3.

17. *See, e.g.*, the foundational references to Berle and Means in the seminal agency costs literature cited at *supra* note 7.

version)[18] and *Power Without Property* (1959).[19] Furthermore, we analyze Berle's overall corporate governance project in accordance with what we see as its four core sub-themes:

A. the limitations of external market forces as a constraint on managerial decision-making power;

B. the desirability of internal (corporate) over external (market) actors in allocating corporate capital;

C. civil society and the public consensus as a continuous informal check on managerial decision-making power; and

D. shareholder *democracy* (as opposed to shareholder *primacy* or shareholder *wealth maximization*)[20] as a socially instrumental institution.

In Part II of this article, we seek to debunk the popular misconception that Berle's early work was a defense of the orthodox shareholder primacy paradigm of corporate governance. This prefaces our analysis in Part III, where we set out and, in turn, examine each of the above four sub-themes of Berle's overall thinking on corporate governance. A recurring theme in this part of our discussion is the over-simplicity of attempting to connect Berle's thinking to the later agency costs paradigm of corporate governance, which we believe fails to reflect the normative and institutional richness of Berle's overall social-scientific project. In Part IV, we build on these insights by assessing the effects of our reinterpretation of Berle's work on contemporary corporate governance debates. We suggest here that Berle's lifetime work on corporate governance, when considered in an integral and non-selective way, provides the basis for a realistic and dynamic understanding of the concept of shareholder democracy and its relationship with wider civil society processes of public and political opinion formation.

II. DEBUNKING A POPULAR MYTH ABOUT BERLE

To anyone familiar with Berle's doctrinal analysis in the middle chapters of *TMC*, depiction of him as the forefather of the agency costs paradigm of corporate governance is not entirely without reasonable basis. In this part of his great work with Means, Berle advanced the following (arguably questionable) positive thesis:

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18. *See* TMC, *supra* note 1.

19. *See* PWP, *supra* note 13.

20. On the distinction between these terms, see *supra* note 4 and accompanying text; *infra* notes 94–95, 104 and accompanying text.

> [A]ll powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears.[21]

Berle consequently posited his "trusteeship" model of corporate law, which denoted that the legitimacy of any corporate act must be assessed, not only by the technical rules of law pertaining to that conduct, but also by a modified[22] version of the equitable rules that apply to a trustee's powers to administer property vested in them as a fiduciary for the trust's beneficiary.[23] Certainly, a selective reading of the above excerpt, viewed alongside Berle's contemporaneous *FWCMAT* piece,[24] provides see-

21. TMC, *supra* note 1, at 220; *see also* Berle Jr., *supra* note 11.

22. In particular, Berle claimed that it was necessary to adapt the basic laws of trusteeship so as to render them less rigorous and therefore more responsive to the wide ambit of flexibility necessarily involved in business decision-making. *See* TMC, *supra* note 1, at 242.

23. Berle's purported trusteeship principle is fundamentally similar to the contemporary shareholder wealth maximization norm, albeit with one significant difference. Whereas the shareholder wealth maximization norm requires simply that a director exercise his official discretion in a manner that is broadly calculated to enhance the market value of the equity holder's residual claim against the company, the trusteeship principle goes further by asserting that a director must not use any statutory or constitutional powers vested in him except in accordance with the purpose for which they were granted (i.e., to promote the collective interest of shareholders within the legitimate bounds of the company's constitutional structure) and not for any extraneous motive. Although these two principles are largely consistent with one another insofar as their practical implications for directors are concerned, it would appear that they can potentially dictate different courses of action in a situation where a company is subject to a takeover bid by way of a hostile (i.e., unsolicited) tender offer to its existing shareholders. In this scenario, deployment by the board of a defensive tactic (e.g., a shareholder rights plan) which has the intended effect of diluting the offeror's holding or otherwise reducing the attractiveness of the bid target may be entirely consistent with the shareholder wealth maximization norm where the target company's directors honestly and rationally perceive the bid, for whatever reasons, to represent inadequate value for its shareholders. However, such a defensive response by the board would arguably be contrary to the trusteeship principle insofar as it represents an illegitimate use of the directors' fiduciary powers for the purpose of distorting the company's existing balance of voting power, and thereby usurping the existing shareholders' constitutional prerogative to decide whether the price offered by the bidder is acceptable in light of their own personal preferences as beneficiaries of the notional corporate "trust." Although (at least to the best of the authors' knowledge) Berle did not explicitly discuss the application of the trusteeship principle in the context of contests for control, the above purported application of the principle would appear to the authors to be justified by analogy with its closest comparative equivalent; namely, the English "proper purpose" doctrine. The latter doctrine is widely acknowledged in England to provide a judicial safeguard to a company's existing democratic governance structure in the face of undue directorial interference, even in situations where such action would otherwise be justifiable as an exercise of the board's honest and informed business judgment as to what they believe to be in the best interests of the shareholders. On this, see *Hogg v. Cramphorn Ltd.* [1967] Ch. 254; *Howard Smith Ltd. v. Ampol Petroleum Ltd.* [1974] 1 All ER 1126 (P.C.) (appeal taken from the Supreme Court of New South Wales); J.E. PARKINSON, CORPORATE POWER AND RESPONSIBILITY: ISSUES IN THE THEORY OF COMPANY LAW 137–140 (1993).

24. *See* FWCMAT, *supra* note 3.

mingly cogent evidence in support of the "Berle as shareholder wealth maximization advocate" hypothesis.

A more integral analysis of Berle's overall normative position in *TMC* establishes, however, that his trusteeship model was intended only as a temporary doctrinal stopgap against what he saw as the corporate control vacuum. This was pending fuller and more fundamental resolution of the accountability and legitimacy problems posed by the public corporate form. While advancing his shareholder-centric conceptualization of corporate law, Berle at the same time expressed his "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 and that the corporate mechanism may prove the very means through which such modification is brought about."[25] He nevertheless conceded on grounds of pragmatism that "[u]ntil this modification does occur, . . . the lawyer is forced to think in terms of private property."[26] Berle therefore claimed that shareholder primacy, by means of the trusteeship principle, was justifiable in the immediate term not only as the least worst solution to the problem of managerial hegemony,[27] but also as the only logical response to the corporate accountability deficit available within the doctrinal machinery of the common law. This was because of what he described as the common law's "ancient preoccupation" with protecting the property and other private interests of individuals in their relationships with one another. Thus, common law logic was ill-equipped for setting up "ideal schemes of government" via regulation of managerial conduct in the interests of the public at large.[28]

In any event, Berle believed that the trusteeship principle could only ever represent, at best, a partial solution to the corporate accountability deficit, given the inevitable judicial difficulties involved in striking an effective balance between: (a) preserving managerial discretion to make various and complex commercial decisions; and (b) mitigating the scope for abuse by directors and managers of their official powers and prerogatives at the shareholders' expense. Berle therefore opined that ultimately, a shareholder's welfare remained largely dependent on "the expectation of fair dealing" by managers as opposed to any concrete and defens-

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25. TMC, *supra* note 1, at 219.

26. *Id*. at 219–20.

27. For an analysis of managerial power as the crucial issue at the heart of *TMC*, see Dalia Tsuck Mitchell, *From Pluralism to Individualism: Berle and Means and 20th Century American Legal Thought*, 30 LAW & SOC. INQUIRY 179, 194 (2005) ("The separation of ownership from control was important to the extent that it contributed to the amassing of corporate power and pointed to ways to tame potential excesses and abuses of corporate power.").

28. TMC, *supra* note 1, at 296.

ible legal basis.[29] In view of this fact, Berle made the somewhat bleak assessment that, even accounting for the existence of his proposed trusteeship model of corporate law, "the shareholder in the modern corporate situation has surrendered a set of definite rights for a set of indefinite expectations" and, in consequence, "is definitely made subservient to the will of a controlling group of managers."[30] This would seem to imply that in spite of his best efforts to this effect in *TMC*, Berle came to the pessimistic conclusion that the search for a legal principle to mitigate managerial hegemony vis-à-vis shareholders was an ultimately futile endeavor.[31]

It would therefore appear that, contrary to current interpretations of his work, Berle did not view shareholder disempowerment and managerial hegemony as problems that were in the long-term either remediable or reversible. On the contrary, he argued that "the reason for the weakening of the shareholder's position lay as much in his inability to manage as in the obvious willingness of the 'control' to take over."[32] In other words, the corporate accountability deficit was due as much to the inevitable control failings of ineffective shareholders as it was to the acquisitiveness of power-hungry managers, and the surrounding corporate law framework had evolved so as to adapt to this economic fact. It was seemingly with this consideration in mind that Berle, in the end, lamented the possibility that "the bulk of American industry might soon be operated by trustees for the benefit of inactive and irresponsible security owners."[33] He nonetheless took solace in his expectation that "[w]hen a convincing system of community obligations is worked out and is generally accepted, in that moment the passive property right of today must yield before the larger interests of society."[34]

The picture that emerges of Berle from an integral reading of *TMC* is not that of a staid conservative fighting against the winds of change, but rather of a radical social reformist possessed with an unusually strong pragmatic trait. In other words, Berle looked to mobilize significant reform but nevertheless acknowledged the incapacity of the available (legal) institutional ammunition to bring his proposed vision into immediate and definite effect. On a normative level, however, Berle's work on the whole was much more concerned with *exploiting* the long-term transformative potential of the separation of ownership and control than

29. *Id*. at 243.

30. *Id*. at 244.

31. On this point, see Antoine Rebérioux, *Does Shareholder Primacy Lead to a Decline in Managerial Accountability?*, 31 CAMBRIDGE J. ECON. 507, 513 (2007).

32. TMC, *supra* note 1, at 131.

33. *Id*. at 311.

34. *Id*. at 312.

mitigating the perceived adverse consequences of that phenomenon in the short term.[35]

III. BERLE'S OVERALL INSTITUTIONAL PROJECT

Introduction

The principal reason for Berle's rejection of shareholder legal empowerment as a long-term solution to the corporate accountability deficit was the impossibility, as he saw it, of bringing about effective shareholder influence over corporate affairs. This was due in part to the doctrinal limitations of the common law as a reformist mechanism in the field of corporate law, as discussed in the previous Part. But it was also attributable, at least in equal part, to the internal autonomy of the capital allocation process within large-scale corporate enterprises. As a result of this process, shareholders became externalized from the corporation both as a continuing source of industrial finance and, in turn, a managerial-disciplinary mechanism. However, Berle, far from viewing this as an inhibition of the modern corporate structure, in contrast saw it as an opportunity for replacing the now redundant "invisible hand" of market pressures with the much more effective governance influence of an energized civil society and regulatory state. Whilst, as we will observe, shareholders still had a role to play within Berle's publicly-oriented managerialist control framework, it was in a more limited capacity and with markedly fewer legal entitlements than they had previously been felt to merit.

We begin this Part by highlighting Berle's argument as to the ineffectiveness of external market forces as a constraint on managerial decision-making power. Second, we discuss Berle's view that internal (managerial) actors were superior to external (market) actors in allocating corporate industrial capital. Third, we examine how, with the diminution of product and capital markets as an effective constraint on managerial hegemony, the substitute influence of civil society pressures and the evolving public consensus came to fill this control vacuum. Finally, we assess the continuing role and position of the shareholder within this institutional framework as perceived by Berle.

A. The Limitations of External Market Forces as a Constraint on Managerial Decision-Making Power

In *Power Without Property*, Berle criticized "[c]lassical nineteenth-century thinking" on the basis that it "ignored rather than avoided the

35. For a fuller argument to this effect, see Moore & Rebérioux, *supra* note 7.

economic power problem," by incorrectly considering "economic power as ultimately and irresistibly controlled by the force of an impersonal open market."[36] In constructing his institutional model of corporate governance, Berle was dismissive of the various markets which were alleged to exert extraneous constraints on managers' executive discretion. This led Berle to the conclusion that managerial hegemony remained a prevalent feature of the modern corporation, even when accounting for the combined operation of the markets for corporate products, capital, and control.

Consistent with other progressive managerialist scholars of his time, such as John Kenneth Galbraith,[37] Berle was aware that the modern conditions of industrial concentration and oligopoly significantly limited the product market's ability to function as a competitive disciplinary force.[38] He did, however, acknowledge the potential of the corporate capital market as a competitive restraint on otherwise hegemonic managerially-controlled firms. In particular, Berle noted in *TMC* that "over half of the recent phenomenal growth of the great corporations was achieved through the raising of new capital in the public markets."[39] Berle consequently regarded the principal market-based safeguard of the shareholder interest to be the necessity for corporations to, from time to time, raise capital from the general public. This would, in theory, compel their managers to maintain favor with the investor community on an ongoing basis. In this regard, Berle's early thinking arguably bears a degree of similarity to his intellectual descendants versed in the "agency costs" school of thought, who advance the capital market as the principal institutional mechanism for mitigating (whether directly or indirectly)[40] the adverse incentives that managers would otherwise have to "shirk" in the performance of their tasks.[41]

However, Berle's initial apparent belief in the disciplinary effectiveness of the capital market did not become a mainstay of his thinking. Although in the first (1932) edition of *TMC* Berle appeared to attach at least some degree of significance to the corporate capital market as a po-

36. PWP, *supra* note 13, at 85.

37. *See* JOHN KENNETH GALBRAITH, ECONOMICS AND THE PUBLIC PURPOSE 81–109 (1973).

38. *See, e.g.*, Adolf A. Berle, *Modern Functions of the Corporate System*, 62 COLUM. L. REV. 433, 434 (1962) ("[T]he aggregate of industry, both in size and in relative importance, has established undoubted dominance. Concentration within it is thus markedly more powerful relative to total production and in the total economic scene today than it was in 1932.").

39. TMC, *supra* note 1, at 62.

40. In other words, the question is whether to mitigate adverse incentives via the direct market discipline of having to maintain access to low-cost capital from the investing public, or the indirect imperative of precluding the advances of a potential hostile takeover bidder. For more information on this point, see *infra* notes 43–45 and accompanying text.

41. On this concept generally, see Fama, *supra* note 7.

tential institutional constraint on managerial hegemony, in the later 1968 edition of the same work he was considerably less emphatic about its value in this regard. In his preface to the 1968 edition, Berle reported empirical evidence that over sixty percent of corporate investment capital was generated by corporations internally from retained earnings, while only less than twenty percent of capital was amassed from the issuance of securities—most of which took the form of fixed-interest bonds as opposed to equities.[42] Berle also disparaged his late contemporary Henry Manne's (soon-to-be-influential) theory that the stock market could indirectly discipline corporate managers by means of the contingent market for corporate control. Manne suggested that this process would be triggered in cases where managerial underperformance inspired a proxy fight by outsiders to gain effective control over the shareholder franchise.[43] In response, Berle argued that "in most really large corporations [proxy fights] never occur at all."[44] He further argued that in the extraordinary instance where a contest for voting control of a corporation does occur, it is "quite obviously a sheer struggle between two tycoons for power," and thus to depict it as a market-driven phenomenon amounts to "mere misdescription."[45]

In view of the above factors, Berle believed that by 1968, "[p]urchases and sales on the New York and other stock exchanges [did]

42. *See* Adolf Berle, *Property, Production and Revolution: A Preface to the Revised Edition* of ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY, at xv (Harcourt, Brace & World, Inc. rev. ed. 1968) (1932) [hereinafter Berle, *1968 Introduction*]. *See also* Berle, *supra* note 38, at 440 (concluding that "[p]ublic utilities aside, the large corporations do not seek substantial capital either by floating bonds or new stock issues, save on very rare occasions.").

43. On this, see Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965); Henry G. Manne, *The "Higher Criticism" of the Modern Corporation*, 62 COLUM. L. REV. 399, 410–13 (1962). For an excellent summary and critical analysis of the Berle/Manne exchange generally, see Paddy Ireland, *Defending the Rentier: Corporate Theory and the Reprivatization of the Public Company*, *in* JOHN PARKINSON ET AL., THE POLITICAL ECONOMY OF THE COMPANY 141, 154–55 (2000).

44. Berle, *supra* note 38, at 439.

45. *Id*. Berle did, however, acknowledge the existence of another staple institution of the agency costs paradigm of corporate governance, namely the market for managerial talent. In *Modern Functions*, he accepted that corporations "compete in hiring promising graduates of business schools and in persuading executive vice presidents to leave the service of one corporation and enter another." *Id*. Berle nonetheless regarded the corporate hiring process as being driven solely by the managerial community itself with no extraneous influence whatsoever from either shareholders or proxy fight participants. Berle was also dismissive of any purported rationality underlying the managerial labor market. In *PWP*, he compared what he called "the catch-and-toss of the [American] market for personal talent" with the alternative Soviet Russian system for relative attribution of intra-firm rewards, and queried with all seriousness "whether the arbitrariness and injustice of a bureaucratic—any bureaucratic—system [of allocating relative organizational rewards to employees] are not greater than the accidents and irrationalities of the American market system." PWP, *supra* note 13, at 145.

not seriously affect the business operations of the companies whose shares [were] the subject of trading."[46]

He argued that "one effect of the corporate system has been to set up a parallel, circulating 'property-wealth' system, in which the wealth flows from passive wealth-holder to passive wealth-holder, without significantly furthering the functions of capital formation, capital application, capital use or risk bearing."[47]

It would therefore appear that by the time of his death in 1971, Berle had come to the opinion that the complete externalization of shareholders from corporate governance had been substantially realized.[48]

B. The Desirability of Internal (Managerial) Over External (Market) Actors in Allocating Corporate Capital

Crucially, Berle was not, in the long run, principally bothered by the issue of shareholder disempowerment vis-à-vis hegemonic managers. On the contrary, he viewed the externalization of shareholders from the corporate productive process as an ultimately progressive economic development. Whilst Berle was cognizant of the accountability deficit that resulted from managers' increasing autonomy over the capital allocation process, he also lauded this deficit as one of the novel advantages of the modern corporate property-holding system. The beneficial outcome of this development, according to Berle, was that the "distribution and redistribution of wealth-holding [could] take place without interruption of the productive process"[49] so that the corporation, in effect, could "run on its own economic steam."[50] Berle demonstrated a strong preference for internal over external methods of capital allocation[51] for two principal (and overlapping) reasons. First, Berle possessed a longstanding lack of faith in the informational efficiency of public stock markets. Second,

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46. *1968 Introduction*, *supra* note 42, at xxiv.

47. *Id*. at xxii. In this regard, Berle recognized that the then-growing body of securities law promulgated by the Securities and Exchange Commission was not concerned with the underlying affairs of corporations but rather with the separate process of ensuring that buyers and sellers on liquid securities markets had sufficient information to make prudent decisions on the relative prices of shares. *Id*. at xxi.

48. Writing in 1962, Berle even went so far as to opine (by his own admission slightly tentatively) that the shareholder's beneficial interest "has been *completely, solidly, and finally severed* from the economic and productive enterprise of the corporation whose shares form the corpus of the trust, on whose success, at long last, he and his fellow beneficiaries depend." Berle, *supra* note 38, at 448 (emphasis added).

49. *1968 Introduction*, *supra* note 42, at xxiv.

50. *Id*. at xv.

51. In this regard, Berle emphatically claimed: "[p]robably the greatest single power inherent in corporate managements is their allocation of the risk capital they thus accumulate." Berle, *supra* note 38, at 441.

Berle was concerned about the social harm that could be caused by empowering irrational securities investors as corporate governance actors.

As to the first of these factors, Berle's skepticism about the rationality of securities markets is a further characteristic that distinguishes him from his descendants versed in the "agency costs" school of thought, whose reasoning is contrarily underpinned by a uniting faith in one or another version of the efficient capital markets hypothesis (ECMH). In essence, the ECMH emphasizes (in varying degrees) the purported tendency of securities market prices to reflect the information that is relevant to the future income-generating potential of any particular security—which in the case of a corporate equity investment will naturally include data pertaining to the underlying performance and prospects of the relevant company's business. Most proponents of the ECMH within law and finance theory appear to recognize the inevitable limitations of the various securities market mechanisms (e.g. securities analysts, stock exchange disclosure rules, and investment banks' securities underwriting activities) that in practice bring about the ongoing process of "data-transfer" from the internal (corporate) to external (market) environment. Nonetheless, "agency costs" approaches to corporate governance are generally united in their preference for external (market) over internal (managerial) methods of capital allocation, as derived from a Hayekian belief in the superior computational capacity of dispersed market actors over concentrated organizational technocrats.[52]

Needless to say, Berle did not share this belief. In *TMC*, he referred to "the great swings in society's appraisal of its own immediate future as reflected in the general level of values in the organized markets,"[53]—a critique that would be echoed in greater detail by John Maynard Keynes four years later in his *General Theory of Employment, Interest and Money*.[54] Berle argued that "liquid[55] property, at least under the corporate

52. On the ECMH generally, see Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970). For more critical analyses of the ECMH, see ROBERT J. SHILLER, IRRATIONAL EXUBERANCE (2000); Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias*, (2003) 28 J. CORP. L. 715 (2003); Lynn A. Stout, *The Mechanisms of Market Inefficiency*, 28 J. CORP. L. 635 (2002); Lynn A. Stout, *Inefficient Markets and the New Finance*, 14 J. FIN. TRANSFORMATION 95 (2005).

53. TMC, *supra* note 1, at 65.

54. JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY (1936).

55. The characteristic of "liquidity" denotes the ease with which a commodity or investment can be readily transferred into cash. Relatively small-scale corporate equity investments which are traded on deep regulated securities markets (such as the New York Stock Exchange) are regarded to be highly liquid in nature in contrast to relatively large-scale entrepreneurial, family or private equity investments, which tend to be viewed as highly illiquid. The implication of this distinction for corporate governance, as explained further below, is that illiquidity in a sense "fixes" the investor to the underlying property (e.g., the relevant company's business), whereas liquidity facilitates an effective

system, obtains a set of values in exchange, represented by market prices, which are not immediately dependent upon, or at least only obliquely connected with, the underlying values of the properties themselves."[56] Berle's skepticism as to the reliability of stock market pricing appears to be much more severe in his later writing. In *AER*, for instance, he observed how "[v]aguely, moving from one inexact calculation to another, the market arrives at a purely romantic estimate of what a share of General Motors or General Electric is worth."[57]

This leads to Berle's second, and arguably more serious, concern about the adverse influence of external capital markets on corporate governance. Similarly to Keynes, Berle's principal concern with securities markets was not so much that investors lacked the relevant information required to make rational decisions in their own interests, but rather that they possessed *the wrong kind of incentives* to make decisions that would further the productivity and effectiveness of the corporations in which they were invested. Therefore, rather than regarding shareholders as being the "victims" of managerial prerogative in any meaningful sense, Berle was, on the whole, much more concerned about the potential harm that shareholders, if institutionally empowered, could cause *to the corporation* by virtue of the peculiar incentives and considerations underlying their investment decisions.

Berle claimed that estimations of share value are typically based not on entrepreneurial predictions of advances in "economic operation," but merely on likely future changes in the value of those shares themselves (echoing Keynes' famous "prettiest face competition" metaphor from his *General Theory*).[58] Both Keynes and Berle contrasted the transient and fleeting quality of financial capital (liquidity) with the more entrenched and durable nature of corporate industrial capital. Keynes believed that "[d]ecisions to invest in private business of the old-fashioned [entrepreneurial] type were . . . largely irrevocable, not only for the community as a whole, but also for the individual."[59] However,

> [w]ith the separation between ownership and management which prevails to-day and with the development of organised investment markets, a new factor of great importance has entered in . . . [insofar as] the Stock Exchange revalues many investments every day and the revaluations give a frequent opportunity to the individual

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divorce between the investor and underlying property by rendering the investor dependent principally on the investment's external market-realization value, rather than internal yield value, in order to secure an effective rate of return on it. On this, see AER, *supra* note 14, at 25.

56. TMC, *supra* note 1, at 250.

57. AER, *supra* note 14, at 32.

58. *1968 Introduction*, *supra* note 42, at xxiii.

59. KEYNES, *supra* note 54, at 150.

> (though not to the community as a whole) to revise his commitments.[60]

Berle and Keynes recognized that the vast majority of stock exchange transactions involved the mere transfer of historical investments in companies that had long since fulfilled their industrial purpose. However, both writers acknowledged that the price of a company's securities on the secondary trading market could potentially affect that company's capacity to raise funds on the primary capital market by determining the acceptable price of any future public offering. It followed that, so long as companies were dependent at least to some extent on the external capital market as a continuing source of finance, there was a corresponding risk that the skewed incentives and horizons of securities investors would have a detrimental effect on industrial capital allocation. While Berle's belief that the passivity of the American shareholder populace precluded the need for direct examination of the potential evils of excessive shareholder influence over corporate capital allocation, Keynes (referring to the less managerially-intensive British corporate governance system) was aware of the adverse effect on national investment and productivity that resulted "[w]hen the capital development of a country becomes the by-product of the activities of a casino."[61]

Berle's recognition of the potentially detrimental implications of involving securities market actors in industrial capital decisions led him to embrace the shareholder's externalization from corporate control as an overall progressive social development. In Berle's view, it was this phenomenon more than any other that enabled the condition of capital liquidity to persist in tandem with the continuing productive demands of the business enterprise. In this way, both industrial corporations and securities markets can most effectively fulfill their respective social objectives (crudely speaking, industrial productivity and financial accumulation) in general autonomy from one another, irrespective of the underlying link between these two institutions represented by the phenomenon of liquid corporate equity.

In conclusion, therefore, Berle felt that the externalization of shareholders from corporate financing and governance was a socially desirable phenomenon that should ultimately be encouraged. Berle preferred capital allocation to be determined by autonomous managers using internal capital reserves and situated within the corporate organization itself. This was because, in Berle's view, expert corporate managers were considerably better situated and equipped than external securities market

60. *Id*. at 150–51.
61. *Id.* at 159.

actors to determine the appropriate rate and direction of industrial development.

C. Civil Society and the Public Consensus as an Informal Check on Managerial Decision-Making Power

Berle's emphatic defense of managerial autonomy from external market influences did not, however, blind him from the significant accountability problems that such autonomy posed. In *TMC*, Berle warned of the potential power reach of the "new princes" of industry[62] that the public corporate form had created. Berle, more than anyone, was aware of the disastrous socio-political consequences that could follow from the exercise of untrammeled managerial discretion. Berle observed how, as a "social organization," the modern corporation "involves a concentration of power in the economic field comparable to the concentration of religious power in the mediaeval church or of political power in the national state."[63] On this basis, he surmised that "more could be learned regarding [corporate controllers] by studying the motives of an Alexander the Great, seeking new worlds to conquer, than by considering the motives of a petty tradesman of the days of Adam Smith."[64]

At the same time, Berle observed the fact that throughout history "[a] constant warfare has existed between the individuals wielding power, in whatever form, and the subjects of that power," and that "[j]ust as there is a continuous desire for power, so also there is a continuous desire to make that power the servant of the bulk of the individuals it affects."[65] In particular, Berle observed within contemporary American society an "insistence that power in economic organization shall be subjected to the same tests of public benefit which have been applied in their turn to power otherwise located,"[66] and argued that "[w]hen a convincing system of community obligations is worked out and is generally accepted, in that moment the passive property right of today must yield before the larger interests of society."[67] On this basis, Berle predicted a future where corporate law assumes the status of "a potential constitutional law for the new economic state," with business practice in its turn "increasingly assuming the aspect of economic statesmanship."[68] Berle envisaged the corporate managerial sector ultimately assuming the status of

62. TMC, *supra* note 1, at 116.
63. *Id*. at 309.
64. *Id*. at 307–08.
65. *Id*. at 310.
66. *Id*.
67. *Id.* at 312.
68. *Id*. at 313.

"a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity."[69]

There is an inclination amongst scholars to regard these radical propositions forwarded by Berle in the final chapter of *TMC* as an exceptional feature of the book—the product of misty-eyed political optimism as contrasted with Berle's sober and hard-nosed doctrinal legal scholarship[70] in the work's previous chapters. It tends to follow that, from this view, the normative arguments of *TMC*'s closing chapter are most appropriately regarded as an ideological anomaly of the work—a hopeful but, sadly, forever incomplete project to institutionalize, via legal means, a truly pluralist (or at least non-proprietary) system for allocating corporate residual wealth within society. Once the "unsuccessful" normative aspect of Berle's work is cast aside in this way, readers can focus on the more "successful" positive aspects of received Berleian theory that *are* indeed borne out by the succeeding course of historical events, such as the separation of ownership and control and remedial shareholder wealth maximization norm. Such a conclusion is understandable if one regards *TMC*'s normative legacy as being purely about the reform of doctrinal corporate law. However, if one instead regards *TMC* as part of a wider inquiry by Berle into the multifarious civil society pressures acting on corporate managers, including *but not restricted to* the formal law, the book's normative propositions acquire a more constructive and lasting significance for social scientists.

Indeed, the essential idea advanced by Berle in *TMC*'s concluding chapter, in which corporate power is ultimately accountable to an external and dynamic body of public opinion, was by no means left at the intellectual wayside by Berle following completion of this seminal text. On the contrary, it became a core and coordinating influence of much of Berle's future thinking on corporate governance—most notably in his classic 1959 work *Power Without Property*.[71]

It was here that Berle developed his theory of the "public consensus," which he defined as "the existence of a set of ideas, widely held by the community, and often by the organization itself and the men who direct it, that certain uses of power are 'wrong,' that is, contrary to the established interest and value system of the community."[72] A key component of Berle's "public consensus" theory was the idea that individual citizens, while having been largely externalized from the corporate deci-

69. *Id*. at 312–13.
70. Coupled with Gardiner Means's equally rigorous empirical economic analysis.
71. PWP, *supra* note 13.
72. *Id*. at 90.

sion-making process in their economic capacity as shareholders, had nevertheless at the same time acquired an increasing degree of influence over corporate affairs in their political capacity as engaged civil society actors.[73] In a profoundly optimistic passage of *PWP*, Berle opined that:

> In terms of industrial property, the system has unquestionably reduced most owners to a passive-receptive role. But in terms of choice of life and choice of political expression, the citizen of the American economic republic probably has as effective a means of control as individuals have ever achieved in a large country.[74]

Berle explained that the public consensus is the body of "general, unstated premises"[75] that provides a basis for the ongoing and often spontaneous process of public opinion formation in respect to any controversial social issue. Although the public consensus itself is unwritten and unsystematic, it can be elicited by reference to (inter alia) "the conclusions of careful university professors, the reasoned opinions of specialists, the statements of responsible journalists, and at times the solid pronouncements of respected politicians."[76] Moreover, while the public consensus contains reference to settled rules of law, "it also includes capacity to criticize that law" and "to insist that principles heretofore comprised only within the consensus must be added to statute or common law, enforceable by courts as well as by public opinion."[77]

Berle argued that, in the first place, the public consensus was effectively "enforced" on managers by means of the "corporate conscience," which was represented by managers' own internal appreciation of the external public consensus.[78] It followed that breach of the public consensus would lead to "loss of prestige, public standing, and popular esteem for the men in the organization itself as loyalty to it is undermined."[79] In the event that these informal sanctions failed to produce the desired changes in managerial conduct, more coercive sanctions were likely to follow in the form of interventionist regulation by the political state.[80] In this regard, Berle claimed that "[h]owever powerless any individual may be to deal with economic organization on the economic plane, he does have, in the American democracy, a solid and respected power in the political field."[81] Berle believed that "[i]f enough individu-

73. *See id*. at 117.
74. *Id*. at 138.
75. *Id*. at 111.
76. *Id*. at 113.
77. *Id.*
78. *Id*. at 91.
79. *Id.*
80. *Id*. at 92.
81. *Id.*

als consider that they are aggrieved, they can energize a political intervention," and that "[i]n American society, the ultimate limitation on economic power is the possibility of energizing, in any one of various ways, the political power of the government."[82] Consequently, political intervention by the state in the event of violation of the public consensus was, in Berle's view, a "near-certainty."[83] Berle further claimed that the public consensus, although inchoate, is nevertheless "a continuously existent force, capable of becoming active and specific, because in a democratic system it can energize action by the State."[84]

Although Berle did not explicitly discuss exactly what the American public consensus demanded of any specific type of corporation, he did make one important observation concerning the way in which the legitimacy of corporate power is judged by the general public. Berle claimed that "[p]ower (aside from its crude or brute form) cannot exist apart from some idea or principle justifying it and, therefore, entitling holders of it to expect allegiance and cooperation."[85] According to this logic, "[e]conomic power is justified chiefly by the fact that it is needed to produce, supply, and distribute goods and services, and to set up attendant conditions of employment and service appropriate to these ends."[86] Berle argued that "[s]o long as an economic organization, Statist or non-Statist, acquires and uses its power to perform this function, it holds and is using the tool for the purpose which justifies its existence."[87]

Berle referred to the tendency of corporate activity to acquire a "functional definition" by assuming a social obligation to fulfill a particular economic task.[88] By this process, "the American consumer accepts enterprise in corporate form as a way of getting its economic decrees fulfilled."[89] In turn, the prevailing public expectation as to the corporation's proper socio-economic function is internalized by managers themselves, such that they "come to recognize (perhaps as 'business statesmen') that first claim on accumulated profits is *the claim of the enterprise itself*," and that the perceived needs of the community in respect of the firm's continuing productive operations "take precedence over the dividend desires of any body of passive stockholders."[90]

82. *Id.*
83. *Id*. at 114.
84. *Id*. at 115.
85. *Id*. at 100.
86. *Id.*
87. *Id.*
88. *Id*. at 101.
89. *Id*. at 102.
90. Berle, *supra* note 38, at 449 (emphasis in original).

The reliance placed on any corporation by the community also tends to increase in direct relation to its size—to the extent that it commands a sufficiently large share of its market so as to become essential to the community.[91] At that point, deprivation of supply or any other misuse by the corporation of its market position (e.g. functionally unnecessary or socially unacceptable price rises) will be sanctioned in effect by the state, which will assume responsibility for providing the relevant service in place of the exploitative corporation.[92] This was particularly so where a corporation used its market power to increase prices to socially excessive levels by deliberately restricting supply of a good or service below the estimated level of demand for it; this, in Berle's view, would amount to a breach of the "powerful tenet in the public consensus that the great corporations on which the American community relies for supply must meet the demand."[93]

The dual effect of Berle's managerial autonomy and public consensus theories was the removal of the corporate decision-making process, to a significant extent, from the control of extraneous (product and capital) market forces, which were eventually replaced by endogenous public and political pressures. In Berle's view, these latter pressures were at the very least as stringent a constraint on managerial decision-making as the former type, and were considerably better suited than the former type to the bureaucratic and quasi-public nature of modern large-scale corporate organizations.

It should be pointed out that Berle, in *PWP*, did not advocate the complete usurpation of the market with politically-driven controls in the sense of a communistic "socialization" of industrial production and capital allocation; on the contrary, he went to great lengths in the book's final chapter to highlight the differences between his perceived view of the American system of corporate financing and governance and its Soviet Russian counterpart. Berle's considerably more modest aim in *PWP* was to highlight what he saw as an already prominent aspect of the essentially market-based, capitalistic, American corporate governance system of the mid-twentieth century, and also to explain and normatively rationalize the key institutional features of this phenomenon. What Berle envisaged was a rich dual framework of endogenous market and civil society constraints on managerial decision-making power in public companies, with the inevitable gaps in the former type of control being "plugged" by the latter, and vice versa.

91. PWP, *supra* note 13, at 102.
92. *See id*. at 103.
93. *Id*. at 115.

In essence, then, Berle emphasized that an autonomous, managerially-centric system of corporate financing and governance need not entail the loss of executive accountability. On the contrary, Berle's public consensus theory demonstrated that publicly-driven civil society pressures could in effect take the place of privately-driven market pressures in enforcing functionally effective managerial decision-making within business organizations of a certain scale and level of influence within society.

D. Shareholder Democracy as a Socially Instrumental Institution

The diminution of proprietary control and corresponding "publicization" of private sector governance within Berle's institutional model posed an important question concerning the rightful position of the *shareholder* in relation to the modern corporation. To what extent, if any, did Berle consider the legal empowerment of shareholders to be an institutional precondition for the effective functioning of his envisaged corporate control framework?

Certainly, Berle's belief in the inherent irrationality of securities market actors would almost certainly have rendered him hostile to the contemporary "shareholder primacy" argument, which asserts that shareholders should enjoy powers of initiation and/or intervention in respect of aspects of core corporate decision-making (for example, in relation to constitutional design and major restructuring decisions) conventionally reserved by U.S. corporate law to the board of directors.[94] Moreover, Berle's lack of faith in the prospects for effective shareholder governance, and the acknowledged limitations of his purported common law trusteeship principle, means that it is difficult to conceive of him placing any more than temporary reliance on the fiduciary shareholder wealth maximization[95] norm as an effective regulatory counterweight to managerial hegemony within large-scale corporations.

Academic arguments for legal empowerment of shareholders today, whether of the more "strong-form" shareholder primacy or "semi-strong-form" shareholder wealth maximization variety, tend to derive from a contractarian frame of reference, which focuses on the alleged instrumental value of shareholding as a distinct function within the business firm. According to this logic, the shareholder offers his residual risk-bearing function to the firm, which he is uniquely equipped to perform in view of the exceptional degree of "risk-hedging" facilitated by the liquid-

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94. For an influential argument to this effect, see Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).

95. On this, see *supra* note 4 and accompanying text.

ity of his investment. In return for exclusively fulfilling this function, the shareholder is said to "bargain for" correspondingly exclusive residual profit and voting rights vis-à-vis the firm's management.[96]

But Berle never ascribed to the "shareholder as risk-taker" adage. In *AER*, he argued that:

> The rewards or losses derived from [passive property] bear no necessary relation (if any) to work done, or risk taken, or the usefulness of the aggregated property. None of the old answers suffice. Both the original moral base (reward for capacity and thrift) and the original pragmatic function (need for individual skill in applying capital) have pretty well disappeared.[97]

Likewise, in *TMC*, Berle described how, with the development of the modern public corporation, the two productive functions traditionally ascribed to entrepreneurial activity, namely risking of wealth and application of skill, had become separated from one another and vested in shareholders and management respectively. On this basis, Berle claimed that there was no longer an economic justification for awarding shareholders corporate profits beyond the "fair return to capital" that is sufficient to induce them to continue risking their wealth in corporate equity. To award profits to shareholders beyond this threshold served no useful purpose insofar as shareholders could not be encouraged to apply a greater degree of skill or effort to business affairs given their complete non-involvement in the corporate-managerial process.[98] In the same work, Berle compared the position of the modern day shareholder to that of a bondholder or lender of money, and argued that the distinction that had hitherto been drawn between these two types of investors was now of little value. Like a bondholder, an equity holder in effect had an expectation of receiving "interest" in the form of periodic dividends, followed by repayment of the "principal" via resale of his holding on a liquid marketplace.[99]

In any event, Berle placed little faith in the shareholder franchise as a potential influence vis-à-vis managers, noting that "the usual stockholder has little power over the affairs of the enterprise, and his vote, if he has one, is rarely capable of being used as an instrument of democrat-

96. On this, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 35–39 (Harvard paperback ed. 1996) (1991); Gavin Kelly & John Parkinson, *The Conceptual Foundations of the Company: A Pluralist Approach in* PARKINSON ET AL., *supra* note 43, at 113, 114–21; Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1192–95 (2002).

97. AER, *supra* note 14, at 43.

98. TMC, *supra* note 1, at 299–302.

99. *Id*. at 245–47.

ic control."[100] Further, he observed how "[a]s the number of stockholders increases, the capacity of each to express opinions is extremely limited" with the effect that "[n]o one is bound to take notice of them."[101] Seemingly with these considerations in mind, Berle pondered in *PWP* whether:

> If we were building the American economic system anew, we might wonder whether the present system of stockholders' votes was the best way, or even a good way, of choosing managers or of locating power. It continues chiefly because no one has come up with a better scheme.[102]

Berle defended the institution of self-selecting boards as being inevitable on the basis that external stockholders lacked the knowledge to elect representatives with sufficient and relevant technical acumen to deal with the complex problems typically faced by modern business corporations. In a passage that would no doubt provoke the ire of many present-day shareholder rights lobbyists, Berle insisted that:

> [u]ntil the community on the one hand or the ritualistic stockholders on the other develop far more inclination and capacity for understanding difficult problems and reaching wise personnel decisions, economic power perhaps is best located in a sort of government of best minds, ultimately responsible to a community consensus which sets up general objectives, standards of performance, and results.[103]

Berle's antipathy towards the shareholder empowerment agenda did not, however, result in the complete elimination of the shareholder from his institutional vision. Rather, Berle continued to recognize the importance of shareholding *as a politico-economic institution* within modern American capitalist society. On this basis he advanced a novel and considered defense of the shareholder protectorate agenda, albeit in a relatively limited form (i.e., as entailing only a residual dual entitlement to voting and profit-taking without any further rights of intervention or influence in respect of corporate decision-making). In other words, Berle ultimately defended shareholder *democracy*[104] in its barest form, whilst

100. TMC, *supra* note 1, at 83.

101. *1968 Introduction, supra* note 42, at xix.

102. PWP, *supra* note 13, at 107.

103. *Id*. at 109.

104. Admittedly, the term "shareholder democracy" only imperfectly encapsulates the notion referred to, given that the political-democratic analogy does not account for the peculiar economic profit-taking rights that corporate equity holders enjoy in conjunction with their voting rights. Therefore we use this term only for want of a better term to describe the phenomenon which we believe Berle defended.

rejecting any more extensive alternative methods for the legal empowerment of shareholders in corporate governance.

Berle's defense of shareholder democracy on politico-economic grounds consisted of two main "sub-defenses": (1) a defense of the institution of shareholder *voting* (the political dimension of shareholder democracy); and (2) a defense of the shareholder's entitlement to receive dividends (the economic dimension of shareholder democracy).

1. Berle's Defense of the Shareholder's Right to Vote (The Political Dimension)

Berle presented the notion of shareholder democracy principally on the basis of its ideological implications for the wider political economy in which corporations operated. A significant factor underlying Berle's continuing support for shareholder democracy was his apparent belief that the progressive diminution of the shareholder's proprietary economic influence over corporate affairs varied *inversely* with the shareholder's growing political influence as a general civil society actor. According to Berle:

> The former property owner, as he loses his importance in carrying on economic initiative, is increasingly becoming important as a consumer and as a political factor through his opinions and through his vote.[105]

Berle explained that, in this latter capacity, a shareholder's opinions "may have quasi-political importance, similar to that of constituents who write letters to their congressman."[106] On this basis, Berle presented the seemingly archaic and outmoded institution of the annual corporate shareholders' meeting in a novel and progressive light, by seeing it as a formal ceremonial fulcrum around which the process of public and political consensus formation could develop. Berle argued that "though methods of locating power and choosing its holders may have become obsolete by rational standards, they nevertheless work remarkably well."[107] This was, in Berle's opinion, attributable to the fact that "[c]ommunity consensus has established minimum standards of capacity and acceptability for the holders of such power," which "are generally taken into account by the people who operate the processes and rituals of selection."[108] According to this process, "a mandate, derived from obsolete processes of selection, will continue to be satisfactory for long pe-

105. PWP, *supra* note 13, at 117.
106. *1968 Introduction*, *supra* note 42, at xix.
107. PWP, *supra* note 13, at 107.
108. *Id.*

riods of time if the men selected are acceptable by community standards."[109] In turn, Berle claimed, "[d]irectors of corporations whose control is held by the 'public' (that is to say, by a great number of scattered shareholders) probably pay greater attention to the unwritten, uncrystallized, but very real standards set up by the public consensus than do the holders of undisputed control."[110]

In essence, Berle's corporate governance vision could be said to comprise centralized and autonomous managerial decision-making power "checked" extraneously by a dynamic and largely informal body of public and political opinion vis-à-vis corporate affairs. Within this model, the corporate shareholders' meeting retains limited functional value as a formal institutional conduit for articulation and expression of the multi-faceted and often inchoate public consensus within economic society. Shareholders, meanwhile, acquire a powerful dual significance in their capacity as simultaneous economic *and* political participants in the governance process.

2. Berle's Defence of the Shareholder's Right to Receive Dividends (The Economic Dimension)

As well as arguing for preservation of the shareholder's voting entitlement, Berle also at notable points in his work provided very convincing normative support for the shareholder's traditional right to receive dividends. In view of Berle's rejection of the notion that shareholders fulfilled any meaningful risk-taking function within the modern corporation, his defense of their entitlement to a periodic share of corporate profits (traditionally regarded as the "reward" for entrepreneurial risk-taking) might initially appear surprising.

Crucially, however, Berle defended the shareholder's dividend right principally on *welfarist* grounds as an institutional precondition for the extensive provision of social security via private sector means. In his 1932 exchange with Dodd, Berle highlighted the fact that in the United States, public corporations had become crucial not just as significant employers and suppliers of goods and services, but also as the primary medium for generating (through stock market returns) sustainable income streams to fund socially essential financial services. Berle recorded that

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109. *Id*. at 108. In a very similar vein, Berle argued in *AER* that "[t]he managers of American corporations who hold power, though it is extra-governmental, satisfy customary requirements by a paper vote of stockholders. But they justify themselves by running their corporations well according to prevailing standards. If they do this, few people ask whether the fiction of a corporate election amounts to much. The telephone company is well run; the steel is well made and in adequate supply; the conditions of production are decent; the price is acceptable." AER, *supra* note 14, at 43.

110. PWP, *supra* note 13, at 109–10.

by 1932, over half of the U.S. population was either directly or indirectly dependent on corporate securities (whether held personally or institutionally) for the purpose of social security provision.[111] For this reason he believed that, with the abandonment of the shareholder protectorate agenda in its entirety, "it becomes necessary to present a system (none has been presented) of law or government, or both, by which responsibility for control of national wealth and income is so apportioned and enforced that the community as a whole, or at least the great bulk of it, is properly taken care of."[112] Thus, corporate equities remained of socioeconomic value within Berle's thinking primarily as aspects of financial property in their own right. Accordingly, the principle of shareholder democracy retained significance insofar as profit-taking and voting rights that attach to corporate equities formed the basis of their identity and value as tradable financial commodities; in this capacity, they formed a centrifugal element of the United States' property-based welfare system.

Berle recognized, however, that the capacity of the shareholder democracy principle to command widespread legitimacy within American society as a contributor to the country's welfare system depended on whether, as a matter of fact, the great bulk of its population was satisfactorily provided for via returns from public corporate equity.[113] To this end, Berle noted in his later work that, over the course of the four decades following his exchange with Dodd, corporate equity holding had spread exponentially across American society to the extent that, by 1968, shares had become by far the most popular form of personal wealth-holding in the United States. Berle observed that between 1929 and 1967, the number of shareholders in the U.S. had increased from around 1 million to between 22 and 23 million.

Berle further argued that the shareholder's residual entitlement to corporate dividends was justifiable on politico-economic grounds as a means towards ensuring a sufficient distribution of wealth in American society so as to enable widespread self-reliance and self-realization.[114] Indeed, in *TMC*, Berle went so far as to query whether the increased dispersal of industrial ownership—made possible by the modern corporation—represented "a permanent change in the ownership of industrial wealth comparable to the shift in land ownership which was an outward growth of the French Revolution."[115] And, although Berle acknowledged that under the system of private security ownership "certain individuals

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111. FWCMAT, *supra* note 3, at 1367–68.
112. *Id*. at 1368.
113. *1968 Introduction*, *supra* note 42, at xxiii.
114. *Id*. at xxiii.
115. *Id*. at 60.

may perhaps acquire a disproportionate share of wealth," he nevertheless regarded this as "an incident to the system and not its major premise." He opined that "statistically, it plays a relatively minor part."[116] In this context, shareholder entitlement to dividends was (somewhat ironically from a present day ideological standpoint) advanced by Berle as "a vehicle for rationalized wealth distribution corresponding to and serving the American ideal of a just civilization,"[117] and as an alternative redistributive mechanism to more rigid and statist measures, such as a national minimum wage or "governmentally assured minimum income."[118] Just like the associated welfarist justification advanced by Berle for the shareholder's right to dividends, however, Berle's wider economic-distributive argument for the phenomenon was contingent on the actual realization of the distributive process across the vast majority of the community, to the extent that "every American family has its fragment of that position and of the wealth by which the opportunity to develop individuality becomes fully actualized."[119]

IV. Conclusion: Implications of Berle's Theory for Contemporary Corporate Governance Debates

The core point that we try to make in this article is that by studying Berle's thinking on corporate governance in an integral and contextual way, it is possible to deduce a consistent ideological thread running throughout his lifetime scholarship. That uniting thread transcends the many apparent ambiguities and inconsistencies that are prone to appear on the basis of more particularized readings of Berle's work. In particular, it is our belief that the three underlying and overlapping central themes of the Berleian corporate governance project—namely managerial autonomy, civil society oversight, and shareholder democracy as a socially instrumental institution—are together capable of representing a coordinating nexus around which Berle's work can be consistently understood.

We hope that this finding will contribute to the ongoing academic debate on corporate governance, both in the United States and beyond, in at least two important respects: (1) the role that might be played by the state in corporate governance; and (2) the nature of the relationship between shareholders and the corporation.

116. FWCMAT, *supra* note 3, at 1365.

117. *1968 Introduction*, *supra* note 42, at xxiv.

118. *Id.* at xxiii.

119. *Id*. at xxiii. Although Berle acknowledged that this distributive process was "still in its infancy," he felt that the development of institutionalized pension funds as a method of widespread indirect stockholding gave hope for the future in this regard. *See id*. at xxiv.

A. Corporate Governance and the State

It is widely acknowledged that the last three decades of the twentieth century represented something of a revolutionary period in the development of academic thinking on corporate governance in the United States. In particular, this era witnessed a progressive growth in the influence of economic logic within corporate governance scholarship, which resulted in the widespread application by scholars of market-based incentive and disciplinary mechanisms as perceived institutional solutions to the corporate accountability deficit. A common theme underlying many such "agency costs" approaches to the corporate governance problem was a uniting faith in the informational efficiency of primary and secondary corporate capital markets, and the resultant credibility of the stock price mechanism as an effective "score card" of managerial performance and the comparative robustness of firm-level governance systems. An implicit normative outcome of such analyses is the conceptual interfusion of corporate "efficiency"—understood in the narrow sense of managerial responsiveness to stock market signals—with the dual tenets of "accountability" and "legitimacy" in the wider socio-political sense. In other words, corporations that are compliant with the dictates of external capital market actors (e.g., institutional shareholders, analysts, ratings agencies, and independent directors) are deemed to be *accountable* companies. This suggests, in turn, that the possession and exercise of managerial decision-making power within these firms is socially *legitimate.*[120]

By this course of logic, the continuing social problem of managerial power and the need for its public legitimization within democratic civil society is conveniently elided by reference to the capital market as an accountability mechanism. In particular, the contractarian frame of reference from which "agency costs" analyses derive is built on the implicit understanding that market-driven pressures and rules are ultimately capable of limiting the decision-making power of corporate managers to socially *un*problematic levels.

Admittedly, some contractarian theorists recognize the inherent limitations of pure market-driven pressures and governance structures as an effective constraint on managerial hegemony, and consequently accept the inevitability of mandatory corporate governance rules as set

120. For a historical account and normative rationalization of the development of this extraneous stock market-based control framework in the U.S., with particular regard to the perceived function of independent directors therein, see Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007).

down rigidly by the state.[121] However, even in these more interventionist contractarian analyses, the basic normative premise remains that the state's legitimate role should ultimately be restricted to *facilitating* the "neutral," market-driven, private ordering process as opposed to superseding it in any way through politically-motivated regulatory measures.[122] The problem with such a de-politicized conception of the regulatory state's role in corporate governance, however, is that it refuses to consider the possibility identified by Berle that public civil society pressures might act as an effective proxy for the inevitable limitations of private market measures as a constraint on managerial decision-making power. By assuming that politically-driven rules in corporate governance are a priori illegitimate, and correspondingly that market-driven or market-facilitative governance rules (whether reversible or mandatory in form) are in themselves capable of constraining managerial power to socially unproblematic levels, contractarian logic in effect reasons away the inevitable residual decision-making power wielded by senior corporate officers. It therefore fails to confront the possibility (implicit in Berle's analysis in *PWP*) that a dual framework of market and political drivers of corporate governance reform—with the latter ultimately subject to the proper constitutional checks and balances of a liberal democracy—might provide a more effective and legitimate system of constraints on managerial power than market-based pressures acting alone.

One further related implication of Berle's thinking is the undermining of the orthodox characterization of politically-motivated corporate governance norms as being necessarily rigid, regulatory, and bureaucratic. This is in contrast to market-driven norms, which by virtue of the implicit private ordering process can be more flexible, informal, and factually tailored in nature.[123] However, in *PWP*, Berle identified that the inchoate public consensus can fulfill an indirect role comparable to that of stock market pressures within today's corporate governance system. In other words, it can provide informal pre-regulatory pressures for go-

121. Lucian A. Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549 (1989).

122. Gordon, for example, claims that "it is a mistake to assume that full contractual freedom in corporate law would necessarily lead to private wealth maximization. The existence of some mandatory rules may lead to better contracts. In other words, the mixed system of optional and mandatory legal rules that we observe may be best even from an essentially contractarian perspective." *Id*. at 1554.

123. For a theoretical exposition of the private rule selection process at play within the U.S. corporate law context, see Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989). For a similar rationalization of the (more overtly contractarian) English model of company law, see R.C. Nolan, *The Continuing Evolution of Shareholder Governance*, 65 CAMBRIDGE L.J. 92 (2006).

vernance reform which, in turn, motivate endogenous, corporate, institutional design by boards as a preemptive response to potential statist regulatory measures.[124] In this way, politicized civil society pressures can be given license to fulfill a structurally similar disciplinary function to that performed by "neutral" stock market pressures within the contractarian governance paradigm whilst, at the same time, recognizing the continuing (albeit inevitably limited) role of the latter type of pressure as a managerial accountability mechanism. The resultant picture that emerges is of a rich dual framework of economic and political drivers of endogenous corporate norm evolution at the individual firm level, reinforced in the last place by a sophisticated multi-partite regulatory system that is responsive to both market and civil society pressures for facilitative regulatory intervention.

B. Corporate Governance and Shareholders

The second, and more radical, outcome that follows from Berle's overall position concerns the continuing normative validity of the shareholder's relatively privileged position within the corporate governance hierarchy. In Part III.C.2, we emphasized that, within Berle's vision, the continuing legitimacy of the notion of shareholder democracy (in both a legal and wider social sense) was contingent on the ideal of an American shareholding democracy being practically realized in the near future. Berle predicted that, as a result, beneficial corporate ownership together with the associated economic benefits would come to be spread diffusely across a sizeable proportion of the country's population. Whether this is indeed the case today is a subject of potentially fierce empirical and interpretative debate beyond the scope of this article. Certainly, however, it is doubtful whether the American shareholder populace in 2010 can be regarded as a sufficiently representative cross-sector of the U.S. citizenry to permit the politico-economic justification of the shareholder wealth maximization norm on grounds of effective social security provision or widespread individual self-realization alone.

Moreover, if it is the case today that the annual shareholder meeting is not regarded as sufficiently pluralist in form to elicit the wider indirect engagement of the general public in corporate governance affairs, it follows that the institution of shareholder suffrage is no longer (if indeed it ever was) capable of representing an appropriate formal fulcrum for public consensus formation. If so, then it may reasonably be questioned whether the public consensus vis-à-vis corporate affairs would be more

124. On the significance of private, pre-regulatory rule-making by boards in response to orthodox economic pressure from shareholders, see Bebchuk, *supra* note 94, at 869–70.

effectively and legitimately mobilized around an additional or alternative institutional nexus that provides a more inclusive quasi-democratic representation of the public interest in large-scale economic organization. A possible starting point for further inquiry in this regard would be reconsideration of whether there is a legitimate role for worker involvement in corporate governance as a potential proxy for comprehensive civil society engagement in the shareholder franchise. Additionally, or alternatively, there is a potential normative case for corporatist state participation in governance processes at an individual firm or industry level, perhaps in conjunction with the federal government's recognized role today as ultimate economic risk-bearer in enterprises of core social significance and impact, such as in the banking and automobile manufacturing sectors.

In any event, the underlying point is that with the rejection of stock market responsiveness as an exhaustive criterion of managerial accountability in itself, there arises the corresponding necessity to acknowledge potential additional institutional mechanisms for achieving the social legitimacy of corporate decision-making power. If the solutions that this inquiry encourages appear radical in nature, it only signifies the extent of the corporate accountability deficit and the resultant importance of ensuring its effective resolution within contemporary economic society.