

REVIEW

The Legitimacy of the Business Corporation in the Law of the United States 1780-1970. JAMES WILLARD HURST. University of Virginia Press, Charlottesville, Va., 1970. Pp. xiii, 191. \$6.50.

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This slim volume (164 pages of text), derived from the Page-Barbour Lectures of 1969 at the University of Virginia Law School, illustrates both the virtues and defects of a short course of lectures. On the plus side, it provides an exceptionally clear and succinct panorama of the development of American corporation law from 1790 to the present. However, such a brief treatment of so sweeping a subject often causes the analysis of individual issues to seem sketchy and unsatisfying; moreover, such broad perspectives fail to provide the firm and careful substructures characteristic of Professor Hurst's other highly respected and scholarly works.

The strength of Hurst's essays lies in his excellent overview of the field. Not only does he sketch the broad outlines of the growth of corporation law from the early restrictive charters to the modern enabling statutes, but he also relates that growth to the general history of the United States. Under his analysis, American "[c]orporation law has always been an instrument of want and energies derived from sources outside the law,"¹ responding mainly to the "inventions and energies of promoters, financiers, managers, marketing men, trade union leaders, and a host of others."² He regards American corporation law as a largely indigenous growth, little influenced by English precedent. The corporate form of business achieved dominance in this country because it was so efficient in assembling funds for useful purposes. According to Professor Hurst, "[h]ad we derived some different legal format to serve these needs, the underlying business drive would have required that the other form of organization in working substance must resemble the corporation."³

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¹ P. 10.

² P. 11.

³ P. 160.

Under this theory, shifts in the emphasis of the law reflected changes in the business needs and accompanying social values of the community. Thus, Hurst notes that the early charters, granted at a time when rapid industrial expansion was of paramount importance, were largely designed to help entrepreneurs in their promotional activities. As we achieved a greater degree of financial and industrial maturity, the law swung to the protection of creditors through limitations upon improper dividends, watered-stock doctrines, etc. The current trend of the law, he points out, emphasizes the protection of investors in the open market.⁴

Within this general framework, Hurst devotes one of three essays to assessing the role played by various legal institutions in the development of corporate law. While he may somewhat underestimate the effect of state blue sky laws and unofficial agencies like the National Association of Securities Dealers and various legal and accounting organizations, he perceptively measures the impact of such major and diverse influences as federalism, the New York Stock Exchange Commission, and the concept of full disclosure. Hurst suggests that the role of the courts in this overall development has largely been to place some limits upon the great freedom legislatures have been willing to grant to businessmen and to establish correctives against abuse of that freedom.

The historical perspective Hurst provides contains certain trenchant insights applicable to the present day. For example, he points out very effectively that much of the early antagonism to corporations grew out of a mistaken association of the concept of the corporation with the special franchises and special privileges obtained by many of the early corporations—mostly utility corporations. This early confusion between the concept of the corporation as a legal entity and the special franchises which it might obtain is similar to the current confusion between the concept of a corporation and the concept of sheer bigness or of economic concentration. If the real grievance in early times was against improvidently granted special utility franchises, then the franchise should have been attacked rather than the nature of the organization which operated the utility. Similarly, if it is size and economic power which is in question in present discussions concerning conglomerates and corporate giants, then it is size and power which should be

⁴ This theory reminds this reviewer of the comments occasionally made by students from Australia, after taking a course in American corporation law, to the effect that American corporation law is "effete" because it devotes too much effort to the protection of investors rather than to the encouragement of promoters and speculative enterprise. Each stage of society has its own priorities.

specifically considered. It is indeed true that the corporate form provides our major device for collection of capital in order that large enterprises may be undertaken; in that sense the corporation, as such, contributes to undue bigness. However, generalized blasts against the corporate system rather than direct attacks upon the specific aspects of business activity which are believed objectionable tend to blunt the effectiveness of any justifiable specific criticism. "Not the least costly aspect of the mid-century confusion between grants of corporate status and grants of special-action privilege was that it postponed coming to grips with the creation of adequate legislative standards and adequate administrative means to deal with problems which the play of the market could not adequately handle."⁵ A similar injunction against confusion of targets and over-generalized diatribes would aid the cause of reform at the present time in connection with the current phenomena of conglomerates and of consumer drives for better products and for greater business commitment to reduction of injuries to the environment.

As the title squarely indicates, the legitimacy of the business corporation is the main theme of Hurst's book. Yet Hurst does not attempt to set forth a precise definition for this nebulous and protean word. He uses the term "legitimacy" or "legitimate" in several different senses throughout the volume; sometimes it means "lawful,"⁶ sometimes "proper,"⁷ and sometimes "justified."⁸ The closest Professor Hurst comes actually to defining his prime term is where he states that:

Legitimacy means that no arrangement of relations or of power recognized in law should be treated as an end in itself or as autonomous. An institution must be legitimated by its utility to some chosen end other than its own perpetuation.⁹

He follows the above statement with the comment that "legitimacy should derive from utility" and that "legitimacy means responsibility."

A more extensive consideration of the literature and background of the concept of legitimacy certainly seems warranted. One wonders whether "legitimacy" is to be defined solely in terms of utility and

⁵ P. 36.

⁶ "An important role of constitutional standards is to legitimate adapting legal order to social change." P. 68.

⁷ "[I]f the law of corporate organization was legitimated by its utility to business enterprise, legitimacy would be most fully achieved if the law empowered businessmen to create whatever arrangements they found most serviceable." P. 70.

⁸ "[T]he legitimacy of their power must be measured by reference to the values outside those of their own institutional being." P. 76.

⁹ P. 58.

responsibility, as Professor Hurst suggests, without some consideration of the relation of legitimacy to existing and prior law and without some standards for measuring utility and responsibility. Moreover, legitimacy is presently being so widely questioned and flouted in many fields of political and academic endeavor that an even more extended consideration of the legal and philosophic meanings of legitimacy, together with a survey of the pertinent literature, would have been welcome.

Similar criticism could be directed at Hurst's discussion of corporate responsibility. According to Hurst, responsibility means "that an institution with power must be accountable to some judgment other than that of the power holders."¹⁰ Proceeding from the landmark case of *Dodge Brothers v. Ford Motor Co.* (which indicated that "management's prime obligation was to pursue profit in the interests of shareholders and not to adopt pricing policies designed to promote the interests of wage earners or to effect wider sharing of the gains of improved technology"),¹¹ Hurst surveys various devices with a potential for achieving corporate responsibility—the effect of stockholder control over management, the effect of the stock market on management decisions, and the possibility of self-imposed obligations by the elite group of managerial professionals. He concludes that:

The classical market held management to a criterion of short-term profits, which, however many social values it ignored or unduly subordinated, was quite definite and exacting. The new market might allow management opportunity for a wider choice and ordering of goals. . . . [T]he appearances of the new situation inevitably invited questions about what external criteria should now measure the social utility of power wielded by those controlling such corporations.¹²

These external criteria have not yet been provided in the "legal regulations external to corporations' own constitutions" upon which, Hurst suggests, we primarily rely "to enforce its [the corporation's] responsibility to its immediate economic functions and to its broader social relations."¹³ With respect to the possibility of management becoming "a legitimate element in modern big-corporation power," Hurst states that:

The situation was unstable because after twenty years or more of talk of corporate statesmanship the idea lacked specific

¹⁰ P. 58.

¹¹ Pp. 82-83.

¹² P. 83.

¹³ Pp. 110-1.

substance, in fact and in law. In law the one defined expression of the concept was the spread of judge-made law and statute law in the states authorizing the expenditure of corporation funds for philanthropic purposes. This apart, the law added no definition of standards or rules to spell out for what purposes or by what means management might properly make decisions other than in the interests of shareholders. If the idea of a permissible, and indeed desirable, broader range of justifications of corporation action has merit, it was strange that it had found so little expression in law.¹⁴

However sound and perspicacious Professor Hurst's trenchant observations on this subject of responsibility may be, it is disappointing that he does not venture to formulate any such criteria or any such statement of purpose nor does he expressly reject the position which he finds unsatisfactory. He only takes the reader up to the verge of the actual problems recently dramatized by such activities as the proxy campaign against Commonwealth Edison Company to force reduction of environmental pollution and the campaign mounted by the Committee for Corporate Responsibility to elect additional directors of General Motors and to cause the creation of a stockholders committee on the social responsibility of the corporation. These problems include the following questions: Is it the duty of management solely to maximize profits and to represent the interests of the shareholders or does management also have the obligation to manage its corporation in the interest of its employees, its consumers, its suppliers and the general public? *E.g.*, can a corporation build a plant which is not expected to be profitable merely to provide jobs in an area where jobs are needed? or, should a corporation take positions on war and peace and other political matters? or, should a corporation refrain from doing business in a country whose internal policies are objectionable to American ideals? or, can a corporation engaged in the manufacturing business devote its profits to a nonprofit or low-profit housing venture because management believes that such housing is desirable for the community?

Unfortunately, we have little law or legal theory with which to answer these pressing questions. There has been much discussion in the general press and the academic journals of the concept of the corporation as a "good citizen" and of the nature of management's social obligations. However, much of the discussion has been emotional rather than analytical. What is needed is a much intensified examination of the role of management in large corporations, of the legitimacy of management, of the validity of maximization of profits as an ulti-

¹⁴ P. 107.

mate objective, and of the nature of the large corporation's responsibility to the community. Professor Hurst's essays do little to fill this void. We are left wondering about the problems involved in opening corporate coffers for philanthropic purposes; we can only appreciate the irony that the business leaders who have fostered the concept of the corporation as a "good citizen" in order to justify corporate charitable gifts may find that their concept has fathered a doctrine of restraints upon management, together with a series of social duties and restrictions, which the original supporters of corporate philanthropy would probably regard as anathema.

Perhaps it is unfair to Professor Hurst to ask him, in such short compass, to provide both an exceptionally clear perspective of the past development of American corporation law and also suggestions concerning criteria and standards by which to measure present performance and future developments. However, this reviewer is somewhat disappointed by the extent to which Professor Hurst remains so much the withdrawn and objective observer throughout his essays. It would have been more valuable and more intriguing if he had offered some tentative solutions to the problems he so ably presented.