

FOR WHOM CORPORATE MANAGERS ARE  
TRUSTEES: A NOTE

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. From time to time other groups, notably labor, have asserted their claims; and these claims are receiving steadily greater recognition as a cost of industry. If these costs are not met, security holders receive an illusory additional profit. But the security holder's claim was the supposed main objective.

Professor Dodd has challenged the theory.<sup>1</sup> He has stated his own thesis:

“The present writer is thoroughly in sympathy with Mr. Berle's efforts to establish a legal control which will more effectually prevent corporate managers from diverting profit into their own pockets from those of stockholders, and agrees with many of the specific rules which the latter deduces from his trusteeship principle. He nevertheless believes that it is undesirable, even with the laudable purpose of giving stockholders much-needed protection against self-seeking managers, to give increased emphasis at the present time to the view that business corporations exist for the sole purpose of making profits for their stockholders. He believes that public opinion, which ultimately makes law, has made and is today making substantial strides in the direction of a view of the business corporation as an economic institution which

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<sup>1</sup> *For Whom are Corporate Managers Trustees?* (1932) 45 HARV. L. REV. 1145.

has a social service as well as a profit-making function, that this view has already had some effect upon legal theory, and that it is likely to have a greatly increased effect upon the latter in the near future."<sup>2</sup>

This is a point of view which can not be ignored.

## I

As a matter of economics and social theory, Professor Dodd's argument is not only sound but familiar. Indeed, the present writer made that argument before the Bureau of Personnel Administration in 1930,<sup>3</sup> and collaborated in working out the statistical basis for it.<sup>4</sup> No one familiar with European or advanced American thought seriously disputes the propositions: *first*, that the present mode of life entails a high degree of large-scale production; *second*, that this necessitates an unprecedented degree of financial concentration which has clothed itself in the corporate form; and, *third*, that the result of such concentration has been, and must be, to pose a few large organisms, the task of whose administrators is, fundamentally, that of industrial government.

In other words, the great industrial managers, their bankers and still more the men composing their silent "control,"<sup>5</sup> function today more as princes and ministers than as promoters or

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<sup>2</sup> *Id.* at 1147-48.

<sup>3</sup> Berle, *The Equitable Distribution of Ownership*, in A SYMPOSIUM ON BUSINESS MANAGEMENT AS A HUMAN ENTERPRISE. The mimeographed symposium is available at the Bureau of Personnel Administration, 420 Lexington Avenue, Room 745, New York City. The paper referred to was dated December 11, 1930. The writer even attempted a tentative classification of the various claims on the corporate wealth and income stream, namely: (1) The security owners. (2) The management. (3) The customer or patron. (4) The workers, including the entire list of salaried or wage earners. (5) Certain general community claims which, however, might best be worked out through taxation. Under this last head would come matters of public welfare like charity and benevolence referred to by Professor Dodd in the article cited.

<sup>4</sup> "The Modern Corporation and Private Property" by the writer and Gardiner C. Means, in the course of publication by the Commerce Clearing House, Chicago, Illinois.

<sup>5</sup> "Control" is here used to mean that individual or small group of individuals who are able to mobilize or cast sufficient votes to elect the corporate management. This is the sense in which the word is used in the financial communities; and the institution has apparently already acquired a legal status.

merchants. Exclusive profit-making purpose necessarily yields to this analysis.

This is the real justification for Professor Dodd's argument. But it is theory, not practice. The industrial "control" does *not* now think of himself as a prince; he does *not* now assume responsibilities to the community; his bankers do *not* now undertake to recognize social claims; his lawyers do *not* advise him in terms of social responsibility. Nor is there any mechanism now in sight enforcing accomplishment of his theoretical function.

Challenge to the security holder's claim has been made, less articulately but with infinitely more effect, by the handful of corporation lawyers, mainly in New York, who really determine legal control of the corporate mechanism. They in fact, and sometimes in words,<sup>6</sup> discard the theory that corporate managements are trustees for corporate security holders. But they know what the social theorist does not. When the fiduciary obligation of the corporate management and "control" to stockholders is weakened or eliminated, the management and "control" become for all practical purposes absolute.<sup>7</sup> The claims upon the assembled industrial wealth and funneled industrial income which managements are then likely to enforce (they have no need to urge) are their own. The history of the past decade indicates this; the pages of every morning newspaper furnish a new illustration, and the situation is merely complicated by the fact that corporate managers have a real position, can render a real service, and can properly make a real claim. The point is that they need recognize no other.

Now I submit that you 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. Roughly speaking, there are

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<sup>6</sup> Robert T. Swaine, reviewing the writer's *STUDIES IN THE LAW OF CORPORATION FINANCE* in (1929) 38 *YALE L. J.* 1003.

<sup>7</sup> The legal demonstration of this has been made elsewhere and would serve no purpose to review it here. See Berle, *Corporate Devices for Diluting Stock Participations* (1931) 31 *COL. L. REV.* 1239. A similar study, appearing in the book referred to in note 4, *supra*, has to do with devices for diverting the income stream from one group within the corporation to another group or to groups outside the corporation.

between five and eight million stockholders in the country (the estimates vary); to which must be added a very large group of bondholders and many millions of individuals who have an interest in corporate securities through the medium of life insurance companies and savings banks. This group, expanded to include their families and dependents, must directly affect not less than half of the population of the country, to say nothing of indirect results. When the fund and income stream upon which this group rely are irresponsibly dealt with, a large portion of the group merely devolves on the community; and there is presented a staggering bill for relief, old age pensions, sickness-aid, and the like. Nothing is accomplished, either as a matter of law or of economics, merely by saying that the claim of this group ought not to be "emphasized." Either you have a system based on individual ownership of property or you do not. If not — and there are at the moment plenty of reasons why capitalism does not seem ideal — 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. Otherwise the economic power now mobilized and massed under the corporate form, in the hands of a few thousand directors, and the few hundred individuals holding "control"<sup>8</sup> is simply handed over, weakly, to the present administrators with a pious wish that something nice will come out of it all.

The only thing that can come out of it, in any long view, is the massing of group after group to assert their private claims by force or threat — to take what each can get, just as corporate managements do. The laborer is invited to organize and strike,

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<sup>8</sup> The two hundred largest corporations, comprising somewhere between forty and fifty per cent of the industrial wealth of the country, have altogether slightly more than twenty-eight hundred directors. From this must be subtracted a certain number of inactive representatives of large stockholdings. The "control" of these corporations represented by holders of dominant minorities or by the beneficiaries of devices such as voting trusts, pyramided holding corporations, and the like, analyzes down to a very few men. If in place of two hundred corporations perhaps six hundred and fifty corporations are taken, the result would show approximately sixty-five per cent of the industrial wealth of the country administered by perhaps five thousand directors and perhaps seven or eight hundred individuals holding "control."

the security holder is invited either to jettison his corporate securities and demand relief from the state, or to decline to save money at all under a system which grants to someone else power to take his savings at will. The consumer or patron is left nowhere, unless he learns the dubious art of boycott. This is an invitation not to law or orderly government, but to a process of economic civil war.

## II

It is a great misfortune that so little of American enlightened juristic thought has dealt with the subject of private property. The great liberals, notably Mr. Justice Holmes, were rooted in the doctrine that the individual could look out for himself in the economic field, provided he had a full kit of civil rights and political privileges. Some portion of the thinking entered the field of labor rights. No one succeeded in becoming effectively interested in what happened to the fruits of labor; there is, even now, entire absence of realization that the corporate system is steadily conscripting and absorbing the bulk of those fruits to the extent that they are not presently consumed.<sup>9</sup> Yet a society based on the individual, whose support and maintenance the state does not assume, can only be carried on by vigorous protection of the property that he has. It is a matter of experience that during two periods of man's life, childhood and old age, he can not support himself; and that sickness, child-bearing, and incidental economic readjustments will make even further *lacunæ*. The only bridge, in our system, to cover these gaps is private property. The common law has based its whole fabric on this premise.

Under this system, property has now split into two distinct categories. One class may be called *active* — the farm, the little business, the collection of tangible property which the owner can himself possess, manage, and deal with. The other may be

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<sup>9</sup> Again reference must be made to "The Modern Corporation and Private Property" now in process of publication. *Cf.* note 4, *supra*. Figures show that during the past few years (1932 is an obvious exception) fifty-five per cent of savings were absorbed into the corporate system, the balance being divided between government securities and real estate in one form or another. Further, this process is not optional. If all investors elected to endeavor to invest their savings outside the corporate system, there would simply not be enough investments to go round.

called *passive* — a set of economic expectations evidenced by a stock certificate or a bond, each representing an infinitesimal claim on massed industrial wealth and funneled income-stream.<sup>10</sup> The owner of passive property is helpless to do anything with it or about it, except to sell for what the security markets will let him have. This no doubt weakens his ethical right to demand compensation for mere ownership. Equally, it leaves him entirely in the hands of the factual possessor or administrator of the massed wealth. Probably half the entire savings of the country are now represented by passive property; the result has been to throw administration of a dominant part of the system of property rights into the hands of corporate administration. The first major breach in the great dyke of property rights was made by the corporation laws in the past two decades — that is, just as passive property was becoming the type-form in the eastern United States. Many things have flowed through that breach — but responsibility to the community has not yet appeared. One recognizes the occasional benevolences of the many corporate managers whose sympathies are warm and whose aspirations are magnificent. The gross result, however, appraised from the angle either of government or economics, has not been either benevolent or idealist. With due appreciation of the fact that the appraisal is bitterly unjust to many men in the corporate system, it must be conceded, at present, that relatively unbridled scope of corporate management has, to date, brought forward in the main seizure of power without recognition of responsibility — ambition without courage.

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<sup>10</sup> The economic distinction between active and passive property, so far as the writer is aware, has only recently been made; it was in part the result of a study carried on under the auspices of the Social Science Research Council of America, the economic work being done by Mr. Gardiner C. Means. In brief, where industrial property is aggregated under the corporate system, the atom of property splits. The power goes in one direction, centripetally, and concentrates in the hands of the corporate management and the corporate "control." The assumed beneficial ownership is dispersed, centrifugally, among many thousand of small security holders. This dispersed residue of beneficial ownership represented by corporate securities is "passive" property. It must be contrasted with the old unit of property — for example, a farm over which the owner had complete dominance.

Individual initiative, stimulated perhaps by the profit motive, can be made to function where the bulk of the property is active and where the units are so small as to make possible a balance of economic forces. The profit motive can not stimulate the owner of passive property to do anything except speculate.

### III

What ought to be the part of lawyers and the law in this interplay of great hope and disillusioning fact?

Unfortunately, the lawyers have not given too good an account of themselves thus far, either in theory or administration. Again the manifest injustice to many individuals must yield to the grim aggregate, whose summation faces us every morning. The private property right, though still honored in tradition even when passive property — securities — are involved, has in practice been cut to pieces by them. A group of New York corporation lawyers drafted the present Delaware Corporation Act, and (practically speaking) passed it. A similar group evolved a reorganization procedure under which equity and economics may be dealt with almost at will by individuals who are not constrained to recognize either, unless by unusual consciences. On the administrative side, a lawyer and an ex-lawyer constructed the outstanding American "investment trust" bubble; and one could follow this with a lengthy list. For prophylactic justice, the Listing Committee of the New York Stock Exchange (in honor it must be observed that they have excellent counsel) is far more useful than any existing legal group.

Nevertheless, development in the corporate field is more likely to come through lawyers than through any other group. For one thing, they do, approximately, understand the system. They have, however, a function widely divergent from that of the economist or the social theorist. They must meet a series of practical situations from day to day. They are not, accordingly, in a position to relinquish one position — here, the idea of corporate trusteeship for security holdings — leaving the situation in flux until a new order shall emerge. Legal technique does not contemplate intervening periods of chaos; it can only follow out new theories as they become established and accepted by the community at large. It is likely that claims upon corporate wealth and corporate income will be asserted from many directions. The shareholder who now has a primary property right over residual income after expenses are met, may ultimately be conceived of as having an equal participation with a number of other claimants. Or he may emerge, still with a primary property right over residual income, but subordinated to a number of

claims by labor, by customers and patrons, by the community and the like, which cut down that residue. It would, as Professor Dodd points out, be unfortunate to leave the law in such shape that these developments could not be recognized as a matter of constitutional or corporation law. But it is one thing to say that the law must allow for such developments. It is quite another to grant uncontrolled power to corporate managers in the hope that they will produce that development.

Most students of corporation finance dream of a time when corporate administration will be held to a high degree of required responsibility — a responsibility conceived not merely in terms of stockholders' rights, but in terms of economic government satisfying the respective needs of investors, workers, customers, and the aggregated community. Indications, indeed, are not wanting that without such readjustment the corporate system will involve itself in successive cataclysms perhaps leading to its ultimate downfall. But apart from occasional and brilliant experiments of men like Mr. Swope and Mr. Young (who after all are the exceptions rather than the rule), we must expect our evolutionary process to be stimulated from quite different quarters.

Unchecked by present legal balances, a social-economic absolutism of corporate administrators, even if benevolent, might be unsafe; and in any case it hardly affords the soundest base on which to construct the economic commonwealth which industrialism seems to require. Meanwhile, as lawyers, we had best be protecting the interests we know, being no less swift to provide for the new interests as they successively appear.

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