At the Conjunction of Love and Money: Comment on Julie A. Nelson, *Does Profit-Seeking Rule Out Love? Evidence (or Not) from Economics and Law*

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Professor Nelson has it absolutely right. Maximization is a thought construct that operates at an ideological level and is not descriptively robust. It is not a natural imperative, even as the need to profit certainly operates as a constraint, applying tightly or loosely depending on the particular firm and market. Nor should we think of the capitalist firm in terms of love "or" money. We should instead describe it around the "and" in "love and money."

This Comment will address a question that arises in the wake of Professor Nelson's intervention: Why did maximization come to dominate our thinking about firms? The answer is that academic paradigms and thinking about firms both tend to follow from the outside political economy. Indeed, capitalism itself has to take the outside political economy as it finds it and work with the social settlement it is handed. It just happens that for the last thirty years or so we have had a political economy that is particularly receptive to the maximization mindset.

It was not always this way. The present paradigm displaced a predecessor borne of the Great Depression, a period in our history that pushed us into the arms of a protective, regulatory state. The accompanying mindset, which endured for decades, took us to the other side of the love and money divide. Now, if it does not sound quite right to describe the New Deal regulatory state as "loving," perhaps a modification of the operative statement of opposing ideological positions can be accepted—instead of love and money, we can oppose cooperation and competition, and stability and

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maximization. Whatever the characterization, a look back at the New Deal regulatory state and the theories that justified it helps us to understand the contingent character of the theories prevailing today, and to appreciate the tie between descriptive accuracy and the use of "and" rather than "or" as the conjunction. Drawing on some previous work,[1] I will present the New Deal mindset through the lens of the writings of Adolf Berle, one of its architects.

Berle's writing continues to be invoked as deep background for today's shareholder primacy paradigm. But Michael Wachter and I have shown that the invocation rests on a faulty understanding of Berle.[2] When Berle elevated the shareholder interest over the management interest in a famous law review article published in 1932, his concern lay entirely with unchecked management power.[3] In the absence of some other, more effective check, he commended a trust for the shareholders' benefit as a palliative. But as his contemporaneous writings make clear, his preferred mode of management power containment was government control.[4] He got that one year later during the New Deal's first hundred days. He would never again put forward the shareholder interest as a countervailing power within corporate law. And at no time did he advance shareholder value maximization as an appropriate corporate purpose.

Indeed, when Berle returned to these topics a quarter century later, he changed his diagnosis and pronounced management power benign.[5] He had two reasons: first, the big stick, post-New Deal state was managing the economy from "an unchallenged position of higher authority," and second, there was a "solid political consensus in

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1. *See* William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737 (2001); William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and* The Modern Corporation, 34 J. CORP. L. 99 (2008) [hereinafter Bratton & Wachter, *Corporatist Origins*]; William W. Bratton & Michael L. Wachter, *Tracking Berle's Footsteps: The Trail of* The Modern Corporation*'s Last Chapter*, 33 SEATTLE U. L. REV. 849 (2010).

2. *See* Bratton & Wachter, *Corporatist Origins*, *supra* note 1, at 109–13.

3. *See* Adolf A. Berle, *For Whom Corporate Managers* Are *Trustees: A Note*, 45 HARV. L. REV. 1365, 1366–67 (1932).

4. *See* Bratton & Wachter, *Corporatist Origins*, *supra* note 1, at 128–30.

5. *Id*. at 133–34.

support."[6] Berle depicted a regulatory state that could and did accurately articulate the social welfare function, and then guide and push the markets to the right result, unencumbered by the ideology of maximization. He described a benign equipoise amongst strong organizations, an equipoise constrained by a wider public consensus that empowered the central government and its social welfare agenda. The Depression was still a vivid memory, so the public wanted stability, in particular job security; if it took regulation to get us from here to there, fine.[7]

Managers had to play ball. Whether they liked it or not, they were caught between the regulatory state and the public consensus. Failure to satisfy the public meant new regulation; avoidance of new regulation meant satisfying the public. So, as a practical matter, managers had to be public-regarding. Indeed, Berle described them as quasi-civil servants.[8] Meanwhile, the shareholders just did not matter. They were passive collectors of dividends with no productive role to play in the political economy. In fact, capital market constraints had ceased to matter more generally. Corporations got new equity capital by retaining earnings and only rarely went to Wall Street to sell stock. The markets served only to provide liquidity to the rich; there was no disciplinary value added.[9]

Berle's writing thus lets us trace our evolution from the market driven political economy of the early twentieth century to a quasi-corporatist state that privileged stability over maximization and sought an alignment of profit and public responsiveness. Significantly, the corporate law of Berle's time easily accommodated a quasi-civil service role for managers. It could do so again today without any need for adjustment. Corporate law does not require profit maximization now any more than it did then.

In fact, corporate law could not successfully require maximization even if a corporate lawmaker ready to wield a maximization mandate suddenly appeared. Maximization can only be *modeled*. In the real world of going concerns no one really knows if wealth is being

6. *Id.* at 134.
7. *Id*. at 136–40.
8. *Id*. at 140–41.
9. *Id*. at 142–43.

maximized.[10] It follows that corporate law can only facilitate, clearing the field so that firms can *attempt* to maximize the value they produce (assuming an intensely competitive environment) or otherwise prosper in the absence of intense competition. Adherence to this facilitative mission keeps corporate law relatively unburdened by any ideology, at least apart from its basic commitment to capitalism. It offers a framework capacious enough to accommodate different political economies and social settlements. The framework, with its business judgment envelope, holds out room for cooperation with the state and redistribution on the one hand and room for leveraged buyouts and plant closings on the other.

Meanwhile, corporate legal theories shift along with political economies, coloring in the capacious legal framework in accordance with the theorists' presuppositions.

To get a sense of today's colors, let us hypothesize how a maximizer would respond to the foregoing description of the corporate law framework. The description, one would hear, misses the point. To ask whether corporate law can be structured affirmatively to effect maximization puts the wrong question. Indeed, a maximizer happily would agree that corporations, left to their own institutional devices, will never push toward maximization. Such are the effects of agency costs. And that is where markets come in. Maximizers look at corporate law's capacious framework and see it constituting hierarchies that get in the way of the markets that should be left free to do the maximizing. And even if real world markets do not maximize perfectly, as they do in theoretical models, at least they do what they do spontaneously, free of the heavy hand of hierarchical direction.

For today's corporate law maximizers, the crucial moment in the history of post-war economic theory is Jensen and Meckling's introduction of agency theory in 1976.[11] Neoclassical economists like Alfred Marshall *assumed* that firms maximized, but offered no

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10. *See* William W. Bratton, *An Anatomy of Corporate Legal Theory*, 24 RES. L. & ECON. 21, 23 (2009).

11. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

microeconomic theory of the firm.[12] Hierarchical organization was thought to be intrinsically unsuited to such an exercise.[13] Jensen and Meckling's agency theory[14] opened the door to a microeconomic, market-driven picture of the corporation's internal workings—a whole new world for maximizing. And crucially, it did so at a time when beliefs were shifting away from the Berlian political economy where regulation moderated competitive forces to one where competitive forces played an increasingly unregulated role. Stability lost out as the goal, replaced by competitive fitness in an uncontrollable international framework.

Corporate legal theory, as always taking its instructions from the outside political economy, promptly reconstituted itself to look to deregulation and market controls. And so, from the 1980s on, corporate law has obsessed on the same structural question: Who should decide how the firm should be managed, the managers or the shareholders themselves? The question poses a choice between institutional security and a model driven by informational signals from the financial markets. The shareholder side contends that prevailing legal and institutional structures fail to provide a platform conducive to aggressive entrepreneurship, instead inviting management self-dealing and conservative decision making biased toward institutional stability.[15] It looks to actors in financial markets for corrective inputs. Unlike the managers, who are conflicted and risk averse, the shareholders, who look to the market price and nothing else, come to the table with a pure financial incentive to maximize value.[16] So the maximizers will readily agree that many firms survive indefinitely when making decisions that are not in their shareholders' best interests. They just want to put a stop to it.

I do not think the market control agenda makes sense as a policy proposition.[17] But for present purposes, the point is that maximization

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12. William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1495–96 (1989).

13. *Id.* at 1496.

14. Jensen & Meckling, *supra* note 11, at 305–06.

15. *See* William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 666 (2010).

16. *Id.*

17. *Id*. at 688–716.

is a direction to which some people point, rather than a goal that firms must meet. They suggest that institutions can be structured so as to move us in that direction with markets as the means to the end. If you want market control, then a stripped-down model of the subject works well.

Indeed, it works all too well, a point aptly stated by Professor Nelson:

> What this Article *does* seek to discredit is the belief that there is something intrinsic in the economic or legal structure of commerce that forces firms, inexorably, as if run on rails, to neglect values of care and concern in order to strive for every last dollar of profits. This widespread belief detracts from human or ecological welfare, for two reasons. First, it lets shareholders, directors, and managers of corporations morally "off the hook" for the social and environmental consequences of business decisions. Second, it places the entire burden of maintaining the moral order onto non-business entities, such as government, nonprofits, and families.[18]

To see widespread adherence to the automaton model of the firm that Professor Nelson describes, along with an array of pernicious effects, just take a look at our present financial crisis. There is a prominent line of analysis that absolves the banks that caused the crisis (and the human actors in charge of them) from responsibility for their own externalities, depicting them as capitalists competing as usual.[19] From there, in a strange twist, blame befalls those who regulated, failed to regulate, or deregulated the companies that did the deeds.[20] All responsibilities for shortcomings in the moral order are ascribed to the government, while the companies themselves dodge the bullet. For further examples, all the reader has to do is open a newspaper.

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18. Julie A. Nelson, *Does Profit-Seeking Rule Out Love? Evidence (or Not) from Economics and Law*, 35 WASH U. J.L. & POL'Y 69, 71–72 (2011).

19. *See, e.g.*, RICHARD A. POSNER, THE CRISIS OF CAPITALIST DEMOCRACY 77–79 (2010) (providing an explanation for why banks took the risks leading to the financial crisis in light of the externalities that led to the market collapse).

20. *Id.* at 79.

I used to dismiss the amoral automaton firm as something that appealed only to ideologues at the fringe, and then only normatively. The financial crisis has shown this assumption to be naive. When the crisis first hit, I was sure that it amounted to enough of a shock to alter the habits of mind Professor Nelson describes. But I was wrong about that too.