John R. Commons, Subsidiarity and the Corporation

Glen W. Atkinson, Eric R. Hake and Stephen P. Paschall

Abstract

The relationship between the corporation and the state has evolved as a function of the co-evolution of law, economics and finance. The corporation is a social artifact not occurring naturally but created to serve a social purpose. The history of the corporation has been characterized by business values which preempt social purposes for the private benefit of financial interests. The widening of the market replaced handicrafts with industrial production. The economic structures of the late nineteenth century built on the role of intangible property have evolved into globalized corporations engaged in financial manipulation diverting the returns from production disproportionately to financial interests.

Corporate power has not been constrained by financial disclosure regimes, such as the Sarbanes-Oxley Act, by regulation of financial innovation, or by antitrust enforcement. Nevertheless the popular response to corporate power is stricter antitrust enforcement which is a backward-looking institution. The history of failure with financial disclosure law and antitrust enforcement should instruct the development of social control policy for today.

The role of ultra vires as the means by which states kept corporations within the boundaries of their purposes was swept aside by the replacement of special charters with liberal general incorporation laws but remains a useful instrument for social control by the states. Corporate charters and state corporation laws can restore the social purpose to the corporation as social artifact. John R. Commons described the process by which the state personified the corporation by imposing rights, duties, liberties and exposures. With Commons' attention to the future, he observed that the working rules established through this process were the rules governing the future behavior of the corporation. The inconsistent manner in which the U.S. Supreme Court has applied the Commerce Clause suggests reliance on federal regulation may be undermined by a conservative Court. Given the long-standing practice of states chartering corporations, the principle of subsidiarity supports exercise of social control at the more local level by the state. The states give 50 laboratories in which forms of social control can be tested and 50 regulatory bodies to enforce the working rules of social control through such methods as requiring broader representation of stakeholders on the boards of directors and the consideration of constituencies beyond shareholders.

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Introduction

The corporation is not a naturally occurring phenomenon nor a manifestation of human nature. It is a social construct; a product of extrinsic agency. It is a social invention; a form of public intervention. Enterprise does not require the corporate form in order to engage in production or commerce. However in the past 130 years corporations have become the common method to conduct business in the United States.

The corporation "as a form of social organization is peculiar to western culture" (Hamilton 1956, p. 12). How did the corporate form become such a favored model for business organizations? What purpose did it serve in the development of the modern economy of the United States? How did it achieve the characteristics of a person for purposes of law? How did corporations come to exercise so much power in the United States? The corporation as we know it today is the outcome of a process of co-evolution as the economy developed, business adapted and courts endorsed emerging business practices. The corporation is a result of cumulative causation.

This paper examines the relationship between the corporation and the state as it has evolved as a function of the co-evolution of law, economics and finance in the following sections. First is a discussion of the historical development of the corporation, the role which the sovereign government had in that process and the implications for social control. Second is a discussion of the ultra vires doctrine as a form of social control over the corporation and the erosion of that control when the role of ultra vires waned with the movement toward liberal general incorporation statutes. Third is an analysis of the
development of corporate power in the absence of social control and the role of finance. The paper concludes with a discussion of a proposal by which states could regain social control over corporations applying the principle of subsidiarity (the vesting of authority in the lowest level of competent social control).

**Historical Development of the Corporation**

Corporations have "persisted for millennia, with roots in the church, local government communes, and early business companies" (Davis 2016, p. 612). Roman law had governed the formation and operation of "public and private corporate bodies" (Hurst 1970, pp. 1-2). The medieval church governed ecclesiastical corporate bodies. These entities required an act by the sovereign (secular or sectarian) to be called into existence (Hurst 1970, p. 2). The early precursors of sovereign authority when creating corporations exerted public control over the purposes and powers of corporations.

In early modern Europe the "corporation was most clearly represented by the guild and commune" (Davis 2016, p. 613). The public authority of the sovereign over corporations under church law and Roman law is analogous to English law on corporations although there "is little indication that English policy makers followed, or even knew much, Roman doctrine" (Hurst 1970, p. 2). Public sovereignty over corporations developed as a national English government asserted authority over local governments. "By 1628 Coke could assert firmly that royal authorization was necessary to create a corporation" (Hurst 1970, p. 3).

Granting of royal charters by the sovereign carried over to the North American colonies. Such charters also commanded the corporations to be responsible to the sovereign and the
public. The formation of corporations in the North American colonies was not widespread and when granted was primarily for local public services. "It appears that only seven business corporations were created in the Thirteen Colonies" (Sylla 2014, p. 35). Some of the royal grants of charters would survive the Revolution, such as one granted by King George III to the Rev. Eleazar Wheelock to created Dartmouth College in 1769 for the purpose of maintaining and educating the children of Native Americans.

The authority of the sovereign to grant charters was a power assumed by state governments after the Revolution (Davis [1917] 1965, p. 4). Charters issued by state governments in the early years of the United States were "for activities of some community interest – supplying transport, water, insurance or banking facilities. That such public interest undertakings practically monopolized the corporate form implied that the public authority must confer it" (Hurst 1970, p. 15). Between 1781 and 1800 state legislatures granted 333 charters for corporations (Davis [1917] 1965, pp. 22-3). Only 28 charters for business corporations were granted up to 1790 (Sylla 2014, p. 335). The role of the public interest would be demonstrated by the experience with the formation of corporations during the eighteenth and much of the nineteenth centuries. Businesses during this period were small and often family owned (Tung 2006, p. 46). Corporations were not the dominant form of organization for business enterprises during this period when sole proprietorships and partnerships represented the bulk of business organizations (Davis [1917] 1965, p. 256).

During the entire eighteenth century only 355 corporations were chartered and many of them were chartered for municipal or charitable purposes (Friedman 1973, p. 166). The corporations formed under acts of state legislatures, known as special charters, were
engaged in local public services, construction and maintenance of highways and banking. Only 4% of the charters were for ordinary business corporations (Davis [1917] 1965, pp. 24-5).

Up to the Civil War most of the corporations were small business entities (Sylla 2014, p. 356). Each of the corporations was granted a charter as a separate act of a state legislature. These special charters would grant specific powers to the corporation and impose limits, such as the number of years the corporation would continue -- not all corporations were granted a perpetual life. The charters would also limit the corporation under such terms as (i) how it could conduct business, (ii) setting an upper limit on its paid-in capital (iii) and prohibiting mergers.

Chief Justice John Marshall's opinion in the US Supreme Court decision in *Trustees of Dartmouth College v. Woodward*, 17 US 518 (1819) would define the relationship between a corporation and its state of incorporation for most of the nineteenth century. King George III granted a royal charter for Dartmouth College in the colony of New Hampshire in 1769. In 1816 the New Hampshire legislature amended the charter without the consent of the Trustees of Dartmouth College. The amendment changed the composition of the Trustees and the method of appointing them. The Trustees challenged the statute and the highest state court in New Hampshire found against the Trustees. Upon appeal to the US Supreme Court, Chief Justice Marshall examined the terms of the royal charter, which had not been set aside by the American Revolution, and applied it to the relationship between New Hampshire and Dartmouth College. The Court found the charter to be a contract and determined that the action by the New Hampshire legislature was unconstitutional because it violated Section 10 of Article I of the US Constitution

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which prohibited a state from enacting a law impairing the obligation of contracts

(Trustees of Dartmouth College 17 U.S. at 524).

Marshall characterized corporations in the following manner: "A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence" (Trustees of Dartmouth College 17 U.S. at 636). Having thus described the corporation as a creature of the state (consistent with prior law) subject to the terms and limits of its charter, Marshall explained that the charter was "plainly a contract to which the donors, the trustees and the crown (to whose rights and obligations New Hampshire succeeds) were the original parties" (Trustees of Dartmouth College 17 U.S. at 643-44). In this landmark decision Marshall set forth the relationship between the sovereign and its corporations consistent with the public interest standard of English law and its predecessors. The corporation had no existence without the authority of the sovereign granting it purposes subject to limits. The purposes were invested with a public interest.

John R. Commons characterized a special charter as a special privilege and a "franchise-to-be" (Commons [1924] 1995, p. 178). He described the charter as "the group of promises and commands which the state makes in the form of working rules indicating how the officials of the state shall act in the future in matters affecting the association, the members of the association, and the persons not members" (Commons [1924] 1995, p. 144). The grant of a charter had the effect of personifying the association of persons as a collective entity upon which the state imposed rights, duties, liabilities and exposures
(Commons [1924] 1995, p. 143). The entity, however, was not merely an association of persons. It had an independent existence by reason of its charter granted by the state.

Corporations "could not exist a day if the sovereign power of the State were not back of them, giving them the rights to buy and sell and hold property, and to act as a single aggregation of capital, with all the enormous power which this implies" (Commons 1894, p. 62). Commons observed how this relationship between the corporation and the state was social control. "If the State creates corporations, it can determine the conditions of their existence" (Commons 1894, p. 62). This relationship was born out in Commons' opinion by the decision of the U.S. Supreme Court in *Van Allen v. The Assessors*, 70 U.S. 573 (1865).

In *Van Allen v. The Assessors* the Supreme Court determined that the ownership of the assets of the corporation was vested in the entity and was distinct from the interest of the shareholders in their proportionate share of the net profits of the corporation. In his analysis of *Van Allen* Commons noted that this distinction between the ownership of property rights in corporations marked the legal recognition of the corporation as a going concern (a collective entity separate from the individual owners) and the legal recognition that the going concern owned a going plant and a going business (Commons [1924] 1995, 174). The corporation was not simply an amalgamation of its shareholders but a collective entity with its own rights and powers distinct from those of the shareholders.

In its earliest pronouncements about the corporation the U. S. Supreme Court characterized it as an artificial entity, a creature of the law. This came to be known as the realist position because it recognized that the corporation was an entity separate and
distinct from its shareholders. The later decisions of the U. S. Supreme Court finding that
the corporation was a person for purposes of the 14th amendment came to be known as
the nominalist position because it found the rights of the corporation and the rights of its
shareholders to be indistinguishable from each other and, therefore, the corporation was
just an association of shareholders with the same rights as the shareholders.

Katsuhito Iwai (1999) offers an explanation for the distinction between the ownership of
the corporation's assets and the ownership of the corporation itself. Iwai observes that "an
incorporated business firm is composed legally of not one but two ownership relations:
the shareholders own the corporation as a legal thing and the corporation as a legal
person in turn owns the corporate assets. The corporation thus plays a dual role - of
'person' and 'thing' - in the legal system" (Iwai 1999, p. 585). Iwai describes the dual
ownership relation as one in which the corporation is both the object of ownership (by its
shareholders) and the subject of ownership (of the corporate assets) (Iwai 1999, p. 593).
Thus, the corporation is not simply a legal "wrapper" around individual owners who
retain their rights as persons under the law. The corporation is distinctively different from
its individual owners for whom it is a "thing" and the object of ownership. It has a legal
identity as a "person" only because it is an entity owning property which is not also
owned by the shareholders and, therefore, the subject of ownership.

Like Van Allen this duality interposes the entity of the corporation between the
shareholders and the corporate assets. The actions of the corporation are legally binding
upon the corporate assets and for this purpose the corporation is a "legal person". The
limited liability which is conferred upon the shareholders for such actions of the
corporation is the outgrowth of the object/subject distinction between the ownership of
assets as was set forth in Van Allen. "In order for a corporation to serve as one of the parties of a contractual relation, it has to be recognized by others as the holder of ultimate rights over some real assets and as the bearer of the ultimate duties associated with their use, independently of its constituent members" (Iwai 1999, p. 591). Thus, security of expectations of parties entering into transactions with corporations demands the characterization of the corporation as the owner of the assets with rights distinct from the rights of its shareholders.

The security of expectations of shareholder protection under limited liability rests upon the object/subject ownership distinction. "It would indeed be illogical to reject the legal personality of the corporation and at the same time embrace the limited liability of corporate shareholders. A corporation and its shareholders are two distinct subjects of property rights, and each owes no legal obligation to any contract the other has independently formed with a third party" (Iwai 1999, pp. 591-92). Despite the insight of the Supreme Court to the object/subject distinction in Van Allen, the Supreme Court would rely on the corporation as a person under the Fourteenth Amendment's protections against deprivation of life, liberty or property without due process of law repeatedly to set aside state regulation of prices, rates and wages. The personhood of the corporation still distorts regulation of the corporation in such decisions as Citizens United v. Federal Election Commission, 588 U.S. 310 (2010).

The process of economic development in the United States accelerated during the middle years of the nineteenth century as the market expanded. The expansion arising first from canals then railroads and telegraph would propel the economy through changes which would affect business. The economy would pass through stages identified by John R.
Commons as Merchant Capitalism, Employer Capitalism and Banker Capitalism. These stages would be characterized first by transformation of production and then by transformation of finance. Commons's analysis explains the replacement of an age of scarcity where handicraft production predominated by an age of abundance where mass industrial production resulted in cut-throat price competition which in turn would be replaced by price and profit stabilization through business consolidation (Commons [1934] 1961, pp. 763-88). "Capitalistic organization of various industries, as opposed to earlier craft organizations, developed with the widening of markets, and the consequent opportunity for mass production and standardization of products" (Mitchell [1927] 1949, p. 72). Hyman P. Minsky would extend this analysis of the role of finance in business into the latter half of the twentieth century. Commons identified the period of the early and mid-twentieth century as the stage of Banker Capitalism. Banker Capitalism would characterize this period of corporate growth "owing to the prevalence of the credit system" (Commons [1934] 1961, p. 766). Minsky referred to the period of the New Deal and immediate post World War II as Managerial Capitalism followed in the latter part of the twentieth century by Money Manager Capitalism (Minsky 1992, pp. 107-113). Both Commons and Minsky saw the development of the corporation as the dominant mode of business organization occurring alongside the greater role of finance in the operation of corporations. Both explained how the financial system developed to accommodate the changes in industrial production.

The use of the corporate form for the organization of business during the latter decades of the nineteenth century was the outcome of the economic circumstances and laws endorsing emerging business practices. Business in response to the expanding markets
would engage in roundabout production entailing extensive time delays between production and sale. This delay and the increasing scale of production would require finance to manage the uncertainty of revenues. However, "what appears to be a sudden transformation from a production economy to a financial one is actually an evolutionary process that can be traced back for several decades" (Atkinson 2010, pp. 289-90). The consequences of the co-evolution of the corporation, finance and the law carried the practices of the late nineteenth century forward into contemporary times.

Before the final decade of the nineteenth century substantial industrial production would be organized as partnerships. Carnegie Steel Company, while the largest producer of pig iron in the United States and valued at $25,000,000, was organized as a "partnership association" – a form of limited partnership under the laws of Pennsylvania. It represented the culmination of a series of partnerships involving Andrew Carnegie, Henry Phipps, Jr., Thomas Carnegie, Andrew Kloman, George Lauder and others beginning with Kloman & Carnegie Brothers, an iron forging company formed under a partnership agreement on December 31, 1870 (Senator John Heinz Pittsburgh Regional History Center Carnegie Steel Company Archives, Box 30, Folder 4). Subsequent partnerships acquired and operated the Lucy Furnaces, the Union Iron Mills and the Edgar Thomson Steel Works (Senator John Heinz Pittsburgh Regional History Center Carnegie Steel Company Archives, Box 30, Folder 5 and Box 22, Folder 8). On April 1, 1882 Carnegie Brothers & Company, Ltd. (the first entity organized by Carnegie under the Pennsylvania Limited Partnership Act of June 2, 1874) consolidated many of the steel operations. On July 1, 1892 the partners of Carnegie Brothers & Company, Ltd. unanimously agreed to change the name to the Carnegie Steel Company, Ltd. (Senator
In the final decade of the nineteenth century much of the steel industry was already operating under corporations "underwritten by banking houses and other financial institutions" (Meade 1901, p. 544). During the panic of December 1900 promoters found themselves unable to sell the securities in their possession at a profit and "found themselves in the position of controlling the policy of the new companies" (Meade 1901, p. 546). Carnegie Steel Company, Ltd. was in a financial position unencumbered by the interests of financiers and with Andrew Carnegie's attention to cost accounting stood in the position to engage in ruinous price competition with such companies as Federal Steel, American Steel and Wire, National Tube and National Steel. Financial interests represented by J. P. Morgan saw the relief from the menace of competition if they could unite the competing companies into one corporation "to remove the danger of competition" (Meade 1901, p. 550). Morgan approached Charles Schwab of Carnegie Steel Company, Ltd. to determine if it could be bought.

The Carnegie Steel Company, Ltd. retained its character as a partnership until it was sold at the end of 1900 to the newly organized United States Steel Corporation formed by J. P. Morgan. The price of Carnegie Steel Company, Ltd. was $480,000,000. The United States Steel Corporation was capitalized at $1,100,000,000 (Wall 1970, p. 792; Standiford 2005, pp. 277-280). Andrew Carnegie received payment of his 51% interest in Carnegie Steel Company, Ltd., in 5% bonds worth $225,000,000 secured by a mortgage on United States Steel Corporation property instead of payment in shares of the new corporation (Wall 1970, p. 792; Standiford 2005, p. 279). "The surplus earnings of the
United States Steel Corporation for the first six months of its existence exceeded $12,000,000 (Meade 1902, p. 214). Morgan's gamble paid off and the menace of competition averted with the plants of the new corporation having approximately 70% of the productive capacity of the steel industry (Meade 1902, p. 214).

The growing use of the corporate form during the period of industrial mass production, such as the United States Steel Corporation, was a response to the menace of competition which arose from production for expanding markets. The merger wave of 1895-1904 brought competitors into new consolidated businesses where prices could be more effectively administered and output of product could be restrained for that purpose. Financiers would be a critical component of this process as "the banking syndicate or the investment banker, usually affiliated with commercial banks, arose out of their former intermittent activity in special flotations of securities of corporations and nations, into a dominant position in the consolidation of industries" (Commons [1934] 1961, p. 773). As David Hamilton (1956) observed, "one of the major incidences of the corporation is in a 'conscientious withdrawal of efficiency'" (Hamilton 1956, p. 14 (citing Thorstein Veblen, The Engineers and the Price System, NY: Viking, 1947)). A corporation was the tool for such consolidation because its stock could be used to acquire competitors. The growth of a stock exchange was stimulated by owners of smaller companies involved in mergers who wanted to trade part of their equity for more liquid assets (Navin and Sears 1955, p. 116). Also consolidation of business under a corporation served to expand "ownership claims without any necessary concomitant expansion of productive apparatus" (Hamilton 1956, p. 14). Corporations became a means for creating income claims on industry while simultaneously reducing its productive capacity in order to stabilize revenues.
The *Ultra Vires* Doctrine and Social Control

A corporation acting beyond the limits set in its charter was said to engage in *ultra vires* acts. An *ultra vires* act was void and unenforceable in a court. Furthermore, a corporation involved in *ultra vires* acts was subject to dissolution and sacrifice of its charter. This was the social control a state had over its corporations. The *ultra vires* doctrine would have a principal role in regulating corporations up until the final decade of the nineteenth century.

Shortly after Marshall was appointed Chief Justice by President John Adams in 1801, the US Supreme Court decided a case about the actions of a corporation beyond its charter. *Head & Amory v. Providence Insurance Company*, 6 US 127 (1804) would apply the *ultra vires* doctrine in a federal context. The case came within federal jurisdiction because it involved parties in Massachusetts and Rhode Island. Head & Amory owned a cargo ship insured by Providence under two policies ($10,000 on the cargo and $6,000 on the ship). The ship was being held in a foreign port under foreign authority without prospects for its release (*Head & Amory v. Providence Insurance Company*, 6 US at 129). The owners of the ship sent notice to Providence to cancel the insurance policies. Correspondence ensued between the parties negotiating the terms of cancellation and a partial return of premium. While negotiations continued the ship left the foreign port and was captured as a prize of war making a claim for the full insured value proper. The final correspondence from Providence to Head & Amory accepting the terms for cancellation was signed by the Secretary of Providence (*Head & Amory v. Providence Insurance Company*, 6 US at 133). The claim for the full insured value under both policies was denied based on the correspondence. Head & Amory challenged the denial on the
grounds the cancellation was ineffective. The opinion by Marshall found in favor of Head & Amory because the charter of Providence Insurance Company required that acts of the corporation be made only by instruments under the signatures of the President and the Secretary. The acceptance of cancellation signed only by the Secretary was *ultra vires* (*Head & Amory v. Providence Insurance Company*, 6 US at 139). Marshall concluded that the corporation "is the mere creature of the act to which it owes its existence, all the qualities and disabilities annexed by the common law to ancient institutions of this sort, it may correctly be said to be precisely what the incorporating act has made it, to derive all its powers from that act, and to be capable of exerting its faculties only in the manner which that act authorizes" (*Head & Amory v. Providence Insurance Company*, 6 US at 167).

From *Head & Amory* and *Trustees of Dartmouth College* two principles emerged which defined the relationship between a corporation and its creating state: "(1) the charter was a limit on the state because it was a contract protected against impairment and (2) the charter was a limit on the corporation under the *ultra vires* doctrine" (Atkinson and Paschall 2016, p. 57). The public interest was protected by the limits the state imposed on the corporation under its charter. The corporation's interests were protected by the prohibition on the state changing the terms of the charter.

The *ultra vires* doctrine thus "embodied the notion that the corporation was a creature of the state" (Greenfield 2001, p. 1303). Strict application of the doctrine meant that actions taken by a corporation were void if they were beyond the formal grant of powers made to the corporation in its charter. Each shareholder of a corporation had the right to enjoin an *ultra vires* act individually and without regard to the opinions of other shareholders.
(Greenfield 2001, p. 1307). Although frequently addressed in federal court decisions, the enforcement of the doctrine was primarily a matter of state corporate law and involved the relationship between the corporation and the state manifested in the corporate charter.

Although an act by a corporation beyond its grant of powers was void under the *ultra vires* doctrine, courts distinguished between the rights of private parties and the state. The Supreme Court of Vermont in 1856 considered a contract made by a railroad company for the purchase of a steamboat company and its property in the case of *Rutland and Burlington Railroad Co. v. N. B. Proctor and W. J. Odell*, 29 Vt. 93 (Supreme Court of Vermont, 1856). The purchase was clearly beyond the powers of the railroad company. Proctor and Odell had purchased one of the boats from the railroad company and agreed to pay the railroad company for furniture for the boat and for repairs (*Rutland and Burlington Railroad Co. v. N. B. Proctor and W. J. Odell*, 29 Vt. at 95). After Proctor and Odell failed to pay, the railroad company sued for payment and the purchasers raised the defense that the purchase of the steamboat company by the railroad company and the subsequent sale of a boat to them were *ultra vires* and unenforceable (*Rutland and Burlington Railroad Co. v. N. B. Proctor and W. J. Odell*, 29 Vt. at 95). The court took notice that the shareholders had not sought to enjoin the acts despite their right to do so and Vermont had taken no action to dissolve the charter of the railroad company (*Rutland and Burlington Railroad Co. v. N. B. Proctor and W. J. Odell*, 29 Vt. at 96). The court concluded that had the shareholders or Vermont intervened then the transaction would be void but in the absence of such intervention the acts, while still void, were enforceable against Proctor and Odell (*Rutland and Burlington Railroad Co. v. N. B. Proctor and W. J. Odell*, 29 Vt. at 97). *Ultra vires* could not be raised by a party to a transaction from
which the party already had received the benefit. This would become the equitable principle exception to the strict application of the *ultra vires* doctrine.

The *ultra vires* doctrine was based on the relationship between a corporation and the state granting the corporation its charter. The charter was a contract between the state and its corporation. It evidenced the exercise of social control over the corporation by limiting the corporation's powers in return for the grant of corporate status. While *ultra vires* contracts under which one party had performed could be enforced against the other party, the contract between the state and its corporation was subject to enforcement by the state.

The right of the incorporating state to enforce the terms of the charter against a corporation did not involve the equitable principle but was rooted firmly in the *ultra vires* doctrine. Each charter was a contract between the state and its corporation. Acts by a corporation beyond those powers were a violation of the charter and subject to enforcement by the state, including dissolution of the corporation. The state acted on behalf of the public to assert the public interest in the actions by corporations.

The distinction between the rights of the state to challenge *ultra vires* acts and the rights of individuals who might be beneficiaries under the equitable principle was addressed by the Court of Errors and Appeals of New Jersey in *Camden & A.R. Co. v. May's Landing & E.A.C.R. Co.*, 48 NJL 530 (1886). The court reasoned that the lease for 999 years was *ultra vires* which affected the rights of the parties but, despite the rights of the parties, the "state may interpose its authority at any time, and compel an abandonment of the act in excess of power, and, if need be, revoke the charter of the company for its usurpation. When the state challenges the legality of a transaction, the paramount and only question
is whether it has bestowed upon the company the requisite authority to engage in it" (Camden & A.R. Co. v. May's Landing & E.A.C.R. Co., 48 NJL at 537). The rights of the state arose by reason of the charter it had granted and the limited powers conferred by the charter.

The action by a state challenging an ultra vires act by a corporation is under a quo warranto proceeding demanding the corporation to show the authority under which it acted. The English writ of quo warranto was one by which the king would challenge the right of an individual to hold an office or exercise a governmental privilege. In the United States a quo warranto proceeding was initiated by a state's attorney general to challenge an exercise of power by a corporation for being ultra vires.

The Pennsylvania Supreme Court explained the authority of the state to bring a quo warranto action against a corporation in Commonwealth v. Delaware & Hudson Canal Co., 43 Pa. 295 (1862). If a corporation "is exercising franchises or functions not granted to it" the court upon the complaint by the state has authority to "oust it [the corporation] from the exercise of such" (Commonwealth v. Delaware & Hudson Canal Co., 43 Pa. at 300). This right of the state does not affect the rights of private parties against each other but "simply asserts a usurpation of franchises or functions not granted by the state" (Commonwealth v. Delaware & Hudson Canal Co., 43 Pa. at 300). This right of the state may be asserted even if ultra vires had been raised as a defense by one of the parties because the rights of the state are not affected by the equitable principle.

A quo warranto proceeding was brought on behalf of the public to protect the public from the exercise of corporate power in excess of the powers granted to a corporation by
the public in the corporate charter. "Corporate bodies that engage in a public or quasi public occupation are created by the state upon the hypothesis that they will be a public benefit. They enjoy privileges that individuals cannot have. Perpetual or certain life is accorded to them" (Stockton, Attorney General v. Central R. Co. of New Jersey, et al., 50 NJ Eq. 52, 71 (Ct. of Chancery of NJ, 1892). In the economic circumstances of the latter part of the nineteenth century quo warranto proceedings would be challenges to the consolidation of corporations.

Efforts made during a period of time late in the nineteenth century to consolidate the organization of independent corporations under a trust form would fail. In four state court decisions between 1889 and 1892 the Sugar Trust, the Chicago Gas Trust, the Distillers' & Cattle Feeders' Trust and the Standard Oil Company Trust were dissolved under quo warranto proceedings in state courts as ultra vires acts by the corporations (People v. North River Sugar Refining Co., 3 N.Y.S. 401 (Cir. Ct., N.Y. County (1889)); People v. Chicago Gas Trust Co., 130 Ill. 268 (Ill. Supreme Ct. (1889)); State v. Nebraska Distilling Co., 29 Neb. 700 (Neb. Supreme Court (1890)); Ohio v. Standard Oil Co., 49 Ohio St. 137 (Ohio Supreme Court (1892)). See Atkinson and Paschall 2016, pp. 76-79). Four state courts found corporate acts resulting in de facto mergers, particularly under the form of a trust, to be ultra vires and void. The states' Attorneys General acting on behalf of the public exercised social control over the corporations. Where the law did not specifically or impliedly grant powers to a corporation, the corporation was denied the right to exercise the power. At best the act would be deemed invalid and void. At worst the act placed the corporate charter at risk of forfeiture.
Extensive use of the corporate form under the domain of the *ultra vires* doctrine would prove to be impractical because of the conflict between the formation of the corporation to enhance private interests and the social control of corporations to serve public interests. This conflict would be resolved by the 1888 New Jersey liberal general incorporation statute (Act of April 3, 1888, ch. 269) which relinquished the power of the state to exercise social control under the *ultra vires* doctrine. The New Jersey statute allowed incorporation for any legal purpose, thus eliminating the enunciation of limited corporate powers under prior laws. Furthermore, corporations organized under New Jersey law could hold stock of other corporations facilitating the trust approach to industrial concentration which had been found to violate the *ultra vires* doctrine in Ohio, New York, Illinois and Nebraska. The Standard Oil Trust which was dissolved under Ohio law and the Sugar Trust disallowed under New York law were reorganized under New Jersey law. Formation of corporations in New Jersey in 1890-1899 increased by 932% over the period 1870-1879 (Atkinson, Hake and Paschall 2019, p. 13). Other states would soon join New Jersey and the ensuing race among states competing to issue corporate charters would result in private interests dominating corporations. The "race" would be characterized by Justice Brandeis of the Supreme Court as a race "not of diligence but of laxity" (*Louis K. Liggett Co. v. Lee*, 288 US 517, 559 (1933)). The extent of the formation of business corporations after the introduction of liberal general incorporation laws can be seen in Table 1 below.
### Table 1
Incorporations By Five Year Period from 1870-1929 for Selected States

<table>
<thead>
<tr>
<th>Period</th>
<th>Connecticut</th>
<th>Delaware</th>
<th>Maine</th>
<th>Massachusetts</th>
<th>New Jersey</th>
<th>Ohio</th>
<th>Pennsylvania</th>
</tr>
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<tbody>
<tr>
<td>1870-1874</td>
<td>*</td>
<td>*</td>
<td>420</td>
<td>*</td>
<td>734</td>
<td>1,699</td>
<td>*</td>
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<tr>
<td>1875-1879</td>
<td>*</td>
<td>*</td>
<td>185</td>
<td>*</td>
<td>367</td>
<td>1,349</td>
<td>757</td>
</tr>
<tr>
<td>1880-1884</td>
<td>361</td>
<td>*</td>
<td>1,247</td>
<td>701</td>
<td>1,495</td>
<td>2,586</td>
<td>1,498</td>
</tr>
<tr>
<td>1885-1889</td>
<td>541</td>
<td>*</td>
<td>1,639</td>
<td>838</td>
<td>2,364</td>
<td>3,359</td>
<td>2,584</td>
</tr>
<tr>
<td>1890-1894</td>
<td>732</td>
<td>*</td>
<td>2,390</td>
<td>1,102</td>
<td>5,124</td>
<td>4,004</td>
<td>3,186</td>
</tr>
<tr>
<td>1895-1899</td>
<td>751</td>
<td>*</td>
<td>2,528</td>
<td>1,233</td>
<td>6,231</td>
<td>4,055</td>
<td>2,814</td>
</tr>
<tr>
<td>1900-1904</td>
<td>1,262</td>
<td>*</td>
<td>4,739</td>
<td>2,353</td>
<td>10,272</td>
<td>7,772</td>
<td>6,508</td>
</tr>
<tr>
<td>1905-1909</td>
<td>1,821</td>
<td>3,998</td>
<td>4,832</td>
<td>6,418</td>
<td>9,533</td>
<td>11,868</td>
<td>7,239</td>
</tr>
<tr>
<td>1910-1914</td>
<td>2,154</td>
<td>7,368</td>
<td>3,238</td>
<td>7,237</td>
<td>8,450</td>
<td>11,614</td>
<td>8,257</td>
</tr>
<tr>
<td>1915-1919</td>
<td>2,528</td>
<td>14,942</td>
<td>2,517</td>
<td>9,772</td>
<td>5,837</td>
<td>15,227</td>
<td>8,592</td>
</tr>
<tr>
<td>1920-1924</td>
<td>3,684</td>
<td>24,663</td>
<td>2,123</td>
<td>*</td>
<td>*</td>
<td>20,421</td>
<td>*</td>
</tr>
<tr>
<td>1925-1929</td>
<td>4,861</td>
<td>28,755</td>
<td>1,881</td>
<td>*</td>
<td>*</td>
<td>20,051</td>
<td>*</td>
</tr>
</tbody>
</table>

*Data is either unavailable or only for part of the period.


The growth in the number of incorporations after the introduction of liberal general incorporation statutes would set in motion a process by which the public purpose of corporations would become subordinate to private benefit and states would cede social control over corporations to the benefit derived from formation of new corporations.
Justice Brandeis in a dissent in *Louis K. Liggett Co. v. Lee*, 288 US 517, 549 (1933) reviewed the history of state control over corporations which had characterized the history prior to 1888. The reluctance of states to grant corporate charters for private business was from "a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations" (*Louis K. Liggett Co. v. Lee*, 288 US 517, 549 (1933)). Thus, he noted, states had limited the maximum capital of a corporation in New York to $2,000,000 in 1881 and $5,000,000 in 1890 (*Louis K. Liggett Co. v. Lee*, 288 US 517, 552 (1933)). For Brandeis the business corporation posed a threat to public welfare (*Louis K. Liggett Co. v. Lee*, 288 US 517, 548 (1933)). What he characterized as the fear of corporate power was borne out by the process begun by New Jersey in 1888 and followed by most states during the final decade of the nineteenth century and the first decade of the twentieth century. The Sugar Trust, Standard Oil Trust, the American Straw Board, the Cotton Oil Trust, the Linseed Oil Trust, the Whiskey Trust, the Chicago Gas Trust, the National Starch Manufacturing Company, the Oil-Cloth Trust and the New York Meat Trust were all organized under New Jersey law (Friedman 1973, pp. 405-6; Lamoreaux 1985, pp. 98-9).

The opportunities for corporations to engage in control of industries developed alongside the Progressive Era interest in reducing the power of monopolies. The Sherman Act adopted by Congress in 1890 attempted to criminalize efforts by businesses to monopolize or restrain trade. However, the role of the United States Supreme Court in mitigating the harshness of the Sherman Act through the Rule of Reason and resistance by the Court to expanding the scope of interstate commerce thereby preventing corporate
acts from coming within the purview of the Sherman Act allowed significant consolidation in major industries during the merger wave of 1895-1904.

The race to the bottom among states to allow corporations to form without regard to limits on their purposes or powers was the beginning of the ceding of social control by the states. Despite the wariness of the eighteenth and early nineteenth centuries about the power which was granted to corporations to exist in perpetuity and to limit the liability of the shareholders, corporations were formed and oligopolies created without consideration of the effect on society at large. Private benefit was predominant. This outcome would soon be joined by an emphasis on shareholder value over all other responsibilities of the leadership of corporations.

Shareholders expected that the reduction of price competition due to economic concentration and the ability to capitalize intangible property in the form of goodwill would enhance their future earnings and they would enjoy immediate liquidity compared to having their wealth tied up in illiquid, tangible property of a family business. The co-evolution of financial innovation and industrial technology enabled the development of oligopolistic industries dominated by a few large firms. Competition was no longer price competition among many firms. Joseph Schumpeter reached the same conclusion. Competition was not price competition described in textbooks, "...but the competition for the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance) - competition which commands a decisive cost advantage and which strikes not at the margins of profits and outputs of existing firms but at their foundations and their very lives" (Schumpeter
[1942] 1950, 84). The creation of huge firms operating in oligopolistic industries owned by passive shareholders allowed management to usurp control.

**Corporate Power and Finance**

As originally described by Thorstein Veblen in *The Theory of Business Enterprise* (1904) the late nineteenth century represented a turning point in the organization of American industry. This shift in industry was accompanied by a shift in financial practices, one Veblen described as the movement from a money economy to a credit economy. With the rise of the credit economy, a new way of organizing, reorganizing, and extending ownership claims came into practice.

As a result, in a process of ceremonial encapsulation, the terminology and meaning of business terms was upended. The practices of accounting and book-keeping, the practical and technical definitions of terms were in flux in this new system. As described in Hake (2001) this involved a shift in accounting practice from the taxonomy of proprietorship to entity accounting, so that old terms were given new meanings.

The line between credit and capital, or between debt and property, in the values handled throughout these strategic operations of coalition, remains somewhat uncertain. Indeed, the old-fashioned concepts of 'debt' and 'property', or 'liabilities' and assets', are not fairly applicable to the facts of the case – except of course in the way of a technical legal distinction (Veblen 1904, 1937, p. 125).

The role of finance in the merger wave of 1895-1904 was fostered by the growth of investment banks which acquired "a controlling position in the economy not only by arranging mergers but also by securing large ownership shares and seats on the boards of directors of newly combined corporations" (Whalen 2001, 812). The growth of a stock
exchange to provide those selling their companies with the means to convert their
interests into cash was not the only purpose for finance in this new, concentrated
industrial environment. "Extension of roundabout production made finance a more
integral and important part of the economy. Thus, as the wider market was served,
industry and finance expanded together" (Atkinson and Paschall 2016, p. 44).

With the rise of the horizontally and vertically integrated firm, such as United States
Steel Corporation, the corporate finance mechanism of industrial reorganization was
responsible for a new model of corporate governance. This created new theories about the
role of the firm and an analysis of the separation of ownership and control, as seen in the
work of Berle and Means, Coase and all who followed. Throughout the twentieth century
a system of industrial organization and reorganization, of rights to income and control
over industry, was created that was based on the expansion of q'equities, the use of new
stock issues, mergers and acquisitions.

With large corporations operating under boards of directors influenced directly by
financiers, the focus of the corporation would be on producing pecuniary values –
streams of revenue to service debt, cover the costs of production and insure a profit. The
development of law which (1) legitimized mergers to reduce cutthroat competition, (2)
protected the corporation from economic regulation by reliance on the Fourteenth
Amendment protections as applied to intangible property and (3) vested the board of
directors of a corporation with the predominant role of determining how its funds would
be used, would make the corporate form the preferred form for large-scale industrial
production. With the growth of corporations and the role of financial interests in the
economy, this period would provide the foundation for the financialization of the US economy.

Unrestrained by the *ultra vires* doctrine because general incorporation statutes of the twentieth century would place few limits on powers of corporations the social control over the public interest aspect of corporations faded. The ineffective enforcement of anti-trust law would permit corporations to exercise increasing power. Unconstrained corporate power would confirm the fears which had originally motivated states to exercise social control. Although many corporations will never be of a size to effectively exercise corporate power, the percentage of corporations operating with the largest asset value are a reasonable surrogate for the extent of corporate power. Table 2 reports the percentages of assets, receipts and net income of the largest corporations filing tax returns in 1940 and 1950.

In these enterprises with stabilized revenues, the shareholders earn returns above those in competitive industries and the resulting financial assets are liquid. Furthermore, the owners enjoy their income without exerting effort in production. Passive shareholders enable boards of directors and managers to control the operations. A basic concept of private enterprise was that owners controlled their property. This unity has been destroyed in the modern corporation. “The recognition that industry has become dominated by these economic autocrats (directors and managers) must bring with it a realization of the hollowness of the familiar statement that economic enterprise in America is a matter of individual initiative” (Berle and Means [1932] 1967, 116). Ownership was divorced from control and the separation was supported by law.
Table 2
Corporations
Assets, Receipts and Net Income
Comparing Largest Corporations (assets of $100,000,000 or more) to All Corporations

<table>
<thead>
<tr>
<th>Year</th>
<th>Assets*</th>
<th>Receipts*</th>
<th>Net Income*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>$153,711,514</td>
<td>$32,025,615</td>
<td>$3,327,404</td>
</tr>
<tr>
<td></td>
<td>Percentage of Total</td>
<td>48%</td>
<td>22%</td>
</tr>
<tr>
<td>1950</td>
<td>$304,127,219</td>
<td>$126,811,716</td>
<td>$18,644,908</td>
</tr>
<tr>
<td></td>
<td>Percentage of Total</td>
<td>50.8%</td>
<td>28%</td>
</tr>
</tbody>
</table>

*US Dollars in thousands; excluding asset classes with deficits

The trend of concentration of assets, receipts and net income continued into the twenty-first century. Table 3 shows assets, receipts and net income for the largest corporation (assets of $250,000,000 or more) and the percentages compared to those of all corporations filing income tax returns for the selected years.
Table 3
Corporations
Assets, Receipts and Net Income<sup>1</sup>
Comparing the Largest Corporations<sup>2</sup> to All Corporations

<table>
<thead>
<tr>
<th>Year</th>
<th>Assets</th>
<th></th>
<th>Receipts</th>
<th></th>
<th>Net Income</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All</td>
<td>Largest</td>
<td>%</td>
<td>All</td>
<td>Largest</td>
<td>%</td>
</tr>
<tr>
<td>1965</td>
<td>1,724</td>
<td>862</td>
<td>50.0%</td>
<td>1,195</td>
<td>374</td>
<td>31.3%</td>
</tr>
<tr>
<td>1975</td>
<td>4,287</td>
<td>2,790</td>
<td>65.1%</td>
<td>3,199</td>
<td>1,451</td>
<td>45.4%</td>
</tr>
<tr>
<td>1985</td>
<td>12,773</td>
<td>9,852</td>
<td>77.1%</td>
<td>8,398</td>
<td>4,224</td>
<td>50.3%</td>
</tr>
<tr>
<td>1995</td>
<td>26,014</td>
<td>21,873</td>
<td>84.1%</td>
<td>14,539</td>
<td>7,984</td>
<td>55.0%</td>
</tr>
<tr>
<td>2000</td>
<td>47,026</td>
<td>42,103</td>
<td>89.5%</td>
<td>20,606</td>
<td>12,516</td>
<td>60.7%</td>
</tr>
<tr>
<td>2005</td>
<td>66,445</td>
<td>51,961</td>
<td>78.2%</td>
<td>25,505</td>
<td>12,179</td>
<td>47.8%</td>
</tr>
<tr>
<td>2010</td>
<td>79,905</td>
<td>64,931</td>
<td>81.3%</td>
<td>26,199</td>
<td>13,341</td>
<td>50.9%</td>
</tr>
<tr>
<td>2013</td>
<td>88,214</td>
<td>71,707</td>
<td>81.3%</td>
<td>30,192</td>
<td>15,535</td>
<td>51.4%</td>
</tr>
</tbody>
</table>


Although the percentage of assets held by the largest corporations was the same between 1950 and 1965 the 1965 percentage was for corporations 250% larger than the threshold for the largest corporation in 1950. By 1975 the largest corporations held more than 70% of all assets and continued to do so through 2013 (the most recent year for which the data is available). Receipts have remained within the range of 50-55% except for 2000. Net income of the largest corporations has consistently been two-thirds or more of all corporations' net income. "Corporate enterprise is now a system wherein a relatively small number of giant corporations compete against a relatively large number of small enterprises, and against the rest of us" (Dugger 1988, p. 80). Large corporations dominate the national arena. Local corporations exercise outsized influence over the local arena through demands for tax breaks enforced by threats to move elsewhere.

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<sup>1</sup> Dollar amounts in billions

<sup>2</sup> Corporations with assets of $250 million or more
Under the influence of the Chicago School the policy of shareholder wealth as the primary duty of the corporation has gained stature. Without the constraints of the *ultra vires* doctrine or antitrust law and with an emphasis on the duties of the directors of a corporation to corporate profits and shareholder wealth, there is little social control over corporations or the power which the largest can assert. The corporation of the twenty-first century has emerged from this evolutionary process as a social organization with considerable power protected by law and not subject to effective social control.

State corporate law has largely enshrined this policy of shareholder wealth when it provides that the directors of a corporation owe a fiduciary duty to shareholders. The Model Business Corporation Act ("MBCA") prepared by the Committee on Corporate Laws of the American Bar Association and first given wide publication in 1950 has been through several revisions over the years and 29 states and the District of Columbia have corporate laws based upon the MBCA.

Section 8.30 of the MBCA sets standards of conduct for directors of a corporation and in subsection (a) requires that each "member of the board of directors, when discharging the duties of a director, shall act (i) in good faith, and (ii) in a manner the director reasonably believes to be in the best interests of the corporation" (Model Business Corporation Act (2016 Revisions), American Bar Association, Committee on Corporate Laws of the Section of Business Law, p. 179 (December 9, 2017)). The Official Comment to this Section explains the standard of conduct "includes concepts courts have used in defining the duty of loyalty" (American Bar Association 2017, p. 181). It goes on to state that in determining the "best interests of the corporation" the director "has wide discretion in deciding how to weigh near-term opportunities versus long-term benefits as well as in
making judgments where the interests of various groups of shareholders or other corporate constituencies may differ” (American Bar Association 2017, p. 182).

Nevertheless, the best interests of the corporation have been regularly interpreted to mean increasing shareholder wealth.

The duty of directors to increase shareholder wealth can be found in the decision of the Michigan Supreme Court in *Dodge et al. v. Ford Motor Co. et al.*, 204 Mich. 459, 465-69 (1919). By July 31, 1916 Ford Motor Company had accumulated assets worth $132,000,000 with $52,000,000 of that in cash. John and Horace Dodge held significant amounts of Ford Motor Company stock despite the fact that by this time they had begun to produce their own automobiles. They were not members of the Board of Directors of Ford Motor Company. Henry Ford with the unanimous support of the Board of Directors planned to reduce the price of Ford cars, invest in increased production capacity and to invest in the operation of iron smelters for the production of automobile parts. Henry Ford also declared on behalf of the Board of Directors that there would henceforth be dividends in an amount of no more than 5% per month based on the capital stock of $2,000,000 because investors through sizeable dividends had already recaptured the value of their initial investments (*Dodge*, 204 Mich. at 465-69).

The Dodge brothers asked the Circuit Court of Wayne County, Michigan to enjoin Ford Motor Company from proceeding on the announced plan (including the investment in iron smelters), to require a special distribution of 75% of the accumulated cash and further to require the Company to distribute future earnings as dividends except such amounts as were reasonably required for conduct of the business (*Dodge*, 204 Mich. at 474). The Circuit Court ordered the payment of a dividend of one-half of the accumulated
cash and enjoined the Company from investing in iron smelters *(Dodge*, 204 Mich. at 486-88).

When asked to review the Circuit Court's decision, the Michigan Supreme Court examined the responsibilities of the board of directors of a corporation. "The purpose of any organization under the law is earnings – profit. Undistributed profits belong to the corporation, and . . . may be lawfully employed as capital" *(Dodge*, 204 Mich. at 497). Henry Ford had announced the policy of limiting the dividend at the same time he expressed his intentions to improve the conditions of employees and to employ more people *(Dodge*, 204 Mich. at 468). Although the Michigan Supreme Court considered those intentions to be inconsistent with the stated purpose of a corporation to generate a profit, it would not summarily supersede the authority of the board of directors. The directors of a corporation have the power to declare a dividend and to determine its amount. A court would not interfere with that exercise of discretion "unless they [the directors] are guilty of a willful abuse of their discretionary powers, or of bad faith or of a neglect of duty" *(Dodge*, 204 Mich. at 500). Nevertheless, under the circumstances of this case given the stated intentions of Henry Ford regarding employees, the court concluded that the directors were not acting in the best interests of the corporation and affirmed the lower court's order to pay a special dividend of one-half of the accumulated cash surplus. The court reversed the lower court's injunction regarding iron smelters as beyond the authority of a court and an interference with the discretion of the directors in managing the corporation *(Dodge*, 204 Mich. at 510).

The Michigan Supreme Court explained its decision by reference to one of its earlier decisions.
It is a well-recognized principle of law that the directors of a corporation, and they alone, have the power to declare a dividend of the earnings of a corporation, and to determine its amount [citations omitted]. Courts of equity will not interfere in the management of the directors unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds, or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud, or breach of that good faith which they are bound to exercise towards the stockholders" (Hunter v. Roberts Throp and Co., 83 Mich. 63, 71 (1890)) cited in (Dodge, 204 Mich. at 500).

Only under the most extreme circumstances would a court find reason to interfere with the board of directors of a corporation in the management of the business or the declaring of a dividend.

The decision in Dodge has been described as an enshrinement of the principle "that companies had a legal obligation to maximize profits for shareholders, and their interests trumped those of anyone else" (Foroohar 2016, p. 71 ). The case also has been the subject of classes in schools of business and of law as legal authority for profit being the most important, if not the only, purpose for organization of business under the corporate form (Stout 2008). Examining the particular facts in Dodge and the court decisions relying on it as precedent, the decision really stands for the position that the directors of a corporation are responsible for management and have broad discretion in the use of the financial resources and profits, whether for reinvestment, reserves or dividends. Their decisions are only subject to challenge when the directors are involved in fraud, breach of good faith or misappropriation of funds. In other words, Dodge stands for the principle announced by Berle and Means that ownership of a corporation is separated from its management.
Dodge is binding precedent only in Michigan and may be considered merely as persuasive authority in courts of other states. Sixty-two decisions have cited to the opinion in Dodge. Twenty-four of those were Michigan decisions. Twenty-four were decisions in courts of other states. Twelve were tax cases related to the extraordinary dividend awarded to the stockholders in Dodge. Two were decisions by the U.S. Supreme Court which did not pertain to the payment of dividends. For the 24 decisions in other states, most declined to find the decisions by a board of directors to violate the broad discretion granted to them. In 1991 the Court of Chancery for New Castle County, Delaware reviewed the claim of minority stockholders that the board of directors of E.C. Barton & Company, an employee-owned company with employees holding the majority interest, had distributed profits through employee benefits instead of dividends thereby providing a benefit to employee stockholders but not to other stockholders (Blackwell et al. v. Nixon et al., 17 Del.J.Corp.L. 1083 (1991)). Noting the prospect for application of Dodge, the court found no basis for such and stated that "[f]ew, if any, cases have involved a set of facts egregious enough to meet that standard" (Blackwell, 17 Del.J.Corp.L. at 1090). Case law applying the standard in Dodge does not hold it forth as precedent for the purpose of the corporation to be the maximization of stockholder wealth or for the right of stockholders to dividends. The decision in Dodge and its subsequent citation in other cases clearly identifies that decision as an undesirable interference with the otherwise broad discretion of the directors to manage the corporation and is to be undertaken only under extraordinary circumstances. Despite the foregoing explanation, the duty of directors to maximize shareholder wealth continues to receive primary
attention in discussions of the standards of conduct of directors and the best interests of the corporation.

Under these circumstances, the long history of equating the best interests of the corporation with shareholder wealth, the effective elimination of the *ultra vires* doctrine as a limit on the exercise of corporate power, and the ineffectiveness of anti-trust law, is there any method for restoring the social control over corporations and the exercise of corporate power? During the Progressive Era in the early twentieth century there was significant discussion about federal chartering of corporations as a means of introducing a federal level of social control. "Federal chartering proposals which – in their various forms – would have added to, limited, or completely replaced state corporation statutes, enjoyed the support of two sitting presidents, both major political parties, and a broad array of political interests, including big business, organized labor, and the national agricultural lobby" (Hutchison 2017, pp. 1022-23). James B. Dill, the corporate lawyer who had a major role in developing the New Jersey general incorporation statute and later the Delaware law modeled after the New Jersey law, advocated for federal chartering of corporations in his testimony before the US Industrial Commission (Hutchison 2017, pp. 1047-48). Despite the support of James B. Dill, William Jennings Bryan, President Theodore Roosevelt and President William Howard Taft for federal chartering or at least federal licensing of corporations engaged in interstate commerce, federal charters would not replace or even augment state chartering.

Senator Elizabeth Warren introduced Senate Bill 3348 in August, 2018 (the Accountable Capitalism Act) calling for federal licensure of corporations engaged in interstate commerce if the corporation had more than $1,000,000,000 in gross receipts. No Senators
co-sponsored the Bill. It was read twice and referred to the Committee on Commerce, Science, and Transportation where it died.

Federal chartering of corporations would be an exercise of federal authority subject to challenge as an invasion of an historically state prerogative which has been recognized as such by the federal court system, including the US Supreme Court. Justice Brandeis in his dissent in *Louis K. Liggett Co. v. Lee*, 288 US 517, 559 (1933) observed the failure of the states to exercise control over corporations through the race to the bottom of adoption of general incorporation laws modeled after that of New Jersey. But such an assessment neglects the power that remains with the states to exercise control even under the regime of liberal general incorporation laws. The MBCA does not provide a direct control over corporate power with its imposition of a duty on directors of corporations to act in the best interests of the corporation and with the dominant place given to corporate profits and shareholder wealth. However, its Official Comment recognizes that there is discretion accorded to the director to weigh short-term against long-term results and the interests of various constituencies. The *Principles of Corporate Governance* issued by the American Law Institute in 1992 ("Principles") expands on the manner of the exercise of discretion by directors. As noted by Macey (2008, p. 178) Section 2.01 of Principles states that a corporation should have corporate profit and shareholder gain as its objective. That Section also "makes clear that the conduct of a corporation's business may be properly shaped by appropriate ethical consideration" (Eisenberg 1993, p. 1276). Eisenberg (1993, p. 1278) also notes that several states have interpreted the ethical considerations to authorize the consideration of the interests of other constituencies as coming within the scope of the director's standard of care.
For example, the Pennsylvania Corporate Code provides that

In discharging the duties of their respective positions, the board of
directors, committees of the board and individual directors of a domestic
corporation may, in considering the best interests of the corporation,
consider to the extent they deem appropriate: (1) The effects of any action
upon any or all groups affected by such action, including shareholders,
members, employees, suppliers, customers and creditors of the
corporation, and upon communities in which offices or other
establishments of the corporation are located. (2) The short-term and
long-term interests of the corporation . . . (15 Pa.C.S.A. § 515 (2017)).

This provision broadening the scope of the "best interests of the corporation" was added
to Pennsylvania law in 1990. Pennsylvania was the first state to adopt this provision
which can be viewed as an outgrowth of the appropriate ethical considerations addressed
by the Principles. Generally viewed as an anti-takeover statute, it nevertheless legitimizes
the consideration of interests beyond shareholder wealth. Similar provisions can be found
in the statutes of Arizona (A.R.S. § 10-830D2), Connecticut (C.G.S.A. § 33-756(g)
[limited to corporations registered under the Securities Exchange Act of 1934], Florida
(F.S.A. § 607.0830(3)), Hawaii (HRS § 414-221(b)), Illinois (805 ILCS 5/8.85), Indiana
(IC 23-1-35-1(d)), Maine (13-C M.R.S.A. § 831 (6)), Massachusetts (M.G.L.A. 156D §
8.30), Minnesota (M.S.A. § 302A.251Subdivision 5), Mississippi (Miss.Code.Ann. § 79-
4-8.30(f)), Nebraska (Neb.Rev.St. § 21-2.102 (a)(2)), New York (McKinney's Business
Corporations Law § 717(b)), North Dakota (NDCC 10-19.1-50(6)), Utah (U.C.A. 1953 §
16-10a-840(5)(b)), Vermont (11A V.S.A. § 8.30(a)(3)), Wisconsin (W.S.A. 180-0827),
and Wyoming (W.S. 1977 § 17-16-830(g)). This is more than one-half of the states which
have adopted a version of the MBCA. The broadening of the constituencies of a
corporation under these provisions lies solely within the discretion of the directors.
Subsidiarity and Social Control

With (i) the failure of federal chartering of corporations at the turn of the twentieth century, (ii) the failure of Senator Warren's Accountable Capitalism Act and (iii) the history of state control over corporate chartering, should the recourse for social control over corporations reside with the states? There is a principle of public policy known as "subsidiarity" which proposes that decisions be made by the lowest level of competent political authority (Zalewski and Whalen 2011, p. 101). In an era where the federal judiciary is, or is likely to become, hostile to the exercise of federal authority it is possible to find the source of social control over corporations in the states where it was vested prior to the advent of liberal general incorporation statutes. Participation in mediating institutions, such as state-sponsored administrative commissions provides opportunities for a voice in collective decisions (Zalewski and Whalen 2011, p. 102). The above discussion of the trend among states of varying political persuasions to permit directors to take into consideration the effect of corporate actions on matters beyond simply shareholder wealth suggests a possible starting point.

A significant issue in such an approach is the race to the bottom which brought us to the point where states ceded authority over their corporations. The beginnings of the return to social control is to be found in the above discussion of the inclusion of interests beyond shareholder wealth in the permissible actions of directors. Also, we have examples of other successful programs beginning within the laboratory of the states. Unemployment compensation and workers' compensation began in the experimental programs of the State of Wisconsin under the influence of John R. Commons and Governor Robert La Follette. The Wisconsin law drafted by Commons created the Wisconsin Industrial
Commission in 1911 (Moss 1996, p. 69). The Industrial Commission was part of what Commons called the "fourth branch of American government" – administrative commissions comprised of the parties in interest and committed to the study of best methods to address "the most urgent of collective conflicts" (Commons 1950, p. 299).

Likewise, unemployment compensation became law in Wisconsin in January 1932 and was endorsed by the Governors' Interstate Commission in February of the same year (Lubove 1968, pp. 169-71). The Ohio Commission on Unemployment came forth with a plan using a social insurance approach in November 1932 but Wisconsin remained the only state with compulsory unemployment compensation until 1935 (173).

Commons' commitment to the use of administrative commissions representing interested parties was rooted in his personal experience working with others seeking to address the new problems arising out of economic and legal conditions. To Commons "reform without the acceptance of all interested parties was unacceptable" (Harter 1962, p. 44). Freed of direct responsibility for adopting programs (legislative authority) and for reviewing the legality of programs (judicial authority), these administrative commissions could investigate the problems and propose solutions taking into consideration the conflicting interests of those parties serving on the commissions. Commons emphasized the importance of broad-based participation to achieve collective action out of conflicting interests (Commons 1950, p. 196). For Commons, when "each organized interest is compelled to bring forward its proposals in the open and in the face of the similar elected representatives of other interests" (Commons 1950, p. 257), the outcome is more likely to represent the collective harmony of interests or "reasonable value" (Ramstad 2001, p. 256). The success of the commissions' proposals also relied on the support of advocacy...
organizations using investigative studies to support the spread of the commissions' work
to other states (Commons 1950, pp. 297-301).

Commons observed the great power which corporations held by virtue of their existence
as a creation of the state. But with enormous power came a responsibility of the
corporation to the state. By virtue of the sovereignty the state held over the corporations it
created the state could control the manner in which corporations could conduct their
business (Commons 1894, pp. 62-63). The risk of a corporation conducting business in a
manner contrary to the interests of the state, such as conditions of employment, meant
that in some circumstances "nothing but the coercive power of government can avail"
(Commons 1894, p. 63). While there may be a basis for the federal government to
exercise such control in matters involving interstate commerce, such as child labor, the
role of the state as the sovereign which called the corporation into existence should be
seen as primary.

There are already 17 states where directors of corporations may take into consideration
several factors in addition to shareholder wealth in serving the best interests of the
corporation. The corporate laws of these states now govern the operation of corporations
in a manner which previously occurred under special charters. Unlike special charters,
however, the laws are not contracts subject to the Non-Impairment Clause of the US
Constitution. The laws can be revised with changes binding on the corporations. A
change in the law governing standards of care of directors could replace the permissive
standard of care related to such matters as other constituencies to make it mandatory. The
states would retain the power they have always had to dissolve a corporation which fails
to act within the scope of its powers. The failure of corporations to act in a manner
cognizant of the effect of corporate decisions on employees, customers, and communities could expose the corporation to dissolution.

The successful adoption of workers' compensation and unemployment compensation began with a single state willing to put into practice the results of experience in other countries, investigations of advocacy organizations and the recommendations of administrative commissions. Reversing the race of laxity described by Justice Brandeis into a regaining of state social control over corporations will require one or more states willing to risk the political power of corporations and the threat to move to another state. This risk could be mitigated by key states acting simultaneously, such as Illinois, Massachusetts, New York and Wisconsin. Following the model of Commons's fourth branch of government, administrative commissions in those states would investigate the possible result of enabling the broader constituencies of corporations and recommend changes in their laws to embody that result. A national investigative body could be granted the power to investigate whether there might be federal incentives to support changes in state laws.

The authors propose that this approach under the principle of subsidiarity is a policy of social control which could be a solution to the problems of corporate power and vested financial interests. It deserves further study and consideration.
References


Senator John Heinz Pittsburgh Regional History Center, Carnegie Steel Company Archives


