

Regulating the Corporation:
Legal and Economic Policy Development in Twentieth-Century America

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INTRODUCTION

The corporation is a central institution of modern economic life. As the legal mechanism through which a substantial portion of all economic activity is coordinated, the corporation occupies a prominent role in both government policymaking and the public imagination.¹ Since the first emergence of state-chartered corporations in the United States in the late eighteenth century—and especially since the rise of national “trusts” at the turn of the twentieth century—corporations have been a central focus of American legal regulation.² In light of their essential role in the functioning of modern capitalism and their political significance as perceived embodiments of private economic power, the regulation of corporations has been a defining policy question of the twentieth century.³

¹ Until relatively recently, the corporation was the primary form of business organization in the United States. Today, more businesses by number are organized as limited liability companies, though the country’s largest, publicly-traded business firms remain organized as corporations. Both historically and at present, the public understanding of the word “corporation” has been *any* large business enterprise, regardless of its technical legal form. Although this dissertation primarily addresses the specific legal conception of the corporation, its public understanding is an essential aspect of any historical analysis. For the major historical works on this broader notion of the corporation, see Alfred D. Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge: Belknap Press, 1994); Alfred D. Chandler, *The Visible Hand: The Managerial Revolution in American Business* (Cambridge: Belknap Press, 1977); Neil Fligstein, *The Transformation of Corporate Control* (Cambridge: Harvard University Press, 1990); J. Willard Hurst, *The Legitimacy of the Business Corporation in the Law of the United States, 1780–1970* (Charlottesville: University Press of Virginia, 1970); Naomi R. Lamoreaux, *The Great Merger Movement in American Business, 1895–1904* (Cambridge: Cambridge University Press, 1988); Glenn Porter, *The Rise of Big Business, 1860–1920*, 3rd ed. (Wheeling: Harlan Davidson, Inc., 2006); William G. Roy, *Socializing Capital: The Rise of the Large Industrial Corporation in America* (Princeton: Princeton University Press, 1997); Ronald E. Seavoy, *The Origins of the American Business Corporation, 1784–1855: Broadening the Concept of Public Service During Industrialization* (Westport: Greenwood Press, 1982); Olivier Zunz, *Making America Corporate, 1870–1920*, paperback ed. (Chicago: University of Chicago Press, 1992). Many of these works equate the corporation with “big business,” either tacitly or explicitly.

² In this dissertation, I use the word “regulation” in its broadest sense: to encompass the fundamental legal structures for recognizing and delimiting private rights. For a classic piece on early American corporations, see Oscar Handlin and Mary F. Handlin, “Origins of the American Business Corporation,” *The Journal of Economic History* 5, no. 1 (May 1945): 1–23. For the leading analysis of the rise of industrial trusts, see Lamoreaux, *The Great Merger Movement in American Business, 1895–1904*.

³ For historical explorations of this question, see Robert E. Wright, ed., *History of Corporate Governance: The Importance of Stakeholder Activism* (Routledge, 2004); Adolph A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: The Macmillan Company, 1932); Scott R. Bowman, *The Modern Corporation and American Political Thought: Law, Power, and Ideology* (University Park: Pennsylvania State University Press, 1996); Fligstein, *The Transformation of Corporate Control*; Tony A. Freyer, *Regulating Big Business: Antitrust in Great Britain and America, 1880–1990* (Cambridge: Cambridge University Press, 1992); Hurst, *The Legitimacy of the Business Corporation in the Law of the United States, 1780–1970*; Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton: Princeton University Press, 1994); Roy, *Socializing Capital*.

Given its importance, one might assume this policy question has been addressed through rational—or at least coherent—decision making processes in the past. For example, one might assume that laws affecting corporations have been determined by economic policy and that legal rules have been purposefully tailored to advance specific economic goals. Alternatively, one might surmise that business corporations have historically been the target of economic populism and that legal regulations have been primarily intended to limit their economic power. Finally, the more cynical observer might assume a dominant role for corporate lobbying and imagine that corporations *themselves* have been the leading actors in establishing the terms of their legal control. In fact, while all of these assumptions reflect a certain degree of historical truth, they each dramatically simplify the historical reality of corporate regulation. Rather than following common assumptions of how business legislation is designed and implemented, the history of American corporate law has been deeply shaped by historical contingency. More specifically, policy decisions made in the context of historically specific political issues have often shaped the possibilities available to decision makers in the future. While policy expertise, economic populism, and the political power of special interests can help explain certain features of the law's treatment of corporations, a more pervasive factor has been the historical circumstances under which specific legal rules were forged.

My dissertation explores this phenomenon by way of three discrete parts, each addressing a different aspect of the legal regulation of corporations. Although these cases do not provide a comprehensive perspective of the history of corporations, they illustrate some of the most important developments in corporations' treatment under law. The first part addresses the historical origins of the long-standing "debt-equity distinction"—that fact that corporate debt and equity are treated differently for U.S. tax purposes.⁴ The second focuses on the United States' subnational system of corporate law, exploring political efforts during the Progressive Era to adopt a federal incorporation system. Finally, the third part addresses postwar developments in Supreme Court antitrust jurisprudence, studying the causes

⁴ An earlier version of this part appeared as Camden Hutchison, "The Historical Origins of the Debt-Equity Distinction," *Florida Tax Review* 18, no. 3 (2015): 95–152.

of the major shift toward a more market-oriented antitrust policy.⁵ While each of these episodes was unique to its particular facts, all three demonstrate a common historical theme: The development of law is only partly driven by the conscious pursuit of identifiable goals and is often shaped by the contingent influence of historically specific political pressures.

If this argument seems conventional by the standards of historical analysis (i.e., particularities matter), it is markedly at odds with much of the legal scholarship on the development and evolution of business law. This legal scholarship and its modes analysis have become the dominant approach to studying the corporation, which in recent years has received far greater attention from legal scholars than from historians.⁶ Often writing under the (direct or indirect) influence of neoclassical economics, legal scholars tend to explain policy in terms of deductive economic theory, rather than by examining the actual historical circumstances. For instance, legal scholars have often explained tax policy from the perspective of public choice theory, according to which self-interested decisions by public officials systematically favor special interests. Many legal scholars of corporate governance have adopted an evolutionary model of corporate law, positing a competitive “race” (either to the bottom or the top) among individual incorporation-granting states. Finally, in the field of antitrust scholarship, postwar changes in antitrust policy are described in starkly teleological terms, in which the backward economic thinking of the early twentieth century has been replaced by “modern,” scientific theory. My intent in this dissertation is not to disparage these narratives, each of which, I believe, encompasses significant explanatory power. However, they also entail a risk of occluding the more complex reality of historical policy development, the facts of which do not always accord with general models of legal change. As discussed in the three parts of this dissertation, the major forces in influencing the treatment of corporations under American law have often been bound with political issues specific to their time and place.

⁵ An earlier version of this part appeared as Camden Hutchison, “Law and Economics Scholarship and Supreme Court Antitrust Jurisprudence, 1950–2010,” *Lewis & Clark Law Review* 21, no. 1 (2017): 145–209.

⁶ The specific literature is discussed in the parts that follow.

Part I, “The Historical Origins of the Debt-Equity Distinction,” addresses the political history of the United States’ distinctive system of corporate taxation, under which corporations can deduct interest on debt, but *not* dividends paid to shareholders, from the amount of profits on which federal income tax is calculated.⁷ This feature of the tax code has been widely criticized by economists, legal scholars, and other commentators for drawing an arbitrary yet consequential distinction between economically similar forms of investment. Surprisingly, although the distinction itself has long been a focus of considerable academic attention, little is known regarding its historical origins. The few historical accounts that exist in the literature are almost entirely speculative, often supposing that interest deductibility was the result of lender and/or borrower lobbying. My research provides the first major study of the debt-equity distinction’s origins and development, tracing its evolution from the Civil War era to the corporate tax controversies of the New Deal. Part I argues that the distinction itself was never a deliberate policy goal, but was rather the unintended result of a series of short-term political decisions. These political decisions were historically specific—in that they responded to immediate political issues—but had consequences that have influenced the structure of corporate taxation ever since.

Part II, “Progressive Era Conceptions of the Corporation and the Failure of the Federal Chartering Movement,” examines political efforts during the Progressive Era to federalize corporate law. A curious subject, perhaps, as these efforts were unsuccessful—the internal affairs of business corporations remain primarily governed by the states. Indeed, one of the major debates in corporate legal scholarship is the harms and benefits of state law competition, which is assumed to play a central role in shaping the law of corporate governance. Unlike this scholarship’s focus on the states—which often paints state corporate law as an intrinsic feature of American federalism—my research draws historical attention to the surprising *absence* of federal corporate law, which was broadly supported by a wide range of political

⁷ Most countries today have “integrated” corporate tax systems that eliminate or reduce the tax disparity between debt and equity. Reuven Avi-Yonah, Nicola Sartori, and Omri Marian, *Global Perspectives on Income Taxation Law* (Oxford: Oxford University Press, 2010), 143–48. Even in the U.S., most small and medium-sized enterprises are organized as “pass-through” entities, making the debt-equity distinction at the corporate level (particularly the double taxation of dividends) all the more incongruous.

groups during the first decades of the twentieth century. I argue that proponents of federal chartering, despite their unanimity on the need for federal corporate law, were deeply divided in their conceptions of corporations, some viewing them as a dangerous threat, others viewing them as central to economic progress. These divisions led to conflicting perspectives on the very purpose of corporate regulation, making agreement on the substantive content of a federal corporation act impossible. Had either side of the corporation debate been better organized or more disciplined, and thus able to break the political deadlock over federal chartering legislation, the twentieth-century history of American corporate law would likely have unfolded differently.

Finally, Part III, “Law and Economics Scholarship and Supreme Court Antitrust Jurisprudence, 1950–2010” provides an empirical study of the influence of “law and economics” on postwar U.S. antitrust policy. Beginning in the 1970s, the Supreme Court issued decision after decision rejecting traditional antitrust principles and instead embracing the “consumer welfare” paradigm articulated by law and economics scholarship. Although this transformation in antitrust law is the subject of substantial academic commentary, its causes remain poorly understood. Most scholars assume that law and economics scholarship had a direct, educative influence on the Court, while certain scholars argue that changes in the Court’s jurisprudence merely reflected changes in the Courts’s composition—particularly the conservative appointments of the Nixon administration. My dissertation advances this debate by presenting a comprehensive, quantitative study of every Supreme Court antitrust case from 1950 to 2010, encompassing the decades before, during, and after the economic turn in antitrust. Unlike previous studies, which have focused on the judicial language of a select number of cases, my comprehensive approach allows for generalized conclusions regarding the broader influence of law and economics. Based on both quantitative and qualitative evidence, Part III concludes that the Nixon appointments of the late 1960s and early 1970s were the primary cause of changes in antitrust jurisprudence, but that academic developments infused these changes with an intellectual legitimacy they might otherwise have lacked, broadening their appeal and effectively insulating them from future changes in the composition of

the Court. Thus, while there has been a genuine (and broadly bipartisan) intellectual shift in antitrust law, its historical origins were inextricably tied to exogenous political developments.

In terms of sources, each part of this dissertation draws on somewhat different sources of evidence. Part I and II are most similar, both drawing heavily on legislative history. In particular, Part I directs close attention to statutory law itself, a tangle of interwoven provisions that few historians have attempted to penetrate. As Part II addresses Congressional legislation that was ultimately never passed, it necessarily focuses more on political debates and less on actual statutes. Part III takes a much more quantitative approach, presenting an innovative statistical analysis of a specific body of Supreme Court case law. In each part, I have used the sources and methodology best suited to my specific research questions.

The creation of corporations, the taxation of their activities, and the regulation of their competitive behavior are three of the most important aspects of legal control of U.S. business. Most obviously, by creating corporations and setting conditions on how they are governed, the “state” (in the broad sense) is fundamentally involved in corporate existence. Second, taxation has a major effect on how corporations structure their business. Finally, at its heyday, antitrust spoke to fundamental questions of the role of corporations in American society. While none of these aspects (or even all three of them) reflect the whole history of the American corporations, each has been an important fact in the modernization of corporate law.

The history of these different areas of law has been influenced by a range of factors, from rarified academic research to the cruder impulses of economic populism. The factor effecting the greatest impact on American corporate lawmaking, however, has often been the historical context in which key policy decisions were made. Thus, the debt-equity distinction was the cumulative result of multiple short-term political decisions, the reasons for which have long been eclipsed by their structural consequences for the tax system. Similarly, the state-based structure of American corporate law is due less to immutable features of American federalism than to the inability of Progressive Era reformers to agree on federal legislation. Finally, while law and economics had a major influence on antitrust law, much of its

influence was contingent upon the receptiveness of the Supreme Court, which would likely have been considerably more measured under a Democratic majority. As each of these histories illustrates, the historical trajectory of legal reform is often shaped by political circumstances, the details of which may seem far removed from contemporary policy concerns.

In short, this dissertation both compliments and challenges legal scholarship on American business, much of which draws its analytical focus from contemporary economic priorities. As important as these priorities may be, they are not historically universal, and conceiving them as such can risk creating a distorted perception of the past. Often, the circumstances under which policy is formed are so closely bound to their historical context that direct evidence of the events themselves is essential to understanding them. And while theory can serve as a powerful tool for informing future policy reform, there are limits on the ability of theory alone to explain the origins of the status quo. If we reject assumptions that law develops according to normatively-inflected theoretical models, we can instead investigate the factual reasons that specific legal structures currently exist. This approach can be of considerable value to present-oriented legal scholars, as it can reveal situations in which contemporary policy is based on outdated historical factors. By attaining a clearer conception of *why* particular laws exist, we improve our ability to evaluate potential reforms. In the end, history matters—not only as the essential means for understanding the origins of legal principles, but also as a source of valuable insight into whether and how these principles should be changed.

PART I: THE HISTORICAL ORIGINS OF THE DEBT-EQUITY DISTINCTION

CHAPTER 1: INTRODUCTION

Few aspects of U.S. tax law have received greater criticism—and attracted fewer defenders—than the long-standing “debt-equity distinction.”¹ This feature of the tax system allows corporations to deduct interest paid on debt, but *not* dividends paid to shareholders, from the amount of profits on which federal income tax is calculated. Other things being equal, the effect of this distinction is to reduce the after-tax cost of debt financing relative to equity financing, making it less expensive for corporations to borrow money than to issue shares. Many economists believe this policy encourages corporations to substitute debt for equity, distorting the capital structure outcomes that would otherwise obtain in perfect financial markets.² Legal scholars have argued that while tax law attempts to draw a bright line between “debt” and “equity,” the distinction lacks a compelling theoretical justification, is difficult to draw in practice, and invites tax avoidance strategies.³ Critics in the financial and popular press have portrayed the distinction as an aggravating factor in the 2008 financial crisis, claiming that interest deductibility

¹ For purposes of Part I, “debt” refers, very generally, to the usual means by which corporations borrow money, including loans, bonds, and commercial paper, while “equity” refers to capital stock. “Interest” refers to compensation for borrowed money (typically paid to debtholders), while “dividends” refers to distributions of corporate income (typically paid to stockholders). As discussed herein, the practical and legal distinctions among these terms are often problematic.

² For a review of the relevant economic literature, see John R. Graham, “A Review of Taxes and Corporate Finance,” *Foundations and Trends in Finance* 1, no. 7 (2006): 573–691.

³ Perhaps the most well-known critique of tax law’s treatment of corporate debt is William Plumb, “The Federal Income Tax Significance of Corporate Debt: A Critical Analysis and a Proposal,” *Tax Law Review* 26 (1971): 369–640. For subsequent commentary on the issue, see Adam Emmerich, “Hybrid Instruments and the Debt-Equity Distinction in Corporate Taxation,” *University of Chicago Law Review* 52 (winter 1985): 118–48; Katherine Pratt, “The Debt-Equity Distinction in a Second-Best World,” *Vanderbilt Law Review* 53 (May 2000): 1055–1158; Ilan Benshalom, “How to Live with a Tax Code with Which You Disagree: Doctrine, Optimal Tax, Common Sense, and the Debt-Equity Distinction,” *North Carolina Law Review* 88 (2010): 1217–73. See also Joseph Allen, “Seeking True Financial Reform: Ending the Debt-Equity Distinction,” *William & Mary Business Law Review* 3, no. 1 (February 2012): 243–72. Although the term “debt-equity distinction” did not enter widespread usage until the late 1960s, earlier scholars recognized the problem, which they often discussed under the rubric of “thin incorporation” or “thin capitalization.” See, e.g., M. R. Schlesinger, “‘Thin’ Incorporations: Income Tax Advantages and Pitfalls,” *Harvard Law Review* 61, no. 1 (November 1947): 50–87; Harry Mansfield, “Thin Incorporation,” *American Bar Association Journal* 40 (March 1954): 237–39; “Thin Capitalization and Tax Avoidance,” *Columbia Law Review* 55 (1955): 1054–66; Boris I. Bittker, “Thin Capitalization: Some Current Questions,” *Taxes* 34 (1956): 830–41; Mortimer Caplin, “The Caloric Count of a Thin Incorporation,” *Marquette Law Review* 43 (1959): 31–71; “Thin Incorporation: The Major Tests of Debt or Equity Financing,” *Washington University Law Quarterly* 1959 (1959): 433–42; William M. Goldstein, “Corporate Indebtedness to Shareholders: ‘Thin Capitalization’ and Related Problems,” *Tax Law Review* 16 (1960): 1–79; Martin Kurzer, “Thin Incorporation: A Continuing Problem,” *Marquette Law Review* 51 (1967): 158–70.

encourages excessive leverage.⁴ In light of Republican presidential candidate Mitt Romney's prior leadership of Bain Capital, a private equity firm known for high-leverage acquisition strategies, interest deductibility even emerged as an issue in the 2012 presidential race.⁵ Also in 2012, the Obama administration proposed reducing the tax advantage of debt by limiting the ability of corporations to deduct interest from taxable income.⁶ Although the administration issued minor changes to debt-equity

⁴ See, e.g., David Cho, "Look at Macy's: U.S. Tax Code Encourages Companies to Rack up Huge Debt," *Washington Post*, August 8, 2010; Jesse Eisinger, "Distortion in Tax Code Makes Debt More Attractive to Banks," *New York Times*, September 19, 2012; Robert C. Pozen, "A Recipe for Cutting Corporate Taxes," *The Washington Post*, October 4, 2012; Felix Salmon, "How to Reduce the Deductibility of Interest Payments," *Reuters*, February 23, 2012, <http://blogs.reuters.com/felix-salmon/2012/02/23/how-to-reduce-the-deductibility-of-interest-payments/>. See also Allen, "Seeking True Financial Reform."

⁵ William D. Cohan, "Private Equity's Public Subsidy Is a Tragedy," *Bloomberg*, January 22, 2012, <http://www.bloomberg.com/news/2012-01-23/private-equity-s-public-subsidy-is-a-tragedy-william-d-cohan.html>; Anthony Luzzatto Gardner, "Romney's Bain Yielded Private Gains, Socialized Losses," *Bloomberg*, July 15, 2012, <http://www.bloomberg.com/news/2012-07-15/romney-s-bain-yielded-private-gains-socialized-losses.html>; James Surowiecki, "Private Inequity," *New Yorker*, January 30, 2012. For a different perspective on Bain Capital, see Josh Barro, "Good Leverage, Bad Leverage and Bain," *Bloomberg*, July 17, 2012, <http://www.bloomberg.com/news/2012-07-17/good-leverage-bad-leverage-and-bain.html>.

⁶ A Joint Report by the White House and the Department of the Treasury, "The President's Framework for Business Tax Reform," February 2012. The House Ways and Means Committee and the Senate Finance Committee also considered limiting interest deductibility. James Politi, "Congress Weighs Corporate Debt Tax Reform," *Financial Times*, March 24, 2013. These proposals followed earlier efforts by the Bush administration—the capital gains and dividend tax reductions included in the controversial "Bush tax cuts," for example, were intended in part to mitigate the tax advantage of debt. See "President Discusses Taking Action to Strengthen America's Economy," January 7, 2003, <http://georgewbush-whitehouse.archives.gov/news/releases/2003/01/20030107-5.html>. See also Pamela F. Olsen, "Tax Reform and the Treatment of Debt and Equity" (2011). The Bush-era capital gains and dividend tax reductions were partially repealed effective January 1, 2013, amidst the federal budget crisis. Under these changes, taxation of capital gains and dividends increased from 15% to 20% for individuals earning more than \$400,000 (or married couples earning more than \$450,000) annually. In addition, for individuals earning more than \$200,000 (or married couples earning more than \$250,000) annually, capital gains and dividends are now subject to a 3.8% surtax under the Patient Protection and Affordable Care Act (popularly referred to as "Obamacare"), raising the maximum rate on investment income to 23.8%. Jeff Benjamin, "Deal on Dividend Tax Is Small Victory for Investors," *InvestmentNews*, January 6, 2013, <http://www.investmentnews.com/article/20130106/REG/301069988>; Tony Nitti, "Obamacare Investment Income: A Downloadable Cheat Sheet," *Forbes*, January 6, 2013, <http://www.forbes.com/sites/anthonymitti/2012/12/06/cheat-sheets-to-the-obamacare-investment-income-tax-regulations-a-downloadable-pdf/>; Hibah Yousuf, "Dividend Tax Hike 'Could Have Been Worse,'" *CNNMoney*, January 2, 2013, <http://money.cnn.com/2013/01/02/investing/fiscal-cliff-dividend-tax-rate/>. Although Republicans have promised to modify or replace Obamacare, their legislative efforts to date have been unsuccessful. The Obama administration's proposals to directly limit interest deductibility echoed the suggestions of several tax commentators. See Lucas W. Goodman and Robert C. Pozen, "Capping the Deductibility of Corporate Interest Expense," *Tax Notes* 137 (2012): 1207–24; Calvin H. Johnson, "Corporate Meltdowns and the Deduction of Credit-Risk Interest," *Tax Notes* 131 (2011): 513–17; Martin A. Sullivan, "Treat Corporate Interest Deductions Like Any Tax Expenditure," *Tax Notes* 136 (2012): 661–63. In 2016, the Treasury department and IRS issued regulations limiting the ability of corporations to characterize intercompany interests as debt for tax purposes. "Section 385 Final Regulations: Initial Reactions," *KPMG*, October 21, 2016, <https://home.kpmg.com/us/en/home/insights/2016/10/tmf-final-regulations-under-section-385.html>. Interest on nonrelated debt instruments remains fully deductible, however.

classification rules in 2016, tax observers have been (rightly) skeptical as to the likelihood of broader reform, given the well-known difficulty of fundamental changes to the tax code.⁷

This widespread criticism presents a puzzle. If economists, legal scholars, and other tax commentators agree the distinction is unsound, then why does it exist? In other words, how and why did U.S. tax law embody a principle that tax policy experts reject? Was the favorable treatment of debt a function of the political influence of business and financial interests? Was the unfavorable treatment of equity due to equalitarian efforts to redistribute wealth? Did the distinction necessarily result from any specific political agenda? Is it even possible to pinpoint exactly when and how the distinction arose?

In general, existing scholarship has not addressed these questions. Although the debt-equity distinction has been the focus of considerable academic attention, few policy-oriented scholars have examined the issue's history.⁸ Economists, reflecting their disciplinary training and expertise, tend to evaluate policies as givens rather than considering their historical contexts. Economic studies of the debt-equity distinction have therefore focused on its effects rather than its causes.⁹ Applied policy research produced by the federal government and other nonacademic institutions is particularly ahistorical—many of these sources recommend reform, but provide no insight into why the current system exists.¹⁰ For their

⁷ Ibid. For discussion of the difficulties of tax reform, see Ezra Klein, “Tax Reform Is Really, Really Hard,” *The Washington Post*, February 22, 2012, http://www.washingtonpost.com/blogs/ezra-klein/post/wonkbook-tax-reform-is-really-really-hard/2012/02/22/gIQA9sD4SR_blog.html; Daniel Shaviro, “How Would the ‘President’s Framework for Corporate Tax Reform’ Pay for Cutting the Corporate Rate?,” *Start Making Sense*, February 23, 2012, <http://danshaviro.blogspot.com/2012/02/how-would-presidents-framework-for.html>; “Reform and Corporate Taxes,” *New York Times*, February 22, 2012.

⁸ This is despite recognition that history matters for understanding current policy structures. Ilan Benshalom, for example, has suggested that better appreciation of the origins of tax rules could lead to better contemporary policy analysis. Regarding the debt-equity distinction, he describes the current state of affairs as follows: “Arbitrary distinctions, such as the debt-equity distinction, have little if any justification for why they should be enforced but for the fact that they are ‘in the Code.’ With this type of shaky *why*, it is no wonder that practitioners devote most of their time to questions of *how*, while academics find it more attractive to solve abstract problems with intellectually ‘cleaner’ solutions.” Benshalom, “How to Live with a Tax Code with Which You Disagree,” 1262.

⁹ This characterization applies to the vast majority of economic scholarship on the issue, much of which is technical in nature. For a review of the literature, see Graham, “A Review of Taxes and Corporate Finance.”

¹⁰ See, e.g., A Joint Report by the White House and the Department of the Treasury, “The President’s Framework for Business Tax Reform”; Ruud de Mooij, “Tax Biases to Debt Finance: Assessing the Problem, Finding Solutions” (International Monetary Fund, May 3, 2011); Department of the Treasury, “Treasury Conference

part, legal scholars have taken a greater interest in the political aspects of the distinction, but they have generally focused on its contemporary persistence, without accounting for its historical origins.¹¹ Such causal explanations as do exist in the literature rely more on reasoned speculation than empirical evidence. Jennifer Arlen and Deborah Weiss, for example, have suggested that lobbying by financial companies may explain the existence of interest deductibility.¹² Barry Adler has written that interest deductibility may be the result of lobbying more generally, with the tacit approval of the taxpaying public.¹³ Katherine Pratt has ascribed the debt-equity distinction to a historical, individualistic conception of debtor-creditor relations, under which interest was considered a legitimate business expense, but dividend payments were not.¹⁴ Given their focus on contemporary policy issues, none of these authors support their explanations with primary historical evidence.

My research pursues a different approach. Rather than conducting a normative assessment of the debt-equity distinction as it exists today, I seek to explain how and why the distinction became law in the

on Business Taxation and Global Competitiveness,” July 23, 2007; Joint Committee on Taxation, “Present Law and Background Relating to Tax Treatment of Business Debt,” July 11, 2011; Michael Keen, Alexander Klemm, and Victoria Perry, “Tax and the Crisis,” *Fiscal Studies* 31, no. 1 (March 2010): 43–79; Office of Tax Policy, Department of the Treasury, “Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century,” December 20, 2007; The President’s Advisory Panel on Federal Tax Reform, “Simple, Fair, and Pro-Growth: Proposals to Fix America’s Tax System,” November 2005.

¹¹ A commonly cited analysis of the contemporary politics of the debt-equity distinction is Jennifer Arlen and Deborah M. Weiss, “A Political Theory of Corporate Taxation,” *Yale Law Journal* 105, no. 2 (November 1995): 325–91. See also Barry E. Adler, “Financial and Political Theories of American Corporate Bankruptcy,” *Stanford Law Review* 45, no. 2 (January 1, 1993): 345–46; Benshalom, “How to Live with a Tax Code with Which You Disagree,” 1238–45; Yariv Brauner, “Integration in an Integrating World,” *New York University Journal of Law and Business* 51, no. 2 (2005): n. 12; Michael Doran, “Managers, Shareholders, and the Corporate Double Tax,” *Virginia Law Review* 95 (May 2009): 517; Anthony Polito, “Advancing to Corporate Tax Integration: A Laissez-Faire Approach,” *South Carolina Law Review* 55, no. 1 (fall 2003): 34–36. Articles that do address the distinction’s history rarely devote more than a few pages. See, e.g., Benshalom, “How to Live with a Tax Code with Which You Disagree,” 1240–43; Curtis Berger, “Simple Interest and Complex Taxes,” *Columbia Law Review* 81 (1981): 218–22; Emmerich, “Hybrid Instruments and the Debt-Equity Distinction in Corporate Taxation,” 121–28; Jeffrey L. Kwall, “The Uncertain Case Against the Double Taxation of Corporate Income,” *North Carolina Law Review* 68 (1990): 618–20; Pratt, “The Debt-Equity Distinction in a Second-Best World,” 1094–98; Alvin C. Warren, “The Corporate Interest Deduction: A Policy Evaluation,” *Yale Law Journal* 83, no. 8 (July 1974): 1585–86.

¹² Arlen and Weiss, “A Political Theory of Corporate Taxation,” n. 163.

¹³ Adler, “Financial and Political Theories of American Corporate Bankruptcy,” 346.

¹⁴ Pratt, “The Debt-Equity Distinction in a Second-Best World,” 1065–67.

first place. Answering this question represents an important contribution to the literature, as no scholar of any discipline has provided an adequate account of the policy's origins. Perhaps given the technical nature of the problem, there is no historical literature to speak of. More generally, however, if tax scholars are guilty of neglecting history, historians are equally guilty of neglecting taxes—very few historians have written on fiscal history at all, and fewer still have delved into the specific details of tax law.¹⁵ A result of this neglect is that the origins of many long-standing tax principles, including the debt-equity distinction, are poorly understood.

An important exception to the general statements above is the work of legal scholar Steven Bank, who has written extensively on the history of corporate tax law. Of particular significance is Bank's work on the rise of "double taxation"—the feature of U.S. tax law by which corporate profits are taxed at both the corporate and individual shareholder levels.¹⁶ Since dividend payments, unlike interest, are not deductible by corporations for tax purposes, double taxation can be thought of as the "equity side" of the debt-equity distinction.¹⁷ Bank's work in this area has been an important influence on my own research, and, indeed, Part I supports many of his findings.

My contribution is distinct from Bank's in important respects, however. Most significantly, I redirect attention to the origins of interest deductibility, while Bank's work has emphasized the tax treatment of equity. I also rely somewhat less than Bank on the agency theory framework of corporate

¹⁵ Among current historians of taxation, W. Elliot Brownlee and Joseph Thorndike are perhaps the most prominent. While valuable, their work has generally focused on broad policy developments rather than specific legal rules. See, e.g., W. Elliot Brownlee, *Federal Taxation in America: A Short History*, 2nd ed. (Cambridge: Cambridge University Press, 2004); W. Elliot Brownlee, ed., *Funding the Modern American State, 1941–1995: The Rise and Fall of the Era of Easy Finance* (Washington: Woodrow Wilson Center Press, 1996); Joseph J. Thorndike and Dennis J. Ventry, eds., *Tax Justice: The Ongoing Debate* (Washington: Urban Institute Press, 2002); Joseph J. Thorndike, *Their Fair Share: Taxing the Rich in the Age of FDR* (Washington: Urban Institute Press, 2013).

¹⁶ See Steven A. Bank, "Corporate Managers, Agency Costs, and the Rise of Double Taxation," *William & Mary Law Review* 44 (2002): 167–261; Steven A. Bank, *From Sword to Shield: The Transformation of the Corporate Income Tax, 1861 to Present* (New York: Oxford University Press, 2010); Steven A. Bank, "The Story of Double Taxation: A Clash Over the Control of Corporate Earnings," in *Business Tax Stories* (New York: Foundation Press, 2005), 153–80.

¹⁷ Bank has also addressed the "debt side" of the distinction in a recent symposium essay. Steven A. Bank, "Historical Perspective on the Corporate Interest Deduction," *Chapman Law Review* 18, no. 1 (2014): 29–48.

governance scholarship. Finally, I pay greater attention to how changes in the historical context, including broad shifts in the American political landscape, transformative economic developments, and unanticipated fiscal crises (such as war, depression, and other exogenous fiscal shocks), imposed a wide array of shifting and often contradictory pressures on U.S. tax policy.

Specifically, Part I argues that the debt-equity distinction is the unintended consequence of an extended series of reactive, ad hoc, short-term political decisions, rather than the intentional realization of any broader policy goal. Each such decision was influenced by decisions that came before it, imparting a distinctly path-dependent character to the process's eventual outcome. Due to the significant "inertia" of tax policy, decisions made in response to specific historical circumstances became difficult to change—even after the circumstances themselves had changed or were no longer applicable. Through an essentially undirected process, the debt-equity distinction became an important feature of federal tax law without ever representing a coherent policy objective.

As discussed herein, this process has important implications for our current understanding of the varied and often contingent forces that have shaped the U.S. tax system. Taxation is a major aspect of the substantive legal control of corporations, which makes understanding the historical context of tax rules all the more important. Intentionally or not, taxation has an enormous impact on how corporations structure their business activities.¹⁸ To the extent that current tax policies reflect outdated or even forgotten political goals, it becomes all the more important to recover their historical origins.

My story begins with the Civil War and the enactment of the first U.S. income tax and concludes with the establishment of full double taxation of dividends in the late 1930s. This roughly 80-year period encompasses the debt-equity distinction's origins and early development. Although the distinction has persisted through the postwar era, I have limited the scope of my analysis to the distinction's formative years, as its more recent history has already received considerable attention in the legal literature. My

¹⁸ This is a phenomenon I have witnessed first-hand in practice.

focus throughout is on the legislative politics that led to specific statutory developments, as well as on the social and economic context that shaped the broader legislative agenda.¹⁹

Part I proceeds as follows: Chapter 2 addresses the temporary income taxes enacted in the nineteenth century, prior to the establishment of a permanent federal income tax system. This chapter focuses in particular on the emerging concept of net income and the attendant deductibility of business expenses. Chapter 3 explores statutory developments from 1909 to 1939, the period in which the debt-equity distinction became a permanent feature of U.S. tax law. Spanning World War I and the Great Depression, these were the formative years of U.S. corporate taxation. Chapter 4 concludes, assessing the broader significance of the debt-equity distinction as an example of legal policy development.

¹⁹ By and large, Part I does not focus on judicial decisions. Since many of the notable decisions in this area have been attempts to delineate “debt” from “equity” in terms of a preexisting statutory distinction, in the interest of concision, the scope of Part I is limited to the evolution of the statutes themselves.

CHAPTER 2: NINETEENTH-CENTURY ANTECEDENTS

The United States' first permanent income tax—initially imposed only on corporations—was enacted by Congress in 1909.²⁰ Following ratification of the Sixteenth Amendment in 1913,²¹ which specifically permitted income taxation without apportionment among the states, Congress expanded the income tax to include personal income as well.²² Income taxation—both corporate and personal—has been a cornerstone of the U.S. tax system ever since, and many of the tax code's defining features can be traced to the legislation of the early twentieth century.

These laws were not the federal government's first efforts at income taxation, however; Congress had enacted income taxes twice before in American history.²³ To help finance the Civil War, Congress enacted an income tax for the first time in 1861,²⁴ which remained in effect (with various modifications) until its repeal in 1871.²⁵ Despite calls for its reenactment, the federal government did without an income tax until 1894, when a broad coalition of equalitarian political interests were able to secure its return.²⁶

²⁰ *An Act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes*, § 38, *U.S. Statutes at Large* 36 (1909): 112–17. Although Congress characterized this tax as a “special excise tax” on corporate profits, it was a corporate income tax for all intents and purposes.

²¹ U.S. Constitution., amend. 16.

²² *An Act to reduce tariff duties and to provide revenue for the government, and for other purposes*, §§ II.A–F, *U.S. Statutes at Large* 36 (1913): 166–71.

²³ For general historical discussion of the Civil War tax regime, see Brownlee, *Federal Taxation in America*, 31–37. Several states, including North Carolina, Oklahoma, South Carolina, Virginia, and Wisconsin, had also previously experimented with income taxation. As of the enactment of the federal individual income tax in 1913, the only state income tax of any significance was that of Wisconsin, enacted in 1911. Edwin R.A. Seligman, *The Income Tax: A Study of the History, Theory, and Practice of Income Taxation at Home and Abroad* (New York: The Macmillan Company, 1911), 388–429. The Wisconsin income tax, which became a model for income taxes adopted in other states, was enacted as Chapter 658, *Wisc. Session Laws* 1911 (1911): 984–999. Surprisingly, the 1911 Wisconsin tax did not feature in the Congressional debates leading to the 1913 federal tax.

²⁴ *An Act to Provide Increased Revenue from Imports, to Pay Interest on the Public Debt, and for Other Purposes*, § 49, *U.S. Statutes at Large* 12 (1861): 309.

²⁵ *An Act to Reduce Internal Taxes, and for Other Purposes*, § 6, *U.S. Statutes at Large* 16 (1870): 257 provided that 1871 would be the final year of the income tax.

²⁶ *An Act to reduce taxation, to provide revenue for the government, and for other purposes*, §§ 27–33, *U.S. Statutes at Large* 28 (1894): 553–57.

This victory was short-lived, however, as the Supreme Court struck down the 1894 tax as unconstitutional within a year of its enactment.²⁷

Despite the chronological gap between the nineteenth-century income taxes and the permanent system established in 1909-1913, these earlier taxes established important precedents for the subsequent tax treatment of debt and equity. Significantly, the nineteenth-century tax laws occasioned Congress's first engagement with one of the most fundamental conceptual problems of income taxation: What, exactly, is "income"? The resolution of this question in the nineteenth century would establish the framework for all future tax laws, influencing the treatment of interest and dividends under the twentieth-century corporate income tax.

A. The Civil War Revenue Acts and the Meaning of Income

The expense of financing the Civil War gave rise to the federal government's first experiments with income taxation. Prior to the war, the government raised most its revenue through import tariffs.²⁸ While sufficient to fund the national government's modest peacetime expenditures, tariffs were seen as inadequate to meet the unprecedented cost of war mobilization.²⁹ In addition, tariff revenue was vulnerable to wartime disruptions to foreign trade, increasing the importance of securing additional sources of government revenue.³⁰ Republican legislators, who dominated both houses of the Union Congress, believed a new tax based on individual income could help solve the North's sudden fiscal

²⁷ As discussed below, the Supreme Court struck down the tax on grounds of violating the apportionment requirement of U.S. Constitution, art. 1, sec. 2. *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895).

²⁸ See F. W. Taussig, *The Tariff History of the United States*, 5th ed. (New York: G.P. Putnam's Sons, 2010), 63–133.

²⁹ See *Ibid.*, 135–47. Following the Civil War, federal spending has increased significantly as a percentage of the U.S. economy. Federal spending as a percentage of GDP was approximately 1.7% in 1859; the same figure was approximately 20.8% in 2013. John Joseph Wallis, Federal Government Finances—Revenue, Expenditure, and Debt: 1789–1939, table Ea584–587 in *Historical Statistics of the United States, Earliest Times to the Present: Millennial Edition*; Office of Management and Budget, Table 15.3—Total Government Expenditures as Percentages of GDP: 1948–2013, <http://www.whitehouse.gov/omb/budget/Historicals> (accessed Nov. 26, 2014). Brownlee, *Federal Taxation in America*, 31.

³⁰ Bank, *From Sword to Shield*, 12; Roy G. Blakey and Gladys C. Blakey, *The Federal Income Tax* (Clark: The Lawbook Exchange, Ltd., 1940), 2; Seligman, *The Income Tax*, 430–34; John Witte, *The Politics and Development of the Federal Income Tax* (Madison: University of Wisconsin Press, 1985), 67.

challenges. Together with tariff increases, excise taxes, and new direct taxes on real property (apportioned among the states), the country's first income tax was adopted August 5, 1861.³¹

Unlike income taxation today, the income tax laws enacted during Civil War applied only to the income of individuals, not to the profits of corporations. Under the 1861 act, the tax was to be levied as 3% of the annual income, in excess of \$800, of "every person residing in the United States."³² Corporations and other business entities were not obligated to pay taxes on profits.³³ Beginning in 1862, the government levied a withholding tax, equal in rate to the individual income tax, on interest and dividends paid by businesses in certain industries. The income targeted by this withholding tax was the income of the individuals themselves, *not* the profits of corporations as entities separate from their investors.³⁴ Corporations and other businesses subject to the withholding tax merely served as collection points. At the time, the perceived injustice of double taxation (taxing income at the corporate level and then again at the individual level) was a sensitive political issue, which Congress sought to avoid by allowing individual taxpayers to deduct interest and dividends subject to the withholding tax from their

³¹ The revised tariffs, excise taxes, direct taxes, and income tax were all included in *An Act to Provide Increased Revenue from Imports, to Pay Interest on the Public Debt, and for Other Purposes, U.S. Statutes at Large*. As discussed below, the 1861 income tax legislation was never enforced, being superseded by replacement legislation in 1862. The Confederacy, facing a similar fiscal crisis, adopted its own income tax in 1863. William D. Samson, "The Nineteenth Century Income Tax in the South," *Accounting Historians Journal* 12, no. 1 (1985): 44–48.

³² *An Act to Provide Increased Revenue from Imports, to Pay Interest on the Public Debt, and for Other Purposes*, § 49. In subsequent years, the 3% rate would increase and the \$800 exemption would decrease. For comparison, the relative value of \$800 in 1861 would be \$ 22,200 in 2016, based on changes in the consumer price index. "Measuring Worth," accessed April 29, 2017, <https://www.measuringworth.com/uscompare/>.

³³ For a summary of the act's key provisions, see row 1 of the Appendix.

³⁴ *An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt*, §§ 81–82, *U.S. Statutes at Large* 12 (1862): 469–70 imposed a 3% withholding tax on interest and dividends paid by transportation companies, as well as on dividends (but not interest) paid by financial and insurance companies; *An Act to Provide Internal Revenue to Support the Government, Pay Interest on the Public Debt, and for Other Purposes*, §§ 117, 120–22, *U.S. Statutes at Large* 13 (1864): 281–82, 283–85 allowed individual taxpayers to deduct interest and dividends subject to withholding tax from their personal income, imposed individual income tax on certain business profits, whether divided or otherwise, imposed a 5% withholding tax on interest and dividends paid by transportation companies, and imposed a 5% withholding tax on dividends (but not interest) paid by financial and insurance companies. Blakey and Blakey, *The Federal Income Tax*, 5; Reuven S. Avi-Yonah, "Corporations, Society, and the State: A Defense of the Corporate Tax," *Virginia Law Review* 90 (September 2004): 1212–13. For an opposing view, see Bank, *From Sword to Shield*, 5, arguing that although Congress purposefully avoided double taxation, the Civil War tax laws planted the seeds of a separate corporate income tax.

personal income.³⁵ This deduction was meant to ensure that taxes withheld from interest and dividend payments were not duplicated when individual investors filed their personal tax returns.³⁶

Despite the absence of a separate corporate income tax, the Civil War revenue acts had important consequences for the subsequent tax treatment of corporate debt and equity. Congress's experience with these early income tax laws first gave rise to the concept of net income, inspiring the deduction system familiar to us today. Since the tax distinction between debt and equity is predicated on the existence of interest deductibility, the emergence of a conception of "net" income was central to the distinction's later development.

When the income tax was first enacted, the precise statutory meaning of "income" was unclear. Under the 1861 law, the 3% tax applied to "the annual income of every person residing in the United States, whether such income is derived from any kind of property, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere."³⁷ The word "income" was not defined in the statute, however, and national, state, and local taxes were the only specified deductions.³⁸ This left considerable ambiguity as to whether the law's purpose was to tax gross income (all revenue

³⁵ *An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt*, § 91; *An Act to Provide Internal Revenue to Support the Government, Pay Interest on the Public Debt, and for Other Purposes*, § 117.

³⁶ Integration of the withholding and individual-level taxes was imperfect, however, in that the withholding tax was set at a flat rate that did not take account of the standard personal exemption. This inconsistency was likely due to limitations in the design and administration of the tax laws, rather than specific Congressional intent. Bank, *From Sword to Shield*, 7–8. To illustrate the relative scale of these taxes, in fiscal year 1864, revenues from withholding tax on interest and dividends amounted to \$5,277,141.07, approximately 24% of all income tax revenues and nearly 5% of internal revenue from all sources. In fiscal year 1865, revenues from withholding tax on interest and dividends increased to \$8,070,367.53, nearly 26% of all income tax revenues and approximately 4% of internal revenue from all sources. Withholding tax on interest and dividends represented a much larger percentage of income tax revenues in fiscal year 1863—approximately 62%—as the administrative infrastructure for collecting income tax directly from individuals on all sources of income was not yet fully in place. "Report of the Commissioner of Internal Revenue on the Operations of the Internal Revenue System for the Year Ending June 30, 1863" (Government Printing Office, 1864); "Report of the Commissioner of Internal Revenue on the Operations of the Internal Revenue System for the Year Ending June 30, 1864" (Government Printing Office, 1865); "Report of the Commissioner of Internal Revenue on the Operations of the Internal Revenue System for the Year Ending June 30, 1865" (Government Printing Office, 1865).

³⁷ *An Act to Provide Increased Revenue from Imports, to Pay Interest on the Public Debt, and for Other Purposes*, § 49.

³⁸ *Ibid.*

received by the taxpayer) or net income (revenue received by the taxpayer, minus associated costs and expenses).

The Congressional debates leading to the tax's enactment suggest that, although certain deductions were implied, the exact scope of allowable deductions was intentionally left unclear. Senator James Simmons (R-RI), who introduced the tax bill in the Senate July 29, 1861, warned against what he considered the disadvantages of specifying deductions. When asked whether "income" meant gross or net income for purposes of the tax bill, Simmons responded that "income" was intended to mean "net profits," but that final authority as to exactly which expenses were (or were not) deductible was best left to the Treasury Department, which was charged with the tax's enforcement.³⁹ According to Simmons, express use of the term "net income" in the language of the statute itself would open the door for taxpayers to claim spurious deductions.⁴⁰ Referring to a hypothetical storehouse owner, Simmons explained:

If I put in the word "net" income, he would try to have all the repairs, and so on, deducted, and would make them amount to as much as the income. That would be the trouble. When a man repairs his buildings, he will have less income that year, because he spends it in repairing. I thought of putting the word "net" in, but I could see so many ways of evading it that I thought it better to let the Secretary of the Treasury prescribe his rules, and let the bill cover all incomes.⁴¹

Other Senators disagreed, believing the meaning of the law should be as clear as possible. Senator Daniel Clark (R-NH), for example, submitted an amendment to insert the word "net" before the word "income," but his proposal was voted down 18-10 in floor debate.⁴² Ultimately, Simmons's preference for ambiguity prevailed, as reflected in the final language of the law. The meaning of "income" under the 1861 act was never subjected to practical interpretation, however. In the first of many revisions to the

³⁹ *Cong. Globe*, 37th Cong., 1st Sess. 315 (1861).

⁴⁰ *Ibid.*

⁴¹ *Ibid.*

⁴² *Ibid.*

Civil War tax laws, a superseding revenue act was signed July 1, 1862, before the 1861 act was put in force.⁴³

Under the 1862 act, the income tax continued to apply to individuals—“every person residing in the United States”—and was now imposed at 3% of income exceeding \$600 (unless the taxpayer’s income exceeded \$10,000, in which case the rate increased to 5% of income exceeding \$600).⁴⁴ Based on the legislative discussion (which included no mention of directly taxing businesses), the tax’s reference to “every person residing in the United States” was probably meant to limit its application to individuals, although a separate section of the act confused the matter by explicitly defining “person” to include “partnerships, firms, associations, or corporations.”⁴⁵ Tasked with enforcing the tax, the Commissioner of Internal Revenue resolved this ambiguity by stating that the income tax applied to individuals only.⁴⁶ Although the tax was not applied to corporations (or other business entities) as such, under the 1862 act, certain corporate interest and dividend payments became subject to a 3% withholding tax.⁴⁷ To avoid

⁴³ The 1861 tax was to be payable June 30, 1862, but the Secretary of the Treasury (Salmon Chase) advised that enforcement of the tax be deferred, as “numerous questions will certainly perplex its assessment and collection.” Seligman, *The Income Tax*, 435–36. The superseding 1862 tax was enacted as *An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt*.

⁴⁴ An Act to provide Internal Revenue to support the Government and to pay Interest on the Public Debt, § 90. For comparison, based on changes in the CPI, the relative value of \$600 in 1862 would be \$14,600 in 2016, while the relative value of \$10,000 would be \$243,000. “Measuring Worth.” Unlike the 1861 act, which explicitly referred to an “income tax,” the corresponding section of the 1862 act referred instead to an income “duty.” Why Congress chose to use the word “duty” in the 1862 version is unclear, but “duty” was changed back to “tax” in 1867. *An Act to Amend Existing Laws Relating to Internal Revenue, and for Other Purposes*, § 13, *U.S. Statutes at Large* 14 (1867): 481–82.

⁴⁵ *An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt*, § 68. This definition was included in a section of the act establishing valued-added taxes on manufactured goods. Although a literal reading of this section might dictate that the term “person” included “partnerships, firms, associations, or corporations” in *all* sections of the act, the legislative history, broader statutory framework, and enforcement by the Commissioner of Internal Revenue suggest that Congress did not intend to levy the income tax on businesses separately from individuals.

⁴⁶ The Commissioner of Internal Revenue issued the following decision in the spring of 1863: “The income tax is assessed against the actual income of individuals. Firms, as such, will not make returns.” Reprinted in George Sewall Boutwell, *A Manual of the Direct and Excise Tax System of the United States* (Boston: Little, Brown and Company, 1863), 275.

⁴⁷ *An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt*, §§ 81–82.

double taxation, these payments were correspondingly deductible from the taxable income of individual investors.⁴⁸

For the most part, the phraseology of the 1861 act was carried over to the 1862 act, with one significant difference: the 1862 act replaced the term “income” with the broader phrase “gains, profits, or income.”⁴⁹ Although this broader language more strongly suggested a net income concept, ambiguity persisted, as reflected in the disagreement that characterized the 1862 legislative debates. Some members of Congress believed the meaning of “gains, profits, or income” was self-evident and that further elaboration would only dilute the statute.⁵⁰ Others argued that the meaning of “gains, profits, or income” was ambiguous, and that express use of the words “net income” was a necessary clarification.⁵¹ Although opponents of the term “net income” claimed to agree, in principle, that taxpayers should be allowed to deduct expenses from taxable income, such claims may have been disingenuous, as opposition to the term seems to have been motivated largely by a desire to limit deductions and thereby maximize revenue. Disagreements over the concept of net income often centered on the fact that taxpayers would use the concept, if specified at law, to reduce their tax obligations.⁵² To give a more specific example, Despite having earlier acknowledged that “gains, profits, or income” meant net income, Representative Justin Morrill (R-VT) specifically opposed the deductibility of mortgage interest.⁵³

⁴⁸ See row 2 of the Appendix. *An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt*, § 91. The salaries of federal employees (including elected officials) also became subject to a 3% withholding tax on amounts in excess of \$600 and were fully deductible from such employees’ personal tax returns. *An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt*, § 86.

⁴⁹ *An Act to Provide Internal Revenue to Support the Government and to Pay Interest on the Public Debt*, § 90.

⁵⁰ See *Cong. Globe*, 37th Cong., 2nd Sess. 1531–32 (1862).

⁵¹ *Ibid.*

⁵² See, e.g., discussion at *ibid.*; *Cong. Globe*, 37th Cong. 2nd Sess. 2486–87 (1862).

⁵³ *Ibid.*, 1531–32.

This issue of mortgage interest received particularly close attention from Congress. By the 1860s, the westward expansion of American agriculture led to unprecedented growth in mortgage lending, as more and more farmers purchased farmland with loans secured by the underlying property.⁵⁴ Mortgage loans were fast becoming one of the most common forms of personal debt, and it is therefore unsurprising that they featured prominently in Congressional debates. Tellingly, some of the same lawmakers who advocated a less precise definition of income also argued that mortgage payments should not be allowable deductions.⁵⁵ As was often the case in nineteenth-century tax politics, there appears to have been a regional cast to these debates, with western agricultural states favoring broad interest deductibility and wealthier northeastern states opposing it.⁵⁶ In an exchange in the House of Representatives, Owen Lovejoy and Steven White, of Illinois and Indiana, respectively, proposed an amendment specifying that “income” meant “net income.” Representatives Justin Morrill and Thaddeus Stevens, of Vermont and Pennsylvania, respectively, opposed the measure. Illustrating the tensions between the western and northeastern states, Stevens of Pennsylvania criticized the proposal as follows: “I oppose the amendment of the gentleman from Indiana. The income tax, as a general rule, will be almost exclusively collected from the large cities. The country, and especially the western country, will not pay a millionth part of it. If the present amendment prevails, they will not pay any part of it.”⁵⁷ In addition to revealing regional frictions, these debates suggest that, from the income tax’s earliest beginnings, some lawmakers were already concerned with the use of deductions as a tax avoidance measure.

⁵⁴ For discussion of the nineteenth-century rise of the national mortgage market, see Jonathan Levy, “The Mortgage Worked the Hardest,” in *In Capitalism Takes Command: The Social Transformation of Nineteenth-Century America*, ed. Gary J. Kornblith and Michael Zakim (Chicago: The University of Chicago Press, 2010), 39–67.

⁵⁵ See *Cong. Globe*, 37th Cong., 2nd Sess. 1531–32 (1862).

⁵⁶ See Blakey and Blakey, *The Federal Income Tax*, 4; Brownlee, *Federal Taxation in America*, 46–47; Seligman, *The Income Tax*, 506–8, 520–21.

⁵⁷ *Cong. Globe*, 37th Cong., 2nd Sess. 1531 (1862). Lovejoy, White, Morrill, and Stevens were all Republicans. Given the dominance of the Republican party, regional differences were often of greater political significance than party differences.

Other lawmakers also opposed the inclusion of a specific mortgage interest deduction, but for essentially the opposite reason—they believed the phrase “gains, profits, or income” clearly entailed the deduction of mortgage interest and feared that specifying particular deductions might imply the disallowance of others.⁵⁸ Following a protracted debate, the “gains, profits, or income” phraseology (without the word “net”) prevailed in the House, but not all representatives agreed that the final language was sufficiently clear. Upon assurances from colleagues that “gains, profits, or income” meant net income, an unsatisfied Representative Lovejoy responded: “All I have to say is, some of the best lawyers in the house understand income to be the gross income.”⁵⁹

These disagreements notwithstanding, most members of Congress probably did understand “gains, profits, or income” to mean net income, as this was the meaning most often articulated in the published Congressional record. As Senator John Sherman, future Treasury Secretary and original sponsor of the Sherman Antitrust Act, noted during the 1862 debates, the word “income” was widely understood to mean net income, both as a practical and legal matter. Conceding that the word “income” had not yet received definitive construction in American law, Sherman argued that the term had a well-established meaning in commercial practice and under the law of England. In both contexts, he maintained, expenses—including interest—were always deducted to arrive at income.⁶⁰ A contemporary analysis of the 1862 law in the *Daily National Intelligencer* supported the “net income” interpretation. Citing dictionary definitions of the words “gains,” “profits,” and “income,” the Washington newspaper concluded that while “income” could be construed literally to mean all revenue that “comes in,” the addition of the narrower terms “gains” and “profits” to form the phrase “gains, profits, or income” weighed in favor of a net concept.⁶¹

⁵⁸ *Cong. Globe*, 37th Cong., 2nd Sess. 1531–32 (1862); *Cong. Globe*, 37th Cong., 2nd Sess. 2486–87 (1862).

⁵⁹ *Ibid.*, 1532.

⁶⁰ *Ibid.*, 2487.

⁶¹ “The Income Tax,” *Daily National Intelligencer*, August 27, 1862.

Similar to the question of the meaning of “person,” the ambiguity of “gains, profits, or income” was ultimately resolved at the administrative level, when the income tax was assessed and collected by the newly formed Bureau of Internal Revenue.⁶² Confronted with the practical problem of how to measure taxable income, the Bureau chose to assess the tax on a net basis. Its standard income return form, published and distributed for use by taxpayers, explicitly provided for the deduction of business expenses, maintenance, insurance, mortgage interest, and rent.⁶³ Letter rulings issued by the Bureau in 1863 emphasized that “income tax is laid upon the net gains after the expenses of conducting the business are deducted”⁶⁴ and that the rate of taxation was to be determined “after those deductions are made, which are in actual diminution of income, such as rents, taxes, repairs, losses, &c.”⁶⁵ Moreover, a 1863 administrative decision of the Bureau ruled that “interest on borrowed capital used in business” was also deductible.⁶⁶ Given the Bureau’s decisive construction of the law, the ambiguity of the statute had little practical significance.

When Congress amended the income tax again in 1864, it followed the Bureau’s lead in addressing deductions explicitly, providing that labor costs, rent, and interest on mortgages were all deductible from taxable income.⁶⁷ Taxpayers could also deduct interest on general (i.e., unsecured) debt, but only up to the amount of interest they had *received* during the tax year.⁶⁸ In addition, the 1864

⁶² For a history of the origins of the Bureau of Internal Revenue, see Joseph J Thorndike, “An Army of Officials—The Civil War Bureau of Internal Revenue,” December 21, 2001, <http://www.taxhistory.org/thp/readings.nsf/ArtWeb/FF949517831B181685256E22007840E8?OpenDocument>.

⁶³ Form 24, reprinted in Boutwell, *A Manual of the Direct and Excise Tax System of the United States*, 155–56.

⁶⁴ Ruling 23, reprinted in Boutwell, *A Manual of the Direct and Excise Tax System of the United States*, 304.

⁶⁵ Ruling 36, reprinted in Boutwell, *A Manual of the Direct and Excise Tax System of the United States*, 306.

⁶⁶ Decision 110, reprinted in Boutwell, *A Manual of the Direct and Excise Tax System of the United States*, 275.

⁶⁷ *An Act to Provide Internal Revenue to Support the Government, Pay Interest on the Public Debt, and for Other Purposes*, § 117.

⁶⁸ *Ibid.*

amendments increased the income tax to a graduated rate of 5%–10% and increased the withholding tax on corporate interest and dividends to 5%.⁶⁹ It is not entirely clear why, having avoided the issue of deductions in previous versions of the tax, Congress chose to address deductions explicitly in 1864. The labor, rent, and interest deductions were included in the 1864 House bill without comment and were never amended (and apparently never discussed) as the bill moved through Congress on its way to enactment.⁷⁰ It seems likely that Congress was simply conforming the law to the collection practices established by the Bureau, but given the lack of legislative discussion, the exact reasons remain unknown. Whatever the impetus, expense deductibility had now become an explicit feature of statutory law.

The income tax remained in place following the conclusion of the Civil War, and its structural details continued to evolve at both the statutory and administrative levels. In 1867, Congress abandoned rate graduation and changed the tax to a flat 5% rate on income exceeding \$1,000.⁷¹ More significantly for present purposes, the interest deduction provision was substantially rewritten. Under the 1867 amendments, general (unsecured) business interest was no longer capped but became fully deductible, while the deductibility of non-business mortgage interest was repealed.⁷² In effect, interest deductibility now depended on whether the underlying debt was business-related, rather than on whether it was secured by a lien. Following this amendment, the Bureau ceased its former practice of allowing taxpayers to deduct interest on home mortgages.⁷³

⁶⁹ See row 3 of the Appendix. *An Act to Provide Internal Revenue to Support the Government, Pay Interest on the Public Debt, and for Other Purposes*, §§ 116, 120, 122.

⁷⁰ H.R. 405, 38th Cong. (1864). The revenue bill passed the House by a vote of 103-33 and the Senate by a vote of 28-3. The deduction provisions do not appear to have been controversial, as I have found no discussion of them in Congressional debates or contemporary news coverage. For vote count information, see “The Vote on the Tax Bill,” *Boston Daily Advertiser*, April 30, 1864.

⁷¹ *An Act to Amend Existing Laws Relating to Internal Revenue, and for Other Purposes*, § 13, *U.S. Statutes at Large* 14 (1867): 470–80. For comparison, the relative value of \$1,000 in 1867 would be \$16,500 in 2016, based on changes in the CPI. “Measuring Worth.”

⁷² *An Act to Amend Existing Laws Relating to Internal Revenue, and for Other Purposes*, § 13.

⁷³ Office of Internal Revenue, *Instructions to United States Assessors* (Washington: Government Printing Office, 1868), 7; “Homestead Income Tax,” *New York Times*, March 28, 1870.

At the time, most interest-bearing debt in the American economy was, in fact, business-related. Mortgage loans were issued primarily for the purchase of farmland, which generated business income for tax purposes. Personal lending was mainly limited to store credit.⁷⁴ Nevertheless, “homestead” mortgage lending (that is, mortgage lending secured by a home, rather than farmland), which did not generate business income and was therefore no longer deductible under the Bureau’s collection practices, had become widespread enough that the Bureau’s actions led to public outcry.⁷⁵ Editorials in major newspapers and periodicals condemned “the weak and oppressive effort of the Internal Revenue Bureau to prohibit the deduction of interest paid on mortgages,”⁷⁶ castigated the Bureau’s policies as lacking “justice or common sense,”⁷⁷ and forewarned that “we are rapidly drifting toward a despotism in this matter of the income tax.”⁷⁸

Perhaps in response, Congressional amendments to the tax laws in 1870 eliminated any distinction between business and non-business interest, allowing taxpayers to deduct “the amount of interest paid during the year” without qualification.⁷⁹ Strangely, however, the Bureau maintained its practice of limiting full interest deductibility to business debt. According to Bureau regulations, interest on home mortgages and other non-business debt was deductible only up to the amount of interest *received* by the taxpayer, which for most taxpayers meant not at all.⁸⁰ This discrepancy between the statutory law

⁷⁴ See Louis Hyman, *Borrow: The American Way of Debt* (New York: Vintage Books, 2012), 17–40.

⁷⁵ “Income Tax Exemptions,” *Independent*, March 24, 1870; “Mortgagors and the Income Tax,” *New York Times*, March 11, 1870; “Reducing Taxes,” *The Merchants’ Magazine and Commercial Review*, June 1, 1870, 420; “The Income Tax,” *New York Times*, March 20, 1870; “The Income Tax and Interest on Mortgages,” *New York Times*, March 15, 1870.

⁷⁶ “Reducing Taxes.”

⁷⁷ “The Income Tax,” March 20, 1870.

⁷⁸ “Income Tax Exemptions.”

⁷⁹ *An Act to Reduce internal Taxes, and for Other Purposes*, § 9, *U.S. Statutes at Large* 15 (1870): 258.

⁸⁰ In other words, non-business interest paid could only be offset against interest received. 7 Internal Revenue Ruling 59, 11 Internal Revenue Ruling 89, 11 Internal Revenue Ruling 97, reprinted in Orlando Bump, *Internal Revenue Laws* (Baker, Voorhis, 1870), 295–96.

and its administrative enforcement highlights the confusion and ambiguity that characterized the early income tax. Yet it illustrates clearly the early conception of interest as a business expense, an association that would continue to influence later corporate tax policy.

The Civil War era income tax ended in 1871. In addition to changing the treatment of interest, the 1870 amendments also provided for the tax's repeal, limiting its existence to the year 1871 "and no longer."⁸¹ In the years following the conclusion of the war, the nation's fiscal situation had begun to improve, budget deficits had turned to surpluses, and the income tax—always unpopular—was no longer considered necessary.⁸² So ended the federal government's first experiment with income taxation, a revenue source that would remain dormant until the Populist movement of the 1890s. Although brief in duration, the Civil War income tax was of major significance to subsequent tax law. Two of its features in particular—the establishment of a tax base grounded in the concept of net income and the designation of interest as a deductible (individual) business expense—would eventually become permanent features of the American tax system.

B. The Income Tax of 1894 and the Advent of the Corporate Interest Deduction

Following the Civil War, the government returned to its previous reliance on import tariffs for revenue, but popular discontent with the tariff system would soon become a major political issue. The postwar nineteenth century was a period of rapid economic development, but also of damaging financial panics, growing labor unrest, and increasingly salient income inequality.⁸³ Amidst these economic changes, the (politically dominant) Republican party's tariff-centered fiscal policies drew mounting

⁸¹ *An Act to Reduce Internal Taxes, and for Other Purposes*, § 6.

⁸² Seligman, *The Income Tax*, 456–68.

⁸³ Richard Franklin Bense, *The Political Economy of American Industrialization, 1877–1900* (Cambridge: Cambridge University Press, 2000), 206–17; Edward Chase Kirkland, *Industry Comes of Age: Business, Labor, and Public Policy, 1860–1897* (New York: Holt, Rinehart and Winston, 1961), 1–12, 163–94, 356–81, 399–409; Porter, *The Rise of Big Business, 1860–1920*, 82–84. For recent work on nineteenth-century labor unrest, see Theresa A. Case, *The Great Southwest Railroad Strike and Free Labor* (College Station: Texas A&M University Press, 2010); Richard Schneirov, Shelton Stromquist, and Nick Salvatore, eds., *The Pullman Strike and the Crisis of the 1890s: Essays on Labor and Politics* (Champaign: University of Illinois Press, 1999); David Omar Stowell, ed., *The Great Strikes of 1877* (Champaign: University of Illinois Press, 2008).

criticism. Many voters perceived high tariffs on manufactured and other imported goods as favoring northeastern industrial interests at the expense of American consumers. Although indirect taxes such as tariffs are generally less “visible” than direct taxes on income, U.S. tariffs were too high and too pervasive to escape public notice. Since tariffs increased the prices of imported goods (including basic necessities), and since the poor spent a greater proportion of income on consumption than the wealthy, the postwar tax system was highly regressive.⁸⁴ Even consumers who avoided imported goods were effectively “taxed” when they purchased competing domestic goods, the high prices of which were supported by tariffs. In addition to taxing imports, Republican fiscal policy also imposed high excise taxes on “sinful” (though highly popular) consumer goods such as alcohol and tobacco.⁸⁵ Serving as the cornerstone of the Republican party’s protectionist trade policy, these import and consumption taxes represented a substantial wealth transfer from consumers to producers.⁸⁶

Popular dissatisfaction with tariff policy helped to energize an increasingly competitive Democratic party, which rose to challenge Republican political dominance in the 1880s and 1890s. Calls to reduce tariffs and reinstate a progressive income tax converged with populist demands for trade liberalization, restrictions on “trusts,” and an inflationary “free silver” monetary policy—all spurred by economic disaffection and increasingly visible concentrated wealth.⁸⁷ Tax reform was a central plank of

⁸⁴ In modern economic parlance, a “regressive” tax system is one in which a given taxpayer’s effective tax rate is inversely related to their ability to pay. In other words, poor taxpayers face higher effective rates than wealthy taxpayers. At the time, the tariff system was widely criticized as favoring the wealthy and disproportionately burdening the poor. Richard J. Joseph, *The Origins of the American Income Tax: The Revenue Act of 1894 and Its Aftermath* (Syracuse: Syracuse University Press, 2004), 89–102; Seligman, *The Income Tax*, 454–55. During the political debates leading to the 1894 income tax, Representative Benton McMillin (D-TN) summarized this view by stating that under the tariff system “want, not wealth, pays the tax” and that an income tax would “put more tax upon what men have, less on what they need.” *Ibid.*, 497.

⁸⁵ In the late nineteenth century, these excise taxes became a major component of the U.S. tax system, often generating as much as one-third to one-half of federal tax revenue. Brownlee, *Federal Taxation in America*, 37–38.

⁸⁶ For discussion of the tax politics of the late nineteenth century, see *Ibid.*, 31–57. Bensel, *The Political Economy of American Industrialization, 1877–1900*, 457–509.

⁸⁷ For discussion of the role of political populism in late-nineteenth-century financial and monetary debates, see Charles Postel, *The Populist Vision* (New York: Oxford University Press, 2007), 137–73; Gretchen Ritter, *Goldbugs and Greenbacks: The Anti-Monopoly Tradition and the Politics of Finance in America* (Cambridge: Cambridge University Press, 1999), 152–207. In the politics of the day, the tax, trust, and trade issues were closely

the Democratic Party Platform of 1892, which described Republican tariff policy as “the culminating atrocity of class legislation.”⁸⁸ The tariff issue helped Democrats win both houses of Congress in the elections of 1892, ending three decades of Republican dominance.⁸⁹ Following the Democrats’ victory, any remaining political resistance to a new income tax was undermined by the financial panic of 1893, which precipitated the worst depression the United States had experienced to date.⁹⁰ Amidst a climate of crisis and resentment, a broad coalition of Democrats and Populists won passage of a new income tax in 1894.⁹¹ To its many supporters, the income tax was more than simply a revenue measure—its passage was also a symbolic victory over economic privilege and inequality.⁹²

Initially, the income tax had been introduced in the House in January 1894 by Representative Benton McMillin, as an amendment to the already pending 1894 revenue bill.⁹³ As originally drafted, the tax generally followed its Civil War predecessor, with certain important structural differences. Unlike the Civil War tax, which had only applied to personal income, the new legislation taxed the profits of business entities separately from the income of individuals. Specifically, in addition to a 2% tax on the annual “gains, profits, and income” in excess of \$4,000 of “every citizen of the United States,” it also imposed a 2% tax on the annual “net profits or income above actual operating and business expenses” of

interconnected. No less than Henry Havemeyer, president of the notorious “sugar trust,” believed that “[t]he mother of all trusts is the customs tariff bill.” “Facts About the Trusts,” *New York Times*, June 19, 1899. For discussion of populism and corporate legislation, see Part II of this dissertation.

⁸⁸ “1892 Democratic Party Platform,” accessed April 30, 2017, <http://www.presidency.ucsb.edu/ws/index.php?pid=29585>.

⁸⁹ Brownlee, *Federal Taxation in America*, 46–47; Seligman, *The Income Tax*, 493–99.

⁹⁰ Douglas W. Steeples and David O. Whitten, *Democracy in Desperation: The Depression of 1893* (Westport: Greenwood Press, 1998), 27–65.

⁹¹ Brownlee, *Federal Taxation in America*, 46–47; Seligman, *The Income Tax*, 493–99.

⁹² Brownlee, *Federal Taxation in America*, 47; Seligman, *The Income Tax*, 507.

⁹³ *Cong. Rec.*, 65th Cong., 1st sess., 1894, 26: 1,594–97.

all “corporations, companies, or associations,” excluding partnerships.⁹⁴ To avoid double taxation, Congress allowed individuals to exclude dividends from taxable income,⁹⁵ since business profits were already taxed at the entity level.⁹⁶ This shift to taxing corporations (and other business entities) separately from individuals reflected the increasing importance of corporations in the American economy, as the prevalence of the corporate form had surged in the second half of the nineteenth century. Since more and more businesses were organized as corporations, there were increasing practical advantages to taxing corporations directly.⁹⁷

Although the 1894 income tax appeared to entail an additional layer of taxation (by taxing corporations directly), it followed the Civil War system closely in substance, which had imposed a withholding tax on dividend payments while exempting dividends from individual tax returns. Under both systems, corporate profits were generally taxed only once.⁹⁸ Indeed, some scholars have argued that

⁹⁴ *An Act to Reduce Taxation, to Provide Revenue for the Government, and for Other Purposes*, §§ 27, 32, *U.S. Statutes at Large* 28 (1894): 553, 556–57. Like today, partnership income was attributable to individual partners. Note that while individual income was taxable only to the extent it exceeded \$4,000, corporate income received no comparable exemption. For comparison, the relative value of \$4,000 in 1894 would be \$ 114,000 in 2016, based on changes in the CPI. “Measuring Worth.”

⁹⁵ See row 4 of the Appendix.

⁹⁶ *An Act to Reduce Taxation, to Provide Revenue for the Government, and for Other Purposes*, § 28.

⁹⁷ During the mid- to late-nineteenth century, rapid economic development, together with the spread of general or “free” state incorporation laws (which allowed firms to incorporate by following a simple administrative procedure, without the need of specific legislative approval), led to increasing numbers of corporations. Robert E. Wright, “The Rise of the Corporation Nation,” in *Capitalism Takes Command: The Social Transformation of Nineteenth-Century America*, ed. Gary J. Kornblith and Michael Zakim (Chicago: University of Chicago Press, 2012), 145. Growth in the number, size, and economic importance of corporations was also driven by institutional changes that occurred during the Civil War, including an increased reliance on corporations to coordinate the extractive, manufacturing, and transportation sectors of the economy. Sean Patrick Adams, “Soulless Monsters and Iron Horses,” in *Capitalism Takes Command: The Social Transformation of Nineteenth-Century America*, ed. Gary J. Kornblith and Michael Zakim (Chicago: University of Chicago Press, 2012), 249.

⁹⁸ The practical similarity of the two systems was magnified by the high dividend payout ratios common in the late nineteenth century. Unlike in later decades, many corporations in the 1890s distributed most of their profits as dividends. Steven A. Bank, *Anglo-American Corporate Taxation: Tracing the Common Roots of Divergent Approaches* (Cambridge: Cambridge University Press, 2011), 108–18; Jonathan Barron Baskin and Paul J. Miranti, *A History of Corporate Finance* (Cambridge: Cambridge University Press, 1999), 189–97; Robert Sobel, *The Great Bull Market: Wall Street in the 1920s* (New York: Norton, 1968), 32; Bank, *From Sword to Shield*, 6–7; Steven A. Bank, “Is Double Taxation a Scapegoat for Declining Dividends? Evidence From History,” *Tax Law Review* 56 (2002): 467–74.

the 1894 corporate income tax actually targeted individual investors rather than corporations qua corporations and was, therefore, merely a variation of taxation “at the source” (i.e., taxation paid at the entity level on behalf of diffuse taxpayers).⁹⁹ This view—suggesting significant continuity between the Civil War withholding provisions and the 1894 corporate income tax—is supported by the statements of Senator George Vest (D-MO), a member of the Committee on Finance and one of the key architects of the 1894 act: “Instead of making the corporation a collector simply for the Government, we have endeavored to simplify the bill and, in my judgment, we have strengthened it, by putting the tax directly upon the corporation and then allowing the corporation to adjust its relations with its own stockholders as it sees proper.”¹⁰⁰ According to this view, the decision to tax corporations directly was a matter of administrative convenience and did not reflect a conception of corporations as economically distinct from their investors.

During the legislative debates leading to the passage of the 1894 tax, the treatment of corporate interest payments received particular attention from lawmakers. As originally drafted, the legislation provided for no deductions from corporate income.¹⁰¹ An amendment supported by Senator Vest, however, proposed that the corporate tax be calculated based on net earnings “above ordinary working or operating expenses.”¹⁰² While clarifying that the tax was to be calculated based on net income, this amendment also seemed to disallow the deduction of interest, which was generally considered a fixed expense rather than an operating expense.¹⁰³ Members of Congress opposed to the income tax’s reinstatement seized on Vest’s amendment as one of several flaws warranting the tax’s rejection. Senator David Hill (D-NY), one of the income tax’s staunchest opponents, assailed the lack of corporate interest

⁹⁹ Avi-Yonah, “Corporations, Society, and the State: A Defense of the Corporate Tax,” 1214–15; Steven A. Bank, “Entity Theory as Myth in the Origins of the Corporate Income Tax,” *William and Mary Law Review* 43 (2001): 504–37.

¹⁰⁰ *Cong. Rec.*, 65th Cong., 1st sess., 1894, 26: 6,866.

¹⁰¹ *Ibid.*, 1,594–97.

¹⁰² *Ibid.*, 6,621.

¹⁰³ *Ibid.*

deductibility during a lengthy floor speech against the tax.¹⁰⁴ Disallowing the deduction of fixed charges such as interest, Hill argued, was an injustice unprecedented in the history of taxation, amounting to “robbery under the form of law.”¹⁰⁵ Invoking the recent financial crisis and the depressed state of the national economy, Hill warned that disallowing corporate interest deductions would “cripple, embarrass, and throw into receivership hundreds of corporations now struggling for existence.”¹⁰⁶

The day after Hill’s speech, Vest modified his proposal, offering language permitting corporations to deduct interest on “bonded indebtedness.”¹⁰⁷ The reasons behind Vest’s amendment are not entirely clear. While it may have been an effort to placate critics such as Hill, it also had the effect of angering the tax’s most fervent supporters. Many observers assumed the new language was a concession to the railroad industry, which was facing dire economic conditions in the wake of the 1893 financial panic.¹⁰⁸ American railroad corporations were heavily reliant on bond financing, and high leverage led to high rates of insolvency as revenues plunged and credit evaporated.¹⁰⁹ Given the power and influence of the railroads, critics of Vest’s amendment were quick to ascribe it to industry lobbying. Claiming that “a large assembly of railroad people” had visited Washington immediately prior to Vest’s proposal, Senator Eugene Hale (R-ME) characterized the amendment as “the surrender to the railroads.”¹¹⁰ Populist Senator William Allen of Nebraska went further, alleging that a “certain railroad magnate” (he declined to specify

¹⁰⁴ Senator Hill—representing New York, one of the nation’s wealthiest and most highly industrialized states—was one of the few Democrats in Congress to oppose the 1894 income tax. Hill’s role in these debates again illustrates that regional differences were often more important than party affiliations in nineteenth-century tax politics.

¹⁰⁵ Ibid., 6,621.

¹⁰⁶ Ibid.

¹⁰⁷ Ibid., 6,690.

¹⁰⁸ “Hill’s War Paint On,” *Boston Daily Advertiser*, June 23, 1894; “Very Near the End,” *Oregonian*, June 23, 1894; Steeples and Whitten, *Democracy in Desperation*, 36–37.

¹⁰⁹ By 1897, more than 25% of the railroad industry’s total capitalization (and more than 40% of track mileage) would fall into receivership. Baskin and Miranti, *A History of Corporate Finance*, 150–51.

¹¹⁰ *Cong. Rec.*, 65th Cong., 1st sess., 1894, 26: 6,690. The exchanges between Hale and Vest were widely reported in the nation’s newspapers.

who) had been invited to the Capitol Building and was dictating tax policy directly to the Finance Committee.¹¹¹ For his part, Vest denied the accusations in full:

I know nothing of any railroad people being assembled here. I have not seen any of them, except as I have seen people here every day for the last four months; but this amendment has not been made at the instigation of any corporation. I am under the influence of no corporation, and have no connection with any corporation; but we are endeavoring to make this bill upon just and equitable principles, and this was the result of consultation amongst the members of the committee.¹¹²

Since Vest’s discussions with the Finance Committee were never publicly reported, the true reasons for the revision—and the extent of railroad industry influence—remain unknown. Given the precarious financial environment and the massive debt overhang facing American business, however, it seems plausible that the solvency of large corporations (such as railroads) was an important consideration in the Finance Committee’s decision making. Indeed, before Vest’s revised language was even put to vote, Senator Oliver Platt (R-CT) suggested expanding the deduction from “bonded indebtedness” to cover *all* corporate debt, of whatever form.¹¹³ This change was quickly accepted, and deductibility of all interest on “bonded or other indebtedness” was incorporated into the final law.¹¹⁴

Deductibility of dividends was also a sensitive issue. As drafted, the 1894 bill provided that individual income was taxable only to the extent it exceeded \$4,000 annually. Corporate income, however, enjoyed no corresponding exemption.¹¹⁵ This meant that while interest paid by corporations to individuals with incomes less than \$4,000 was essentially tax free (being deductible at the corporate level and untaxed at the individual level), the dividends they paid to such low income investors were “taxed” at the corporate level, in that they were not deductible from corporate income. During the debates over the

¹¹¹ Ibid., 6,709.

¹¹² Ibid.

¹¹³ Ibid., 6,773.

¹¹⁴ Ibid., 6,777; *An Act to Reduce Taxation, to Provide Revenue for the Government, and for Other Purposes*, § 32.

¹¹⁵ *Cong. Rec.*, 65th Cong., 1st sess., 1894, 26: 1,594–97.

tax bill, many lawmakers sought to reduce this disparity by allowing corporations to deduct some portion of their dividends.

Discussion of this issue was strongly influenced by differing perceptions of bondholders and shareholders. In the early 1890s, prior to the “Great Merger Movement” of 1895–1904, large corporations in need of outside financing typically issued bonds, which enjoyed an longer established, deeper, and more liquid market than equity securities.¹¹⁶ Perhaps for this reason, ownership of bonds and other forms of debt was commonly associated with the capitalist elite, while ownership of shares was more often associated with small investors and dependent beneficiaries, including the proverbial widows and orphans. Given these stereotypical notions of bondholders and shareholders, the less favorable treatment of dividends under the tax bill was controversial; In the House, Representative Tom Johnson (D-OH) argued that, as drafted, the corporate tax would punish the most disadvantaged members of society, including “widows or orphans or aged people.”¹¹⁷ Senator Hill of New York lamented that “this injustice is upon those people who have incomes of less than \$4,000, the poor people of the country, the widows and orphans, and the men of infirm health, who rely upon the little accumulations which have been given to them or which they have worked for and laid up.”¹¹⁸ Although a supporter of the income tax, Senator James Smith (D-NJ) also warned that the provisions concerning corporations risked “discriminating against the widow, the orphan, and the man of moderate means.”¹¹⁹

To address these concerns, in June of 1894 Smith introduced an amendment in the Senate allowing corporations to deduct “any dividends paid to a single stockholder not exceeding \$4,000

¹¹⁶ Vincent P. Carosso, *Investment Banking in America* (Cambridge: Harvard University Press, 1970), 50. The dominance of bonds over stock in the financing of large corporations would not begin to wane until the onset of the Great Merger Movement.” Baskin and Miranti, *A History of Corporate Finance*, 194.

¹¹⁷ *Cong. Rec.*, 65th Cong., 1st sess., 1894, 26: 1,652.

¹¹⁸ *Ibid.*, 6,865.

¹¹⁹ *Ibid.*, 6,871.

annually.”¹²⁰ Smith argued that this deduction was necessary to protect not only vulnerable dependents such as widows and orphans but also owners of small businesses and members of agricultural cooperatives.¹²¹ Smith’s proposal was criticized on the grounds that it would be impracticable to administer—according to Senator Vest, the deduction provision “would be almost impossible of execution.”¹²² These criticisms were apparently effective, as Smith’s amendment was tabled (set aside) by a 31-24 vote.¹²³

Immediately following the vote on Smith’s amendment, Senator Hill proposed a substantially similar amendment—the only difference being that it provided a \$3,000 per shareholder deduction, rather than \$4,000.¹²⁴ Explaining the purpose of his amendment, Hill stated that his goal was not to benefit corporations, but rather to protect individual investors. Again characterizing the income tax as fundamentally flawed, he claimed its operation would constitute an injustice against the poor: “I am not complaining because it affects corporations,” he stated, “I am simply complaining that you make a discrimination against the poor man.”¹²⁵ Hill’s rhetorical appeals notwithstanding, his amendment fared no better than Smith’s, being rejected by a vote of 20-33.¹²⁶ Then, in a striking display of either dogged determination or political posturing (probably the latter), Hill proposed substantially similar amendments twice more—first with a deduction of \$2,000 and finally with a deduction of \$1,000.¹²⁷ These too were rejected.¹²⁸ Ultimately, no deductions of dividends would be included in the final law.

¹²⁰ Ibid., 6,867.

¹²¹ Ibid., 6,871–72.

¹²² Ibid., 6,867.

¹²³ Ibid.

¹²⁴ Ibid., 6,872.

¹²⁵ Ibid.

¹²⁶ Ibid.

¹²⁷ Ibid.

¹²⁸ Ibid.

Congress finally passed the revenue bill in late August.¹²⁹ As enacted, it retained the 2% tax on individual income exceeding \$4,000¹³⁰ as well as the 2% tax on all corporate income.¹³¹ Interest payments, but not dividends, were fully deductible by corporations.¹³² The corporate interest deduction was now law.

These developments proved short-lived, however. The following year, in *Pollock v. Farmers' Loan & Trust Co.*, the Supreme Court struck down the new tax before it was ever collected.¹³³ In a controversial five to four ruling, the Court held that the income tax violated the Constitution's requirement that direct taxes be apportioned among the states on a population basis.¹³⁴ The Court's decision was a staggering defeat for the tax's supporters, who had spent years fighting for income taxation in the national political arena.

Like the Civil War income taxes before it, however, the 1894 tax's influence would extend far beyond its abbreviated lifespan. In removing interest—but not dividends—from the corporate income tax base, the 1894 act established a precedent followed by the income tax laws of 1909–1913. Under the 1894 act, interest was deductible from corporate income and subject to taxation when received as personal income by investors, while dividends were *not* deductible from corporate income and *not* subject to taxation when received by investors. Since interest and dividends were each subject to a single level of taxation (interest being taxed at the investor level and dividends being taxed at the corporate level), and since the individual and corporate tax rates were both 2%, the respective tax burdens on debt and equity were similar for investors whose income exceeded \$4,000.¹³⁵ As detailed in Chapter 3, this same basic

¹²⁹ *An Act to Reduce Taxation, to Provide Revenue for the Government, and for Other Purposes.*

¹³⁰ *An Act to Reduce Taxation, to Provide Revenue for the Government, and for Other Purposes*, § 27.

¹³¹ *Ibid.*, § 32.

¹³² *Ibid.*

¹³³ *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895).

¹³⁴ U.S. Constitution, art. 1, sec. 2.

¹³⁵ If an investor earned less than \$4,000 annually, interest went untaxed.

structure—interest taxed at the investor level (above certain minimum income levels) and dividends taxed at the corporate level—was initially recreated by the tax legislation of the early twentieth century. It was only during the decades of 1909–1939, under the pressures of war, depression, and a massively expanding federal budget, that preferential treatment of debt financing emerged as a permanent feature of American tax law.

CHAPTER 3: THE STATUTORY EVOLUTION OF THE DEBT-EQUITY DISTINCTION

Income taxation returned to the United States in the early twentieth century, this time permanently. Due to the constitutional constraints on direct taxation imposed by the *Pollock* decision, corporate and individual income taxation was reintroduced in two separate phases: First, a “special excise tax” on corporate profits (a corporate income tax in all but name) was enacted in 1909. Following ratification of the Sixteenth Amendment in 1913, Congress passed additional legislation creating a personal income tax. Although the rates of these taxes were initially low (only 1% on corporate profits and 1%–7% on personal income), they would be increased significantly within a few years of their enactment. The extraordinary cost of World War I would prompt the expansion of the income tax, transforming it into the government’s single largest source of revenue. Tax rates decreased after the conclusion of the war and remained stable during the prosperity of the 1920s, but the back-to-back crises of the Great Depression and World War II brought further dramatic changes to the tax system.

Throughout this period, a variety of policy concerns pulled Congress in conflicting directions regarding the tax treatment of corporate debt and equity. On the one hand, many lawmakers feared that allowing corporations to deduct interest would encourage them to take on excess debt as a tax avoidance measure. On the other hand, lawmakers were also concerned that disallowing interest deduction would impose costs on individual shareholders, who, in theory at least, were the ultimate beneficiaries of corporate profits. Any taxation of funds allocable to interest payments, lawmakers assumed, would therefore be passed on to shareholders in the form of reduced dividends. The tax treatment of dividends themselves was also a complex issue. Politicians were vocal in their opposition to double taxation (i.e., at both the corporate and individual level), but as we shall see, this opposition could waver in the face of political expediency. Finally, organized business became increasingly involved in tax policy during this period, adding further complications to Congressional decision making. Spurred into action by World War I’s elevated tax rates—by far the highest to that point in American history—business exerted significant influence at several key junctures in the income tax’s evolution. During the three decades

preceding World War II, these various factors converged to shape the contemporary debt-equity distinction.

A. The Corporation Tax of 1909

In the years following the *Pollock* decision of 1895, political pressure to reestablish income taxation continued to mount, despite the constitutional hurdles imposed by the Supreme Court.¹³⁶ An unprecedented wave of business consolidations occurring from 1895 to 1904 increased popular concern over the economic power of large corporations.¹³⁷ In a rapid burst of merger activity, approximately 1,800 firms disappeared into larger enterprises, mainly by way of horizontal consolidations.¹³⁸ Sudden, dramatic increases in the market share of America's largest corporations fueled public resentment toward concentrated wealth, leading even Republican President Theodore Roosevelt to advocate graduated estate and income taxes in 1906.¹³⁹ Pressure to reduce tariffs had not subsided in the years following the *Pollock* decision, and with even Republican opposition softening, some form of major tax reform began to seem inevitable.¹⁴⁰ As the tax issue built to a head in 1909, newly-elected Republican President William Howard Taft brokered a tax reform compromise between Congressional conservatives (who opposed income taxation and supported the tariff) and progressives (who supported income taxation and opposed the tariff): Under Taft's plan, a small tax on corporate profits would be enacted immediately, while the question of an individual income tax would be submitted to the states as a proposed constitutional amendment.¹⁴¹ Rather than describing the new corporation tax as an income tax, the

¹³⁶ Blakey and Blakey, *The Federal Income Tax*, 22–23; Brownlee, *Federal Taxation in America*, 47–53.

¹³⁷ See Part II of this dissertation.

¹³⁸ Lamoreaux, *The Great Merger Movement in American Business, 1895–1904*, 1–13.

¹³⁹ Blakey and Blakey, *The Federal Income Tax*, 21.

¹⁴⁰ *Ibid.*, 22–24.

¹⁴¹ From a procedural standpoint, the 1909 corporation tax was an unusual piece of tax legislation. It was first proposed by the presidential administration and then introduced by the Senate Finance Committee as an amendment to a revenue bill that had already passed the House. This process was arguably inconsistent with the constitutional requirement that all revenue bills originate in the House. Indeed, the corporation tax would be (unsuccessfully) challenged on these grounds in federal court. See note 142 below. The Taft administration's support of a

measure was labeled a “special excise tax” pegged to corporate profits, a transparent (and ultimately successful) bid to circumvent the *Pollock* holding.¹⁴² Labels aside, the 1909 corporation tax was an income tax both in design and effect.

The treatment of corporate debt was an important question in the drafting of the new tax law. As part of the political compromise to which it owed its existence, the corporation tax was initially drafted by members of the Taft Administration, and the choice of whether to tax interest on bonds was a major issue in the Administration’s internal decision making.¹⁴³ In the popular consciousness, corporate bonds remained closely associated with the nation’s wealthy elite, and the Administration was reluctant to be seen allowing wealthy bondholders to avoid taxation.¹⁴⁴ According to Senator Elihu Root (R-NY), a close ally of the Taft Administration and one of the corporation tax’s primary authors, the treatment of corporate bonds “was the subject of repeated discussion in which the President, the Attorney-General, and other members of the Cabinet and members of the Committee on Finance of the Senate took part.”¹⁴⁵ Despite initial reluctance, the administration ultimately decided to allow corporations to deduct the

corporation tax may have been an effort to forestall an individual income tax. This was clearly the goal of conservative Republicans in Congress. Avi-Yonah, “Corporations, Society, and the State: A Defense of the Corporate Tax,” 1217. Morton Keller, *Regulating a New Economy: Public Policy and Economic Change in America, 1900–1933* (Harvard University Press, 1990), 215–18. Senator Nelson Aldrich (R-RI), chairman of the Finance Committee and long-time opponent of income taxation, explained his support for the Administration’s proposal as follows: “I shall vote for a corporation tax as a means to defeat the income tax.” *Cong. Rec.*, 59th Cong., 1st Sess., 1909, 44: 3,929.

¹⁴² Soon after its enactment, the corporation tax was challenged in federal court on the same grounds as the 1894 income tax—that it violated the Constitution’s prohibition on unapportioned direct taxation. It was also challenged (in the same case) on the grounds that its introduction by the Senate Finance Committee violated the constitutional requirement that all revenue bills originate in the House. The Supreme Court upheld the tax on the theory that it was an excise tax, not a direct tax (despite its similarities to the tax of 1894). *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911). In general, an excise tax is a tax levied on the production or sale of a particular good or service, while a direct tax is levied directly on profits or income. As the corporation tax was calculated based on corporate profits, there is reason to believe the Supreme Court characterized the tax as an excise in order to avoid the result of *Pollock*.

¹⁴³ Blakey and Blakey, *The Federal Income Tax*, 40–47.

¹⁴⁴ “Insurgents’ Fight Will Hold Congress,” *New York Times*, June 28, 1909; “Is Corporate Taxation Just, and Will It Aid the Revenues?,” *Wall Street Journal*, June 26, 1909; “Taft’s Corporation Tax Framed to Reach the Rich,” *New York World*, June 18, 1909.

¹⁴⁵ *Cong. Rec.*, 59th Cong., 1st Sess., 1909, 44: 4,007.

interest they paid on bonds, as the tax’s drafters feared that to do otherwise would subject shareholders to double taxation. In Senator Root’s words, “[t]he final conclusion was that the imposition of this tax on the entire income, including the income assignable to the payment of interest on bonds, would result not in the taxation of bondholders, but in imposing a double tax on the stockholders, and it was not thought advisable to do it.”¹⁴⁶ In other words, Senator Root (and others) believed that taxation of any revenues allocable to interest payments would be passed on to equityholders. The administration also considered taxing interest directly upon receipt by bondholders, but this approach was deemed infeasible in light of the *Pollock* decision, as it would clearly be a tax on income.¹⁴⁷

When the administration presented its proposals to the Senate Finance Committee in June 1909, many committee members were opposed to interest deductibility, fearing that corporations would substitute bonds for stock in order to avoid the tax.¹⁴⁸ Compounding this fear was the widespread practice of selling “watered stock”—stock issued at prices exceeding a corporation’s book value, to the benefit of promoters and other corporate insiders who had received their stock at a relative discount. A specific concern regarding interest deductibility was that it would encourage corporations to issue discounted stock to insiders and then exchange the stock for debt (at full face value), so as to “water” (or dilute) the stock of outside investors while simultaneously sheltering income.¹⁴⁹ Representative Cordell Hull (D-TN), a key figure in the drafting of the legislation, recalled the issue in 1916: “I think the original theory of the matter was that corporations could issue quite a lot of watered stock, transfer that into bonds, mortgage their property, and incur interest, and make a great many shifts in many ways that would result in avoiding the real purpose of the law.”¹⁵⁰

¹⁴⁶ Ibid.

¹⁴⁷ Ibid.

¹⁴⁸ Blakey and Blakey, *The Federal Income Tax*, 46–47; “Senate to Accept Taft’s Plan,” *The Washington Herald*, June 22, 1909.

¹⁴⁹ See Bank, *From Sword to Shield*, 14–15.

¹⁵⁰ *Cong. Rec.*, 64th Cong., 1st Sess., 1916, 53: 10,656.

Despite these concerns, a majority of the committee eventually agreed that at least some measure of interest deductibility was necessary, for two reasons. First, as noted above, many lawmakers believed that disallowing interest deductibility would indirectly increase the tax burden on shareholders.¹⁵¹ Since the payment terms of outstanding corporate bonds were fixed—and since bond investors were generally thought to enjoy greater bargaining power than shareholders—lawmakers feared that taxing amounts paid as interest would simply reduce the residual funds available for dividends.¹⁵² Second, given that the corporation tax was designed to avoid the *Pollock* holding, some lawmakers feared that taxing revenue allocable to bondholders (or taxing bondholders directly) would be a step too far in the direction of an undisguised income tax, inviting constitutional challenge.¹⁵³ Faced with these conflicting concerns, the Finance Committee settled on a middle position proposed by Senator Root: Corporations would be permitted to deduct interest, but only on an amount of debt not exceeding their “paid-up capital stock.”¹⁵⁴

When the corporation tax advanced from the Finance Committee to the wider Senate, many Senators had misgivings over allowing even limited interest deductibility. In session in July, Senator Augustus Bacon (D-GA) argued that no portion of a corporation’s interest payments should be exempt from taxation, repeating the familiar warning that corporations would avoid the tax by converting stock to bonds.¹⁵⁵ Referring to popular attitudes toward bondholders, Bacon asserted that “[t]he desire to reach the bonded interests of the country would be very much more generally shared by the people at large than the

¹⁵¹ Blakey and Blakey, *The Federal Income Tax*, 46–47; “Rush of Objections to Taft Tax Plan,” *New York Times*, June 22, 1909; “Taft Is to Fix Tax,” *Washington Post*, June 22, 1909.

¹⁵² Blakey and Blakey, *The Federal Income Tax*, 46–47; “Doubling up the Burdens on the Stockholders,” *Washington Times*, June 19, 1909; “Rush of Objections to Taft Tax Plan”; “Senate to Accept Taft’s Plan”; “Taft Is to Fix Tax”; “Tariff Revision Before All Else,” *Chicago Daily Tribune*, June 19, 1909.

¹⁵³ *Cong. Rec.*, 59th Cong., 1st Sess., 1909, 44: 4,007; Blakey and Blakey, *The Federal Income Tax*, 46–47. The tax would be (unsuccessfully) challenged in any event. See note 142 above.

¹⁵⁴ *Ibid.* According to Root, “paid-up capital stock” meant corporate stock for which full value had been paid. *Cong. Rec.*, 59th Cong., 1st Sess., 1908, 44: 4,007. To illustrate the working of this provision (which would ultimately be included in the final law), a hypothetical corporation capitalized with \$1,000 of debt and \$500 of paid-up capital stock would be allowed to deduct interest on only \$500 of debt.

¹⁵⁵ *Ibid.*, 4,007–08.

desire to reach simply the stocks of corporations.”¹⁵⁶ Based on this interpretation of popular opinion, Bacon introduced an amendment to tax interest payments directly (at a rate of 2%), requiring corporations to withhold and pay the tax on behalf of bondholders.¹⁵⁷ On motion of Senator Aldrich of Rhode Island, Bacon’s amendment was tabled by a 41-34 vote, and no such withholding provision was included in the Senate’s version of the bill.¹⁵⁸

Similar concerns were raised in the House, however. Representative William Cox (D-IN) protested that accumulated wealth in the form of bond holdings would not be adequately taxed under the Senate bill. Since interest payments would be deductible from corporate income, but would not be taxed when received by individual investors (there being no individual income tax), a significant portion of corporate revenue would escape taxation altogether. According to Cox, “[t]he railroads alone, being bonded for upward of \$6,000,000,000, and the trusts for at least an equal sum, these sums representing one-ninth of the total wealth of the country, under this system of taxation all this immense wealth will escape the burden.”¹⁵⁹ Highlighting the association—both actual and perceived—between corporate debt and the nation’s wealthiest citizens, Cox argued that bond holdings such as the Carnegie and Gould fortunes would avoid “their just and proportionate share of taxation.”¹⁶⁰ “The idea that men like Carnegie,” he stated, “now the holder of more than \$300,000,000 worth of the bonds of the United States steel trust, escape federal taxation is indeed absurd.”¹⁶¹ Despite these criticisms, Cox ultimately agreed to support the bill, a reflection of Congress’s limited taxation options following the *Pollock* ruling. From

¹⁵⁶ Ibid., 4,062.

¹⁵⁷ Ibid.

¹⁵⁸ Ibid., 4,062–63.

¹⁵⁹ Ibid., 4,422.

¹⁶⁰ Ibid., 4,424.

¹⁶¹ Ibid. Carnegie obtained his massive bondholdings by selling his Carnegie Steel Company into the J.P. Morgan-financed United States Steel Corporation in 1901, creating the country’s first corporation to be capitalized at over one billion dollars.

the perspective of Cox and other Democrats, if taxing individual investors was off the table, then the proposed corporation tax, however flawed, was better than nothing.¹⁶²

The Finance Committee's limitation of interest deductibility to debt not exceeding paid-up capital stock was agreed to by the Conference Committee and included in the tariff act of August 5, 1909, imposing a 1% tax on "net income" in excess of \$5,000.¹⁶³ The corporation tax was the final section of a much larger tariff act, reflecting its status as a compromise with anti-tariff Democrats.¹⁶⁴ Since the corporation tax was not accompanied by an individual income tax, corporate income paid as interest to individual debtholders went untaxed, subject to the paid-up capital limitation. Profits paid as dividends, on the other hand, were taxed at the corporate level.¹⁶⁵ This disparity bestowed a tax advantage on debt financing, as corporations were able to offset interest payments against taxable income. With a corporate tax rate of only 1%, however, this advantage was small enough that it likely had little effect on corporate financing decisions. It was not until after the return of individual income taxation in 1913 that the tax advantage of debt financing would become economically significant.

B. The Return of Individual Income Taxation

The return of individual income taxation in 1913 occurred at the height of the Progressive Era. Progressive Democrat Woodrow Wilson had won the 1912 presidential election, and the year 1913 witnessed several major developments in progressive legal and regulatory reform. These developments included the Pujo Committee's critical report on the "money trust" of Wall Street banking firms, the creation of the Federal Reserve system, the establishment of separate U.S. departments of commerce and labor, and the ratification of the Sixteenth and Seventeenth Amendments to the Constitution.¹⁶⁶

¹⁶² Ibid., 4,421–44.

¹⁶³ *An Act to Provide Revenue, Equalize Duties and Encourage the Industries of the United States, and for Other Purposes*, § 38, *U.S. Statutes at Large* 36 (1909): 112–17.

¹⁶⁴ Ibid.

¹⁶⁵ See row 5 of the Appendix.

¹⁶⁶ Carosso, *Investment Banking in America*, 137–55; James Livingston, *Origins of the Federal Reserve System: Money, Class, and Corporate Capitalism, 1890–1913* (Ithaca: Cornell University Press, 1986), 215–34;

The tax-related developments of 1913 were particularly significant. Following ratification of the Sixteenth Amendment—which allowed Congress to levy an unapportioned income tax, effectively overturning *Pollock*—the revenue act of 1913 reinstated individual income taxation while simultaneously reducing tariffs. This act marked the beginning of a longer-term policy shift by which income taxation would ultimately replace tariffs as the federal government’s primary source of revenue.¹⁶⁷ The tax system evolved rapidly in the years following 1913, especially during the crises of the world wars and the Great Depression. Although the most significant of these changes came in the form of higher income tax rates, structural features of the tax system—such as the treatment of debt and equity—saw important changes as well. The tax burden on debt and equity was similar under the 1913 act, but by the late 1930s debt enjoyed a significant tax advantage over equity, a feature of the U.S. tax code that has persisted to the present day.

As enacted, the 1913 income tax was more elaborate than its predecessors. The revenue act imposed a “normal income tax” of 1% on the net income of citizens that exceeded \$3,000 (\$4,000 for married couples), plus an “additional tax” on net income exceeding \$20,000 that increased in graduated brackets to a maximum of 6% on income exceeding \$500,000.¹⁶⁸ As under the 1909 act, corporations, joint-stock companies, and associations (but not partnerships) were subject to a flat income tax of 1% (though now without the \$5,000 exemption).¹⁶⁹ Interest payments remained deductible, but the 1913 act relaxed the statutory deduction limit: a corporation could now deduct interest on an amount of debt equal

Samuel P. Hays, *The Response to Industrialism, 1885–1914* (Chicago: University of Chicago Press, 1995), 90–91; Jay S. Bybee, “Ulysses at the Mast: Democracy, Federalism, and the Sirens’ Song of the Seventeenth Amendment,” *Northwestern University Law Review* 91 (1996): 536–47.

¹⁶⁷ Brownlee, *Federal Taxation in America*, 55.

¹⁶⁸ *An Act to reduce tariff duties and to provide revenue for the government, and for other purposes*, § II.A. Based on changes in the CPI, the relative value of \$3,000 in 1913 would be \$74,100 in 2016, while the relative value of \$500,000 would be \$12,300,000. “Measuring Worth.” Given the national income distribution, this was a highly progressive tax—in its first years, only about two percent of American households paid any income tax at all. *Ibid.*

¹⁶⁹ *An Act to reduce tariff duties and to provide revenue for the government, and for other purposes*, § II.G(a).

to one-half the sum of its paid-up capital plus its outstanding debt.¹⁷⁰ Interest received by investors was taxed as ordinary income, subject to both the normal and additional taxes.¹⁷¹ Unlike interest, dividends were not deductible at the corporate level.¹⁷² At the individual level, however, dividends received a partial tax break: they were excluded from income for purposes of the normal tax, but were included for purposes of the graduated additional tax.¹⁷³

The combined effect of these rules was that corporate revenues were subject to similar rates of taxation regardless of whether they were paid as interest or distributed as dividends. To illustrate, profits distributed as dividends were subject to (1) the 1% corporate tax and (2) the individual additional tax (depending on the individual investor's total income), while interest payments were subject to (1) the 1% individual normal tax and (2) the individual additional tax (depending on the individual investor's total income). If a corporation were managed with the goal of minimizing the tax burden on its investors, it would have been indifferent between issuing debt or equity with the same pre-tax return.¹⁷⁴

There were exceptions to this general parity, however. Dividends paid to other corporations (e.g., dividends paid by a subsidiary to a holding company) were *not* excluded from the receiving corporation's income. Under the 1909 act, such "intercompany dividends" had not been taxable.¹⁷⁵ Under the 1913 act, they were subject to the 1% corporate tax, even though the paying corporation was also taxed on the

¹⁷⁰ Ibid., § II.B. Under the 1909 act, corporations could deduct interest on debt not exceeding paid-up capital stock. Any firm with a debt:equity ratio greater than 1:1 would be able to deduct more interest under the 1913 act.

¹⁷¹ Ibid.

¹⁷² Ibid., § II.G(b).

¹⁷³ See row 6 of the Appendix. *An Act to reduce tariff duties and to provide revenue for the government, and for other purposes*, § II.B.

¹⁷⁴ In reality, corporate managers may have found debt financing more attractive, as the tax on interest was payable by investors rather than by the corporation itself. Again, since the corporate tax rate was only 1%, any such preference was likely minor.

¹⁷⁵ *An Act to Provide Revenue, Equalize Duties and Encourage the Industries of the United States, and for Other Purposes*, § 38.

underlying profits.¹⁷⁶ Despite rhetorical opposition to double taxation, many lawmakers considered it politically necessary that the income tax reach unpopular “trusts” and “holding companies.” Given the massive corporate consolidation of the previous decade, lawmakers feared that exempting distributions from subsidiaries to holding companies would create the appearance of letting the nation’s largest corporations off the hook.¹⁷⁷ Since profits were taxed at both the subsidiary and holding company levels, the 1913 act disadvantaged equity as a means of effecting intercompany transfers. A holding company wishing to avoid the double tax could instead structure its interest in a subsidiary as a loan.

As for the treatment of debt, the 1913 act’s relaxation of the interest deduction limit was the first in a series of steps that would (eventually) culminate in the limit’s repeal. As originally reported by the Ways and Means Committee in April 1913, the revenue bill followed the 1909 act in limiting interest deductibility to debt not exceeding paid-up capital.¹⁷⁸ After the bill passed the House, however, the Senate Finance Committee relaxed the limit. Under the Finance Committee’s version, corporations were allowed to deduct interest on debt not exceeding one-half the sum of outstanding debt and paid-up capital, a change accepted by the House in conference.¹⁷⁹ During the Finance Committee’s hearings on the bill, several business lobbyists had requested that the deduction limit be increased, characterizing it as unfair to highly-leveraged companies and unnecessary given the new individual income tax.¹⁸⁰ Although neither the Finance Committee’s amendment nor its acceptance by the House were specifically explained in the legislative record, it seems likely that this business lobbying played a role in Congress’s decision.

¹⁷⁶ Blakey and Blakey, *The Federal Income Tax*, 100.

¹⁷⁷ “Big Trusts Face a Two-Fold Tax,” *Chicago Daily Tribune*, October 31, 1913.

¹⁷⁸ H.R. 3321, 63rd Cong., § 2.G (1913).

¹⁷⁹ S. Rep. No. 63-80, 26 (1913). H.R. Rep. No. 63-86 (1913). To illustrate, a hypothetical corporation capitalized with \$1,000 of debt and \$500 of paid-up capital stock would be allowed to deduct interest on only \$750 of debt.

¹⁸⁰ Bank, *From Sword to Shield*, 15–17.

The deduction limit was increased again in 1916—this time to debt not exceeding the sum of paid-up capital and one-half of outstanding debt.¹⁸¹ Unlike in 1913, this increase was accompanied by specific legislative discussion. During House debate on the 1916 bill, Representative Joseph Sherley (D-KY) suggested that the deduction limit be removed entirely. Sherley questioned the limit’s fundamental rationale, given that interest was now taxed when received by individual debtholders. He also argued that the limit was unfair to corporations, since sole proprietorships, partnerships, and other unincorporated businesses—taxed under the individual income tax rules—were allowed to deduct interest in full. Finally, he pointed to problems with the limit’s application by the Bureau of Internal Revenue, arguing that “the provision has resulted in endless confusion in the department, conflicting rulings, and more trouble than almost any other single paragraph in the income-tax law.”¹⁸² Responding to Sherley’s criticisms, Representative Hull of Tennessee reiterated the limit’s primary purpose—to reduce the incentive for corporations to exchange stock for bonds. Although Hull supported maintaining the limit, his comments suggest he was not unsympathetic to the complaints being raised by the business community. Describing the more stringent limit of the 1909 act as “somewhat drastic,” Hull remarked that subsequent increases were intended to moderate the limit’s effect.¹⁸³ Ultimately, the deduction limit remained in place, though it became less and less strict.¹⁸⁴ This trend toward greater leniency would continue into American involvement in World War I, during which major developments in business taxation would lead to the limit’s complete repeal.

¹⁸¹ See row 7 of the Appendix. *An Act to increase the revenue, and for other purposes*, § 12(a), *U.S. Statutes at Large* 39, (1916): 767–69. To illustrate, a hypothetical corporation capitalized with \$1,000 of debt and \$500 of paid-up capital stock would be allowed to deduct interest on all \$1,000 of debt. However, particularly highly-leveraged corporations were not able to deduct interest on all of their debt. For example, a corporation capitalized with \$1,400 of debt and \$100 of paid-up capital stock would be allowed to deduct interest on only \$800 of debt.

¹⁸² 53 *Cong. Rec.* 10,656 (1916). There had been considerable confusion surrounding the Treasury Department’s application of the 1913 limit. Treasury had initially interpreted the limit as one-half of the sum of outstanding debt and paid-up capital, but later revised its interpretation to the sum of paid-up capital and one-half of outstanding debt. Bank, *From Sword to Shield*, 17–18.

¹⁸³ 53 *Cong. Rec.* 10,656 (1916).

¹⁸⁴ In Hull’s words, “the original provision was modified, but it was not thrown wide open.” 53 *Cong. Rec.* 10,656 (1916).

C. World War I and Unlimited Interest Deductibility

American entry into World War I brought major changes to the new income tax. Like the Civil War before it, World War I required extraordinary spending by the federal government while simultaneously disrupting tariff revenues from foreign trade. Congress relied on the income tax to help finance mobilization, raising tax rates to levels unimaginable before the war. Ironically, while World War I led to substantially higher tax rates, it would also lead to the repeal of the limit on corporate interest deductibility.

During the war, higher corporate income tax rates, together with the introduction of supplemental “excess-profits” and “war-profits” taxes, significantly increased the tax burden on American businesses.¹⁸⁵ The excess-profits tax was particularly heavy, accounting for approximately two-thirds of all tax revenues during the war.¹⁸⁶ In 1917, the standard corporate income tax increased to a total rate of 6%.¹⁸⁷ For the 1918 tax year, it increased again to 12%.¹⁸⁸ These figures were dwarfed by the excess-profits tax, which reached, as explained below, reached as high as 80% for the 1918 tax year.¹⁸⁹

With American soldiers dying overseas, business leaders were hesitant to directly criticize higher taxes. Rather than lobbying for the reduction of nominal tax rates, businesses instead focused on the tax laws’ more technical provisions.¹⁹⁰ The interest deduction limit is a case in point. Higher marginal tax rates had increased the value of deductions by increasing the amount of tax savings that deductions from income could achieve. Moreover, the excess-profits tax was calculated based on net income under the

¹⁸⁵ The “war-profits tax” was the statutory designation for the highest bracket of the excess-profits tax. *An Act to provide revenue, and for other purposes*, § 301(a), *U.S. Statutes at Large* 40 (1919): 1088.

¹⁸⁶ Brownlee, *Federal Taxation in America*, 64–65.

¹⁸⁷ The 1917 act added a 4% tax to the existing 2% tax of the 1916 act. *An Act to provide revenue to defray war expenses, and for other purposes*, § 4, *U.S. Statutes at Large* 40 (1917): 302.

¹⁸⁸ *An Act to provide revenue, and for other purposes*, § 230(a)(1).

¹⁸⁹ *Ibid.*, § 301(a).

¹⁹⁰ Blakey and Blakey, *The Federal Income Tax*, 127–218, 141.

standard corporate income tax, increasing the value of deductions even further.¹⁹¹ As the economic value of deductions increased, a broad array of businesses, trade groups, and conservative editorial boards began to call for the complete repeal of the interest deduction limit.¹⁹²

Perhaps strategically, criticisms of the interest deduction limit often emphasized abstract notions of tax “fairness,” rather than focusing on the dollar amounts that businesses would save (and the Treasury would lose) if the limit were repealed. A common criticism was that overlap between the excess-profits tax and the interest deduction limit unfairly penalized debt financing, an argument based on the technical operation of the excess-profits tax. First enacted in 1917, the excess-profits tax—which applied to all businesses, not just corporations—was levied in addition to the standard income tax and was intended to capture the “excess” profits derived from war contracts. The tax was implemented in two different versions: the original version was enacted in the fall of 1917¹⁹³ and a revised version (applicable to the 1918 tax year) was enacted in early 1919.¹⁹⁴ Under the 1917 version, the tax was calculated as a graduated percentage of a company’s net income, ranging from 0% to 60%, which increased as a function of the ratio of the company’s net income to its statutorily-defined “invested capital.” In other words, the greater a company’s net income divided by its “invested capital,” the higher the rate of the excess-profits tax.¹⁹⁵ Under the 1919 version, the tax was calculated as a graduated percentage of net income, ranging from 0% to 65%, which, again, increased with the ratio of the company’s net income to its “invested

¹⁹¹ Ibid., 185–88.

¹⁹² See, e.g., Senate Committee on Finance, *Revenue to Defray War Expenses: Hearings and Briefs Before the Senate Comm. on Finance*, 65th Cong., 1st sess., 1917, 14–23 (statement of A. E. Holcomb); Senate Committee on Finance, *To Provide Revenue for War Purposes: Hearings Before the Senate Comm. on Finance*, 65th Cong., 2d sess., 1918, 104–19 (statement of Robert E. Reed); “Federal Treatment of Borrowed Capital,” *New York Times*, April 5, 1918.

¹⁹³ *An Act to provide revenue to defray war expenses, and for other purposes*, §§ 200–14.

¹⁹⁴ *An Act to provide revenue, and for other purposes*, §§ 300–37.

¹⁹⁵ *An Act to provide revenue to defray war expenses, and for other purposes*, §§ 201–03.

capital.”¹⁹⁶ The 1919 version also added a “war-profits” bracket of 80%, subject to a deduction based on the company’s pre-war financial performance.¹⁹⁷ Under both the 1917 and 1919 versions, the greater a company’s “invested capital” (other things being equal), the less its excess-profits tax liability. Critically, “invested capital” in both acts was defined to include equity and undistributed profits, but *not* to include most forms of debt.¹⁹⁸ Since debt financing did not contribute to “invested capital,” the excess-profits tax weighed more heavily on highly leveraged firms, whose “invested capital” was less than that of similarly-sized firms with greater equity. Critics argued that this penalty on debt financing more than offset the benefit of interest deductibility and, that as long as the excess-profits tax remained in effect, the interest deduction limit should be removed.

Examples of this argument can be found in Congressional hearings on the war revenue acts, in which business representatives (often present at Republican invitation) submitted their views on pending tax legislation. In a statement to the Finance Committee in 1917, A. E. Holcomb, the Assistant Secretary of AT&T, argued that the deduction limit, although perhaps justified under the 1909 corporation tax, had become a “peculiar and arbitrary” anachronism now that interest income was taxable to individuals.¹⁹⁹ At the same hearing, representatives of the Interborough Rapid Transit Co. termed the limit “unjust,” arguing that it was particularly inequitable in conjunction with the excess-profits tax.²⁰⁰ At another Finance Committee hearing, Benson Watson, Secretary of the National Association of Credit Men (a major trade group representing credit professionals), argued that since debt was excluded from “invested capital”

¹⁹⁶ *An Act to provide revenue, and for other purposes*, § 301(a). This is a necessarily simplified description of the tax.

¹⁹⁷ *Ibid.*, §§ 301(a), 311. Again, this is a necessarily simplified description.

¹⁹⁸ *An Act to provide revenue to defray war expenses, and for other purposes*, § 207; *An Act to provide revenue, and for other purposes*, § 325.

¹⁹⁹ Senate Committee on Finance, *Revenue to Defray War Expenses: Hearings and Briefs Before the Senate Comm. on Finance*, 65th Cong., 1st sess., 1917, 21–22 (statement of A. E. Holcomb).

²⁰⁰ Senate Committee on Finance, *Revenue to Defray War Expenses: Hearings and Briefs Before the Senate Comm. on Finance*, 65th Cong., 1st sess., 1917, 27 (memorandum submitted on behalf of the Interborough Rapid Transit Co. of New York City).

under the excess-profits tax, “the business entity should have the privilege of charging, as a business expense, the total amount of interest paid.”²⁰¹ W. E. Humphrey, a lobbyist representing northwestern mortgage lenders, testified that under the excess-profits tax, highly indebted firms could accrue tax liabilities even when operating at a loss, an outcome with “no justice in it.”²⁰² This injustice was only compounded by the operation of the interest deduction limit.²⁰³ Addressing the limit’s original policy rationale, Humphrey summarized his critique as follows:

I never knew of but one reason why it was inserted in the present law, and that reason was, probably, to keep a corporation from decreasing its capital stock and increasing its bonded indebtedness. But if that was the reason, that is the only reason I can imagine why it ever did get into law; and that reason has disappeared under the excess-profits tax, because if they reduce their capital stock and increase their bonded indebtedness they would have to pay more.²⁰⁴

Thus, according to Humphrey, the excess-profits tax negated the deduction limit’s reason for existence.

Perhaps responding to these criticisms, the Treasury Department issued regulations in early 1918 that broadened the definition of “invested capital” under the excess-profits tax. Under the Treasury Department’s regulations, corporations were permitted to include debt in “invested capital,” but only to the extent that interest thereon was not deductible from taxable income (i.e., to the extent it exceeded the statutory deduction limit).²⁰⁵ By reducing the excess-profits tax’s penalty on debt financing, this action seemed to address the business community’s primary grievance.

Nevertheless, lobbying against the deduction limit continued. In what seems to have been a particularly influential lobbying effort, a large coalition of banks and trust companies petitioned the Ways

²⁰¹ Senate Committee on Finance, *To Provide Revenue for War Purposes: Hearings Before the Senate Comm. on Finance*, 65th Cong., 2d sess., 1918, 287 (statement of Benson Watson).

²⁰² *Ibid.*, 627 (statement of W. E. Humphrey).

²⁰³ *Ibid.*, 626–29 (statement of W. E. Humphrey).

²⁰⁴ *Ibid.*, 627 (statement of W. E. Humphrey).

²⁰⁵ U.S. Dept. of the Treasury, Regulations No. 41, Relative to the War Excess Profits Tax Imposed by the War Revenue Act, Approved October 3, 1917, 18 (1918).

and Means Committee in June of 1918.²⁰⁶ In written testimony cosigned by 36 financial companies, including powerful Wall Street institutions such as Chase National Bank, Goldman, Sachs & Co., and the Guaranty Trust Company, the coalition put forward several tax reform recommendations, including complete elimination of the interest deduction limit.²⁰⁷ Many of these companies stood to benefit from the deduction limit's repeal, not only because they themselves employed considerable amounts of debt financing, but also because a major portion of their business was underwriting bonds issued by their clients.²⁰⁸

The Committee on Ways and Means was receptive to the coalition's arguments. "The suggestions are most valuable," Chairman Claude Kitchin (D-NC) remarked, "and I am sure that the Committee will take them under serious consideration."²⁰⁹ Indeed, several of the coalition's proposals—including its suggestion to eliminate the interest deduction limit—were incorporated by the Committee into the revenue bill reported in September.²¹⁰ In its report, the Committee explained (in language echoing that of corporate lobbyists) that, since borrowed money was not included in "invested capital" under the excess-profits tax, it was "only fair" to allow the deduction of all interest from taxable income.²¹¹ Strangely, the Committee made no mention of the fact that the Treasury Department had

²⁰⁶ "Present Revenue Tax Reforms," *New York Times*, June 25, 1918.

²⁰⁷ One of the petition's primary drafters, Morris F. Frey of the Guaranty Trust Company, had publically called for the limit's repeal earlier in the year. "Plea for Revision of Income Tax Law," *New York Times*, May 29, 1918.

²⁰⁸ See Charles R. Geisst, *Wall Street: A History*, paperback ed. (Oxford: Oxford University Press, 2004), 124–51.

²⁰⁹ "Present Revenue Tax Reforms."

²¹⁰ H. R. Rep. No. 65-767 (1918). This bill became law as *An Act to provide revenue, and for other purposes*. In addition to calling for repeal of the interest deduction limit, the coalition also proposed that all corporate debt be included within the definition of "invested capital" under the excess-profits tax. *Ibid.* This latter proposal was not adopted by the Committee.

²¹¹ *Ibid.*, 12–13 (1918).

already addressed this issue earlier in the year.²¹² In any case, the Committee’s change—lauded in the business press—was included in the final law enacted February 24, 1919.²¹³

As this sequence of events makes clear, Congress’s primary rationale for repealing the interest deduction limit was its “unfair” interaction with the excess-profits tax. However, when the excess-profits tax was *itself* repealed in 1921, unlimited interest deductibility remained in place, without any explanation in the legislative history.²¹⁴ Although previously a frequent subject of Congressional debate, in just a few short years, interest deductibility appears to have become an accepted norm among lawmakers. The sole discussion of interest deductibility in the legislative history of the 1921 act concerned whether individual taxpayers could deduct interest on debt incurred to purchase tax-exempt securities.²¹⁵ At no point in these discussions did lawmakers express any doubt as to whether interest should be fully deductible by corporations in ordinary course.²¹⁶

In repealing the excess-profits tax without restoring the interest deduction limit, the Revenue Act of 1921 inaugurated the era of unlimited interest deductibility. Interest has remained fully deductible by corporations ever since, subject to specific and relatively narrow exceptions. During the 1920s, the tax advantage conferred on debt financing by interest deductibility was relatively small, as interest received was taxable to individuals, while dividends remained partially exempt. As discussed below, the advent of full double taxation of dividends in the 1930s would upset this balance, providing debt a more significant economic advantage over equity.

²¹² See note 205 above and accompanying text.

²¹³ See row 8 of the Appendix. Bank, *From Sword to Shield*, 22–23.

²¹⁴ See row 9 of the Appendix. *Revenue Act of 1921*, §§ 300-38, *U.S. Statutes at Large* 42 (1921): 271–77 provided that 1921 would be the final year of the excess-profits tax. Warren, “The Corporate Interest Deduction,” 1586.

²¹⁵ Under the Revenue Act of 1921, Congress prohibited taxpayers from deducting interest on debt incurred to purchase tax-exempt securities (such as municipal, state, and certain federal bonds) because of the potential for such transactions to serve as abusive tax shelters. *Revenue Act of 1921*, § 214(1)(2).

²¹⁶ See, e.g., the exchange at 61 *Cong. Rec.* 7,231 (1921).

D. Double Taxation

Despite Congress's oft-expressed antipathy to double taxation, corporate profits were in fact regularly double taxed, even prior to the 1930s. Under the revenue act of 1913, corporate profits were taxed at the entity level. When the same profits were then distributed to shareholders as dividends, they were excluded from personal income for purposes of the modest "normal income tax," but included in personal income for purposes of the graduated "additional tax."²¹⁷ This meant that dividend income received by shareholders who were subject to the additional tax (i.e., wealthier shareholders) was actually taxed twice: once when recognized by the corporation as profits and again when paid as dividends and received as income by the individual investor.

At first, this limited form of double taxation was of little economic significance, as the corporate rate of 1% was not only extremely low, but also identical to the individual normal rate.²¹⁸ Parity between the corporate rate and the individual normal rate (from which dividends were exempt) meant that interest and dividends were generally subject to the same amount of *total* taxation, regardless of the individual taxpayer's income. To clarify, corporate profits distributed as dividends were subject to (1) the 1% corporate tax when earned by the corporation, plus (2) the applicable amount (if any) of the individual additional tax when received by an individual shareholder. Corporate revenues paid as interest were subject to (1) the 1% individual tax when received by an individual debtholder plus (2) the applicable amount (if any) of the individual additional tax. An exception, of course, was interest paid by corporations in excess of the interest deduction limit. These interest amounts were subject to the corporate tax, the individual normal tax, and the individual additional tax.²¹⁹ As discussed above, the interest deduction limit was repealed by the Revenue Act of 1918.

²¹⁷ *An Act to reduce tariff duties and to provide revenue for the government, and for other purposes*, § II.B. See text accompanying notes 185–189.

²¹⁸ Under the 1913 act, the corporate rate and the individual normal rate were both 1%. *Ibid.*, §§ II.A, II.G(a).

²¹⁹ *An Act to provide revenue, and for other purposes*, § 234(a)(2).

Beginning in 1917, corporate and individual rates began to diverge, with the corporate rate surpassing the individual normal rate.²²⁰ Although a higher corporate tax rate would have tended to disadvantage equity relative to debt (since dividends were not deductible from corporate income), the operation of the excess-profits tax from 1917 to 1921 overwhelmed this effect by significantly penalizing debt. Given the higher corporate tax rate and the elimination of the interest deduction limit, this disadvantage was suddenly reversed when the excess-profits tax was repealed. The total tax burden on dividends (i.e., corporate plus individual taxes) was greater than that on interest for the remainder of the decade.

The tax disadvantage of equity financing increased during the Great Depression, when a series of New Deal legislative developments led to full double taxation of dividends. During President Franklin D. Roosevelt's first term, amidst the depths of the Great Depression, several of Roosevelt's advisers recommended policies to deter corporations from "hoarding" profits in the form of retained earnings.²²¹ These advisers, including Adolf Berle, Raymond Moley, and Rexford Tugwell (each Columbia University professors and members of Roosevelt's "brain trust"), believed excessive earnings retention had contributed to the depression and was impeding economic recovery.²²² They argued that encouraging corporations to increase dividends would stimulate the economy by putting money back in the hands of shareholders.²²³ The administration was also concerned that retained earnings were being insufficiently taxed, as income retained at the corporate level—and not distributed as dividends—escaped the graduated

²²⁰ In 1916, the individual normal rate was 2% (with a \$3,000 standard deduction) and the corporate rate was 2% (with no standard deduction). *An Act to increase the revenue, and for other purposes*, §§ 1(a), 7(a). In 1917, the individual normal rate increased to a total of 4% (with a \$1,000 standard exemption), while the corporate rate increased to a total of 6% (with no standard deduction). *An Act to provide revenue to defray war expenses, and for other purposes*, §§ 1, 3, 4. For the 1918 tax year, the individual normal rate increased to 6% on income between \$1,000 and \$5,000, and 12% on income above \$5,000, while the corporate rate increased to 12% on all income. *An Act to provide revenue, and for other purposes*, §§ 210(a), 216, 230(a)(1).

²²¹ Bank, "Corporate Managers, Agency Costs, and the Rise of Double Taxation," 184–88. Retained earnings are profits held or reinvested by a corporation, rather than distributed to shareholders.

²²² *Ibid.*, 198–203.

²²³ *Ibid.*

surtax otherwise payable by wealthy investors (as had been the case since 1913, individual income remained subject to a graduated additional tax, now called a “surtax,” at high income levels).²²⁴ In order to address both issues, Roosevelt’s advisers proposed levying a special tax on retained earnings.²²⁵

Following this recommendation, Roosevelt proposed major changes to corporate taxation in a special budget message delivered to Congress in early 1936.²²⁶ Under the President’s proposal, (1) earnings retained by corporations would be subject to a new undistributed-profits tax, (2) corporations would be permitted to deduct dividend payments from taxable income, and (3) dividend payments received by investors would be fully taxed at the individual level (under both the normal income tax and the surtax).²²⁷ The combined effect was that corporate income would be taxed once at the corporate level if retained (under the undistributed-profits tax) *or* once at the individual level if distributed as dividends (under applicable individual taxes). Corporate income would be subject to double taxation only if it were retained in one tax year and then distributed to shareholders in a subsequent tax year. Describing a need to plug “leaks” in the tax system, President Roosevelt argued for his proposal in the following terms:

The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, as a matter of fundamental equity, should be to seek equality of tax burden on all corporate income whether distributed or withheld from the beneficial owners. As the law now stands our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends; while the shares of stockholders who can afford to leave earnings undistributed escape current surtaxes altogether.²²⁸

²²⁴ Kwall, “The Uncertain Case Against the Double Taxation of Corporate Income,” 619–20. Accumulation of undistributed earnings by a corporation for the purpose of avoiding the individual additional tax was prohibited by law beginning with the revenue act of 1913. Due to difficulties in establishing the necessary intent, however, enforcement of this prohibition was nearly impossible. Blakey and Blakey, *The Federal Income Tax*, 404–6.

²²⁵ Ibid.

²²⁶ Supplemental Budget Message to Congress (March 3, 1936); Blakey and Blakey, *The Federal Income Tax*, 401–3.

²²⁷ Supplemental Budget Message to Congress (March 3, 1936).

²²⁸ Ibid.

In other words, Roosevelt advocated direct taxation of corporate surpluses in order to reach the beneficial (if unrealized) income of individual shareholders.

Roosevelt's proposal drew strong criticism from the business community. The primary objection was not that Roosevelt's proposal entailed higher taxes, but rather that the government was attempting to use the tax system to substitute its own business judgment for that of corporate managers.²²⁹ Many business leaders feared that an undistributed-profits tax would incite shareholders to demand higher dividends, reducing management prerogative over the allocation of corporate funds.²³⁰ For administration advisers such as Adolf Berle, who believed managers hoarded earnings to entrench their own economic power, this was exactly the point.²³¹

The controversy over the undistributed-profits tax reflected two major developments in American business history: first, the growth of public stock ownership during the early twentieth century, and second, the corresponding increase in managers' independence from investors. The growth of public shareholding, beginning in the 1890s and accelerating rapidly in the 1920s, meant that large corporations were increasingly owned by diffuse, anonymous public shareholders.²³² Reflecting this trend, the total annual trading volume on the New York Stock Exchange increased dramatically, growing from 159 million shares in 1900 to a pre-crash peak of 1.1 billion shares in 1929.²³³ Increasingly, much of this

²²⁹ Bank, "Corporate Managers, Agency Costs, and the Rise of Double Taxation," 198–203.

²³⁰ Ibid.

²³¹ Berle's views were expressed in his seminal work on corporate governance (written with Gardiner Means), *The Modern Corporation and Private Property*. Berle and Means, *The Modern Corporation and Private Property*.

²³² The rise of public stock ownership was initially driven by the Great Merger Movement, in which a sweeping wave of industrial consolidations was financed in large part by floating public stock. Baskin and Miranti, *A History of Corporate Finance*, 193–97; Julia C. Ott, *When Wall Street Met Main Street: The Quest for an Investors' Democracy* (Cambridge: Harvard University Press, 2011), 9–35.

²³³ Baskin and Miranti, *A History of Corporate Finance*, 167. This increase in trading volume was accompanied by rising stock values: The Dow Jones Industrial Average increased from a low of 52.96 in 1900 to a pre-crash peak of 381.17 in 1929. Dow Jones Industrial Average (1900–present, monthly), <http://stockcharts.com/freecharts/historical/djia1900.html> (accessed Mar. 13, 2014).

trading volume was made up of middle-class retail investors.²³⁴ Broad public shareholding contributed to the separation of ownership and control identified by Berle.²³⁵ As corporate ownership became more and more dispersed, professional managers (often holding only small equity stakes) became increasingly autonomous from unorganized investors.²³⁶

Notwithstanding this separation of ownership and control, the interests of management and affluent shareholders were aligned for tax purposes at the time of Roosevelt's proposal. Wealthy shareholders benefited if earnings were retained at the corporate level due to the high individual surtax that would otherwise be triggered by dividend payments. As of 1935, this surtax ranged as high as 75%, while the maximum corporate rate was only 15.75%.²³⁷ As Roosevelt had intimated in his budget message to Congress, many shareholders preferred that earnings *not* be distributed as dividends, a preference which was reinforced by favorable tax treatment of capital gains.²³⁸ At the time, up to 70% of long-term capital gains could be excluded from individual income, meaning that if an investor held corporate stock long enough prior to sale (the maximum exclusion was achieved if stock was held 10 years or more), appreciation was taxed at a maximum rate of only 23.7%.²³⁹ Wealthy shareholders therefore paid less taxes if corporate earnings were "locked in" at the corporate level and realized as capital gains in later years. Roosevelt's proposal to replace the corporate income tax with a heavy

²³⁴ Baskin and Miranti, *A History of Corporate Finance*, 167; Julia C. Ott, *When Wall Street Met Main Street*, 191–213.

²³⁵ Berle and Means, *The Modern Corporation and Private Property*.

²³⁶ In addition to Berle and Means, *The Modern Corporation and Private Property*, see Chandler, *The Visible Hand: The Managerial Revolution in American Business*; Eugene F. Fama and Michael C. Jensen, "Separation of Ownership and Control," *Journal of Law and Economics* 26, no. 2 (June 1, 1983): 301–25; Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance*. For an examination of the historical developments in American corporate law that contributed to the disempowerment of small investors, see Colleen Dunlavy, "From Citizens to Plutocrats: Nineteenth-Century Shareholder Voting Rights and Theories of the Corporation," in *Constructing Corporate America*, ed. Kenneth Lipartito and David Sicilia (New York: Oxford University Press, 2004), 66–93.

²³⁷ See row 10 of the Appendix. *Revenue Act of 1935*, §§ 101–02, *U.S. Statutes at Large* 49 (1935): 1014–17.

²³⁸ Supplemental Budget Message to Congress (March 3, 1936).

²³⁹ *Revenue Act of 1934*, § 117(a), *U.S. Statutes at Large* 48 (1934): 714.

undistributed-profits tax threatened to reverse this calculus. By taxing the “accumulation of surplus in corporations,” the undistributed-profits tax was intended to drive a wedge between managers’ and shareholders’ preferences regarding dividend policy.²⁴⁰ Despite staunch opposition from business groups, the administration’s proposals—including an undistributed-profits tax ranging as high as 42.5%—were included in a revenue bill passed by the House in April 1936 by an overwhelming 267-93 margin.²⁴¹

When the bill reached the conservative Senate Finance Committee later that month, however, business interests managed to successfully intervene. The U.S. Chamber of Commerce (the nation’s largest business group), a number of smaller trade organizations, and a host of individual companies invested significant political effort into influencing the committee’s handling of the bill. These efforts were not enough to block the undistributed-profits tax entirely, but the version of the tax that emerged from the Finance Committee was significantly weaker than the administration’s original proposal.

In the course of its deliberations, the Finance Committee heard testimony from approximately 100 witnesses, most of whom spoke on behalf of business interests.²⁴² Reflecting the growing presence of business organizations in national politics, the range of industry groups at the hearings was extremely broad, including not only the U.S. Chamber of Commerce, but also the American Association of Railroads, the American Bankers’ Association, the American Management Association, the American Mining Congress, the National Association of Credit Men, the National Association of Manufacturers, and many others. Over the preceding decades, national business associations had grown in number, size, and influence, often with active support from the U.S. Department of Commerce. The involvement of these associations in federal lawmaking had actually increased under the “cooperative” system of industry

²⁴⁰ Supplemental Budget Message to Congress (March 3, 1936).

²⁴¹ Turner Catledge, “House Gets New Tax Bill, but Yield Is Still in Doubt; Quick Passage Is Forecast,” *New York Times*, April 22, 1936; “\$803,000,000 Tax Bill Wins by Vote of 267-93 in House; Business Attacks New Deal,” *New York Times*, April 30, 1936.

²⁴² Blakey and Blakey, *The Federal Income Tax*, 414–17.

cartelization administered by Roosevelt's National Recovery Administration.²⁴³ In Washington, these associations were collectively represented by the U.S. Chamber of Commerce, itself originally created at the behest of the Taft administration.²⁴⁴ These groups, lobbying on behalf of their members, overwhelmingly opposed the undistributed-profits tax.²⁴⁵

For the most part, business groups represented the policy preferences of professional managers.²⁴⁶ It is important to note the undistributed-profits tax was also opposed by at least some shareholders, however. A particularly interesting example is that of Catherine Curtis, director of Women Investors in America (claiming to represent between one-third and one-half, by number, of all shareholders in large public corporations), who testified to the Finance Committee that the likely result of the “unsound,” “revolutionary,” “confiscatory” undistributed-profits tax was that “small businesses are destroyed, recovery is retarded, investments are impaired.”²⁴⁷ Of particular concern to Women Investors in America was that the undistributed-profits tax would prevent corporations from building financial reserves to protect against business downturns. This was precisely the same argument made by many corporate managers. The extent to which Women Investors in America's position was representative of other shareholder groups is unclear, but—perhaps tellingly—I have found no evidence of any shareholder groups *supporting* the undistributed-profits tax.

Following its hearings, the Finance Committee significantly modified Roosevelt's bill. The U.S. Chamber of Commerce was particularly influential during this process—not only did it participate in the

²⁴³ Robert Higgs, *Crisis and Leviathan: Critical Episodes in the Growth of American Government* (New York: Oxford University Press, 1987), 159–95.

²⁴⁴ Richard Hume Werking, “Bureaucrats, Businessmen, and Foreign Trade: The Origins of the United States Chamber of Commerce,” *The Business History Review* 52, no. 3 (October 1, 1978): 321–41.

²⁴⁵ Blakey and Blakey, *The Federal Income Tax*, 414–17.

²⁴⁶ *Ibid.*

²⁴⁷ Senate Committee on Finance, *Revenue Act, 1936: Hearings Before the Senate Comm. on Finance*, 74th Cong., 2d sess., 1936, 820 (statement of Catherine Curtis).

hearings, it was also directly involved in drafting the committee's amendments.²⁴⁸ The committee's most important changes were to reduce the maximum undistributed-profits tax from 42.5% to 7%, while at the same time restoring the standard corporate income tax.²⁴⁹ Although business interests would have preferred to reduce *all* corporate taxation as much as possible (including eliminating the standard corporate income tax), a looming federal budget deficit barred major reductions to tax revenue.²⁵⁰ A compromise solution acceptable to business was to maintain the existing corporate income tax, while significantly reducing the undistributed-profits tax.²⁵¹

In early June, the Finance Committee's amendments were accepted by the wider Senate, meaning the Conference Committee was faced with conflicting versions of the same bill.²⁵² Following protracted negotiations, House and Senate conferees eventually reached an elaborate compromise. The undistributed-profits tax was set at graduated rates of 7%–27% (based on the percentage of the corporation's net income that remained undistributed in a given tax year), a range that was lower than the House version, but higher than the Senate version.²⁵³ The standard corporate income tax was preserved at graduated rates ranging from 8%–15%.²⁵⁴ Finally (and significantly), dividends received were no longer exempt from the individual normal tax.²⁵⁵ Thus, under the final legislation enacted June 22, 1936, corporate earnings were subject to full double taxation: profits were taxed at the corporate level when

²⁴⁸ Bank, "Corporate Managers, Agency Costs, and the Rise of Double Taxation," 218.

²⁴⁹ *Ibid.*, 218–22.

²⁵⁰ *Ibid.*, 171–81. Although the government had anticipated a balanced budget for fiscal year 1937, the Supreme Court's invalidation of processing taxes under the Agricultural Adjustment Act and Congress's acceleration of World War I veterans' bonus payments created an unexpected deficit.

²⁵¹ *Ibid.*, 213–26.

²⁵² Blakey and Blakey, *The Federal Income Tax*, 421–25; Bank, "Corporate Managers, Agency Costs, and the Rise of Double Taxation," 226.

²⁵³ Blakey and Blakey, *The Federal Income Tax*, 422–27; Bank, "Corporate Managers, Agency Costs, and the Rise of Double Taxation," 226–28.

²⁵⁴ Bank, "Corporate Managers, Agency Costs, and the Rise of Double Taxation," 226–28.

²⁵⁵ The dividend exemption was removed from § 25 of the Revenue Act of 1936. See row 11 of the Appendix. *Revenue Act of 1936, § 25, U.S. Statutes at Large* 49 (1936): 1662–63.

recognized by the corporation, then taxed again at the individual level (if distributed to shareholders) or again at the corporate level (if retained as undistributed profits).²⁵⁶

The passage of the undistributed-profits tax, even in diluted form, did not bring an end to business's lobbying campaign against the measure. Upon its enactment, the U.S. Chamber of Commerce issued a statement condemning the new tax and urged businesses to press for its repeal in the next Congressional session.²⁵⁷ A year later, in 1937, a reversal of the burgeoning American economic recovery created further hostility to the tax. Just as the nation was finally recovering from the Great Depression, the U.S. economy entered a severe "double-dip" recession in 1937, the Dow Jones Industrial Average losing nearly half its value in 1937–1938. Business leaders were quick to blame the undistributed-profits tax, claiming that it had shattered business confidence.²⁵⁸ This argument was (unsurprisingly) embraced by Congressional Republicans, but, as the administration failed to produce an effective response to the economic downturn, hostility toward the tax began to spread to conservative and moderate Democrats as well.²⁵⁹ By 1938, bipartisan dissatisfaction with the undistributed-profits tax had reached a level at which Congressional intervention seemed all but certain.²⁶⁰ Indeed, "in an effort to encourage and stimulate business" and to promote "a freer flow of capital into productive enterprises," the

²⁵⁶ *Revenue Act of 1936*. Key provisions of the Revenue Act of 1936 are summarized at Blakey and Blakey, *The Federal Income Tax*, 424–28.

²⁵⁷ "Text of Four Reports Adverse to the Compromise Tax Bill," *New York Times*, June 20, 1936.

²⁵⁸ Bank, "Corporate Managers, Agency Costs, and the Rise of Double Taxation," 234–39. As a matter of economic history, claims that the undistributed-profits tax caused the 1937 recession are dubious. Most economists who have studied the recession have laid the blame on reductions in federal spending and/or an ill-advised contraction of the money supply by the Federal Reserve. See, e.g., Milton Friedman and Anna Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton University Press, 1963), 493–545; Christina Romer, "The Lessons of 1937," *The Economist*, June 18, 2009. In one major study of the recession, the economist Kenneth Roose did assign a contributory role to the undistributed-profits tax, however. Kenneth Roose, *The Economics of Recession and Revival; an Interpretation of 1937–38* (New Haven: Yale University Press, 1954), 239.

²⁵⁹ Bank, "Corporate Managers, Agency Costs, and the Rise of Double Taxation," 234–39.

²⁶⁰ *Ibid.*

Revenue Act of 1938 reduced the undistributed-profits tax to only 2.5%.²⁶¹ The next year, the Revenue Act of 1939 allowed the tax to expire completely.²⁶²

While effectively killing the undistributed-profits tax, the 1938 act did *not* restore the dividend exclusion to the individual normal tax—an incongruous outcome given the pro-investment rhetoric surrounding the act’s passage. Why was the dividend exclusion not restored? An important reason may be that during the political run-up to the 1938 act, the undistributed-profits tax was the overriding concern of business groups, and—whether by strategy or oversight—they focused little attention on the tax treatment of dividends paid to investors.²⁶³ After all, corporate managers had only limited incentives to lobby for tax rules that would primarily benefit shareholders. Another reason may be that shareholders themselves were far less politically organized than the management-dominated business lobby. The legislative record provides abundant evidence of the influence of business associations on tax legislation, but with rare exceptions (such as the 1936 testimony of Women Investors in America), shareholders are most notable for their absence. A final reason may be that since the individual normal tax was only 4%, the issue was simply neglected in the context of much higher surtax rates.²⁶⁴ Whatever the reasons, the result of preserving the corporate income tax without restoring the individual dividend exclusion was that dividends paid to individual shareholders remained subject to full double taxation, taxed first as corporate profits and then again as personal income. Given decades’ worth of impassioned denunciations of double taxation by both parties in Congress, this outcome is probably best understood as an ironic byproduct of the political bargaining process. There is nothing to suggest that either Republicans or Democrats viewed double taxation as a policy goal.

²⁶¹ S. Rep. No. 75-1576, 1 (1938). Under the Revenue Act of 1938, the undistributed-profits tax took the form of a maximum 2.5 percentage point reduction in the corporate income tax rate. See row 12 of the Appendix. *Revenue Act of 1938*, § 13(c)(2)(B), *U.S. Statutes at Large* 52 (1938): 355.

²⁶² *Revenue Act of 1939*, *U.S. Statutes at Large* 53 (1939): 862.

²⁶³ For a detailed discussion of the legislative history of the Revenue Act of 1938 (as it relates to double taxation), see Bank, “Corporate Managers, Agency Costs, and the Rise of Double Taxation,” 239–55.

²⁶⁴ *Revenue Act of 1938*, §§ 11,12.

The irony of this result in hindsight is highlighted by the fact that double taxation—a product of business lobbying—would later become the target of intense criticism from business groups. Arguing that double taxation severely burdens capital investment, business groups today, including the U.S. Chamber of Commerce, persistently call for its elimination.²⁶⁵ During the Near Deal era, business groups were apparently willing to accept this burden if it meant avoiding the undistributed-profits tax.²⁶⁶ Indeed, it was not until after the undistributed-profits tax was slated for expiration that business leaders began to publically criticize double taxation. Even then, lobbying against double taxation was a low priority for corporate managers—especially compared to business-level tax cuts that more directly affected the economic resources under their control.²⁶⁷

According to Steven Bank, managers' willingness to trade double taxation against the undistributed-profits tax is yet another example of the agency problem well known in corporate governance scholarship.²⁶⁸ For the most part, I agree with this explanation. What must be added to Bank's account, however, are the sweeping changes in American political economy—the emergence of the corporation as the nation's dominant economic institution, the increasingly decentralized ownership of corporations by diffuse public shareholders, and the growing political power of the national business lobby—which together *allowed* the policy preferences of corporate managers to succeed in Washington, even during years (1933–1939) in which Democrats controlled the White House and both chambers of Congress. At a more detailed level, what must also be emphasized is that the shift from “partial” double

²⁶⁵ Business Roundtable, “Effective Leadership on the World Stage,” February 2011; National Association of Manufacturers, “Tax Policy,” winter 2012, <http://www.nam.org/Issues/Official-Policy-Positions/Tax-Technology-Domestic-Economic-Policy/TTDEP-01-Tax-Policy.aspx>; U.S. Chamber of Commerce, “Chamber Pushes Broadest Tax Relief for All,” May 6, 2003, <http://www.uschamber.com/press/releases/2003/may/chamber-pushes-broadest-tax-relief-all>; U.S. Chamber of Commerce, “State of American Business 2003,” January 15, 2003, <http://www.uschamber.com/press/speeches/2003/january-15>.

²⁶⁶ Bank, “Corporate Managers, Agency Costs, and the Rise of Double Taxation,” 222–23.

²⁶⁷ *Ibid.*, 256–57.

²⁶⁸ For a more economically rigorous analysis of the agency costs surrounding the undistributed-profits tax, see William G. Christie and Vikram Nanda, “Free Cash Flow, Shareholder Value, and the Undistributed Profits Tax of 1936 and 1937,” *The Journal of Finance* 49, no. 5 (December 1, 1994): 1727–54.

taxation to “full” double taxation in 1936 resulted in only a four percentage point increase in the total taxation of dividends, at a time when surtax rates (which had always been applicable to dividends) ranged as high as 75%. From this perspective, the marginal difference between dividend taxation pre- and post-1936 was simply not very significant.

It was not until the normal income tax and the surtax were consolidated into a single graduated income tax after World War II that double taxation of dividends became a mobilizing issue. During the 1950s, marginal rates as high as 91% prompted growing criticism of double taxation, leading to a number of political proposals to integrate the corporate and individual income taxes.²⁶⁹ High corporate tax rates also encouraged the postwar proliferation of “hybrid” securities—custom investment instruments designed to provide the economic characteristics of equity securities and the tax benefits of debt securities (thus allowing the deduction, as “interest,” of payments to investors).²⁷⁰ As corporations sought to avoid the heavy taxation of equity capital, they became more and more creative in the design and use of hybrid securities. Indeed, it was precisely these practices—made possible by the law’s binary treatment of debt and equity—that drew increasing critical attention to the debt-equity distinction in the legal literature during the latter half of the twentieth century.²⁷¹

Although the U.S. tax system continued to evolve through the postwar era and beyond, the debt-equity distinction had become fixed in place by the beginning of World War II. Following the Revenue Act of 1938, interest was fully deductible at the corporate level and fully taxable at the individual level,

²⁶⁹ See, e.g., “Stock Exchange Heads Urge Senate to Ease Double Tax on Dividends,” *Wall Street Journal*, April 13, 1954. This criticism helped contribute to the statutory provision of the “S corporation,” a type of corporation immune from entity-level taxation (similar to a partnership), but only available to small businesses. Mirit Eyal-Cohen, “When American Small Business Hit the Jackpot: Taxes, Politics, and the History of Organizational Choice in the 1950s,” *Pittsburgh Tax Review* 6 (2008): 1–59. Double taxation would remain in effect for public corporations through the end of the century. Bank, “Corporate Managers, Agency Costs, and the Rise of Double Taxation,” 191–236.

²⁷⁰ The corporate income tax rose as high as 52% in the 1950s and 1960s. Tax Policy Center, “Historical Corporate Top Tax Rate and Bracket: 1909–2014,” accessed May 12, 2017, http://www.taxpolicycenter.org/sites/default/files/legacy/taxfacts/content/pdf/corporate_historical_bracket.pdf.

²⁷¹ See, e.g., Emmerich, “Hybrid Instruments and the Debt-Equity Distinction in Corporate Taxation”; Plumb, “The Federal Income Tax Significance of Corporate Debt.”

while profits were fully taxable at the corporate level and taxable again when received as dividends. Despite widespread criticism and persistent calls for reform, this same legal framework remains in place today.²⁷²

²⁷² Congress has recently taken partial steps toward integration. Dividend income (and capital gains) is today subject to a preferred rate of 23.8%, compared to the maximum rate of 39.6% for ordinary income. See note 6 above.

CHAPTER 4: CONCLUSION

The history of the debt-equity distinction reveals little forethought or intentional design. Rather than advancing any conscious policy goal, each major step in the distinction's evolution was an ad hoc response to the immediate historical context. Thus, the (permanent) institution of corporate interest deductibility in 1894 was shaped by (temporary) economic conditions following the panic of 1893. Similarly, the (permanent) repeal of the interest deduction limit during World War I was premised on the (temporary) operation of the excess-profits tax. Finally, the rise of (permanent) double taxation in the 1930s was due to the political battle over the (temporary) undistributed-profits tax. Intended to address short-term political issues, these decisions have had consequences that have outlived their historical origins.

Beyond the specific issue of the debt-equity distinction, what can this history tell us regarding the broader development of the U.S. tax system? One implication is that tax policy outcomes are not the result of rational technocratic processes, but neither are they sufficiently explained in simple terms of special-interest politics. Rather, tax policy is often the result of reactive, context-driven decision making, by which short-term political issues come to dictate long-term policy outcomes. Path dependence, a common feature of institutional evolution, may be particularly significant in the tax policy context. The economic and political benefits of stable, predictable tax rules create a strong bias against reform—even in situations where existing rules are merely the legacy of historical circumstances. Robert C. Clark has written that the structure of the corporate tax system derives from political choices made at its inception, the system's "major traits determined by a set of genes fixed in its infancy."²⁷³ Clark may overstate the point, but his argument is suggestive of the longevity of tax policy choices.²⁷⁴

²⁷³ Robert C. Clark, "The Morphogenesis of Subchapter C: An Essay in Statutory Evolution and Reform," *Yale Law Journal* 87, no. 1 (November 1, 1977): 90–92.

²⁷⁴ Clark's primary concern in *The Morphogenesis of Subchapter C* is the growing complexity of tax law over time, a process which he argues has occurred in a "cumulative, evolutionary way." *Ibid.*, 92. For another account of tax law's increasing complexity, see Berger, "Simple Interest and Complex Taxes." For an analysis of the income tax's historical development framed in the political theory of incrementalism, see Witte, *The Politics and Development of the Federal Income Tax*.

The second insight (in some tension with the first) is that the policy preferences of corporate managers, as represented by the national business lobby, have played a major role in the development of corporate tax law. Business interests were an important factor in each of the key junctures in the debt-equity distinction's evolution: the decision to allow corporations to deduct interest on debt in 1894; the relaxation, and eventual repeal, of the interest deduction limit during the years 1913-1921; and the advent of full double taxation of dividends in the 1930s. The national business lobby's increasing role in tax policy reflected broader developments in the relative political power of corporate managers and investors. Just as the rise of interest deductibility and the defeat of the undistributed-profits tax reflected the political influence of corporate managers, the establishment of full double taxation reflected the *lack* of influence of unorganized shareholders. Again, however, lest the ability of managers to dictate their preferred vision of tax policy be overstated, it should be emphasized that double taxation—a byproduct of business opposition to the undistributed-profits tax—is today the subject of persistent criticism from the business community itself.²⁷⁵ This ironic turn of events suggests that the priorities of special interest groups may be subject to the same short-term biases as those of legislators.

Ultimately, the history of the debt-equity distinction lends support to the arguments of its present-day critics. Lacking a consistent policy basis and shaped by ad hoc responses to shifting external pressures, it is hardly surprising that the distinction appears arbitrary from a contemporary perspective. The history of the distinction may also offer tangible lessons regarding tax reform. Three such lessons spring immediately to mind: First, major features of the tax system can (and do) emerge in the absence of intentional policy design. Second, there is no reason to expect such features to be optimal from any theoretical standpoint. Finally, tax policy decisions possess significant inertia, becoming difficult to reverse once made. These lessons suggest that serious reform proposals regarding the tax treatment of debt and equity *should* be based on deliberate, theoretically-informed policy design, that Congress's past legislative decisions on the matter should be afforded little deference, and that better tax policy may be

²⁷⁵ See note 265 above.

possible if the system were reconsidered from the ground up. Unfortunately, they also suggest that fundamental tax reform is extraordinarily difficult and that smaller changes at the margin may be the only realistic course available. In the end, from the perspective of achieving simple, elegant, and economically efficient tax policy, the lessons of the debt-equity distinction may be less than encouraging.

**APPENDIX TO PART I: SELECTED DEVELOPMENTS
IN THE TAX TREATMENT OF CORPORATE DEBT AND EQUITY, 1861–1938**

This table summarizes certain legislative developments discussed in Part I. The goal is to show major structural changes in the taxation of corporate revenues (both at the corporate level and upon distribution to investors). This table represents a partial summary only—many tax law developments are not included. In particular, note that while much of the legislation described below applied to business entities generally (e.g., corporations, joint-stock companies, and associations), the table focuses specifically on the treatment of corporations.

LEGISLATION	DEBT		EQUITY	
	Tax Treatment of Interest Paid by Corporations	Tax Treatment of Interest Received by Individuals	Tax Treatment of Corporate Profits	Tax Treatment of Dividends Received by Individuals
1. Revenue act of 1861 (income tax was enacted but not collected)	No corporate-level income taxation	Subject to income tax of 3% on income in excess of \$800	No corporate-level income taxation	Subject to income tax of 3% on income in excess of \$800
2. Revenue act of 1862	No corporate-level income taxation Withholding tax of 3% applicable to interest paid by certain transportation companies	Subject to income tax of 3% on income exceeding \$600 (5% if the taxpayer's income exceeded \$10,000) Interest payments subject to corporate withholding tax deductible from individual income	No corporate-level income taxation Withholding tax of 3% applicable to dividends paid by certain financial and transportation companies	Subject to income tax of 3% on income exceeding \$600 (5% if the taxpayer's income exceeded \$10,000) Dividends subject to corporate withholding tax deductible from individual income
3. Revenue act of 1864	No corporate-level income taxation Withholding tax of 5% applicable to interest paid by certain transportation companies	Subject to graduated income tax ranging from 5%–10% Interest payments subject to corporate withholding tax deductible from individual income	No corporate-level income taxation Withholding tax of 5% applicable to dividends paid by certain financial and transportation companies	Subject to graduated income tax ranging from 5%–10% Dividends subject to corporate withholding tax deductible from individual income

LEGISLATION	DEBT		EQUITY	
	Tax Treatment of Interest Paid by Corporations	Tax Treatment of Interest Received by Individuals	Tax Treatment of Corporate Profits	Tax Treatment of Dividends Received by Individuals
4. Revenue act of 1894 (income tax was enacted but not collected)	Deductible from taxable corporate income	Subject to income tax of 2% on income in excess of \$4,000	Subject to corporate-level income tax of 2%	Excluded from individual income taxation
5. Revenue act of 1909	Deductible from taxable corporate income, but only on debt not exceeding paid-up capital stock	No individual income taxation	Subject to tax of 1% on profits in excess of \$5,000	No individual income taxation
6. Revenue act of 1913	Deductible from taxable corporate income, but only on debt not exceeding one-half the sum of debt and paid-up capital stock	Subject to normal income tax of 1% on income in excess of \$3,000 Also subject to graduated additional tax ranging from 1%–6% on income in excess of \$20,000	Subject to corporate income tax of 1%	Exempt for purposes of the normal income tax Subject to graduated additional tax ranging from 1%–6% on income in excess of \$20,000
7. Revenue act of 1916	Deductible from taxable corporate income, but only on debt not exceeding the sum of paid-up capital stock and one-half of outstanding debt	Subject to normal income tax of 2% on income in excess of \$3,000 Also subject to graduated additional tax ranging from 1%–13% on income in excess of \$20,000	Subject to corporate income tax of 2%	Exempt for purposes of the normal income tax Subject to graduated additional tax ranging from 1%–13% on income in excess of \$20,000

LEGISLATION	DEBT		EQUITY	
	Tax Treatment of Interest Paid by Corporations	Tax Treatment of Interest Received by Individuals	Tax Treatment of Corporate Profits	Tax Treatment of Dividends Received by Individuals
8. Revenue act of 1918 (enacted February 24, 1919)	Fully deductible for purposes of the corporate income tax and excess-profits tax	Subject to normal income tax of 6% on income up to \$4,000 and 12% on income in excess of \$4,000 Also subject to graduated surtax ranging from 1%–65% on income in excess of \$5,000	Subject to corporate income tax of 12% Also subject to graduated excess-profits/war-profits tax ranging from 0%–80%	Exempt for purposes of the normal income tax Subject to graduated surtax ranging from 1%–65% on income in excess of \$5,000
9. Revenue act of 1921 ^a	Fully deductible from taxable corporate income	Subject to normal income tax of 6% on income up to \$4,000 and 8% on income in excess of \$4,000 Also subject to graduated surtax ranging from 1%–65% on income in excess of \$5,000	Subject to corporate income tax of 12.5%	Exempt for purposes of the normal income tax Subject to graduated surtax ranging from 1%–65% on income in excess of \$5,000
10. Revenue act of 1935	Fully deductible from taxable corporate income	Subject to normal income tax of 4% Also subject to graduated surtax ranging from 4%–75% on income in excess of \$4,000	Subject to graduated corporate income tax ranging from 12.5%–15.75% ^b	Exempt for purposes of the normal income tax Subject to graduated surtax ranging from 4%–75% on income in excess of \$4,000

^a Pursuant to the Revenue Act of 1921, the excess-profits tax was repealed as of January 1, 1922.

^b Corporations were allowed to deduct 90% of dividends received from other corporations.

LEGISLATION	DEBT		EQUITY	
	Tax Treatment of Interest Paid by Corporations	Tax Treatment of Interest Received by Individuals	Tax Treatment of Corporate Profits	Tax Treatment of Dividends Received by Individuals
11. Revenue act of 1936	Fully deductible from taxable corporate income	Subject to normal income tax of 4% Also subject to graduated surtax ranging from 4%–75% on income in excess of \$4,000	Subject to graduated corporate income tax ranging from 8%–15% ^c	Subject to normal income tax of 4% Also subject to graduated surtax ranging from 4%–75% on income in excess of \$4,000

^c Corporations were allowed to deduct 85% of dividends received from other corporations. Corporate profits that were not distributed to investors were subject to a graduated undistributed-profits tax ranging from 7%–27%.

**PART II: PROGRESSIVE ERA CONCEPTIONS OF THE CORPORATION AND THE
FAILURE OF THE FEDERAL CHARTERING MOVEMENT**

CHAPTER 5: INTRODUCTION

Among the most salient features of American corporate law is its distinctly subnational structure. Under the U.S. federal system, the internal affairs of a corporation—including the rights and obligations of its managers and shareholders—are governed by the substantive law of its state of incorporation, not that of the federal government. Historically, this allocation of corporate law to the individual states was constitutional in nature. In early American history, when the Commerce Clause was a stronger limit on federal economic legislation, and when the activities of most corporations were confined to their home states, Congress lacked constitutional authority to pass a general corporation law. Although federal law has expanded in the areas of securities regulation,¹ proxy voting,² gatekeeping,³ retirement fund investments,⁴ certain reorganizational transactions,⁵ and (more recently) executive compensation, board composition, and disclosure by hedge fund and private equity fund managers,⁶ the fundamental principles of corporate governance remain the purview of the respective states. This subnational aspect of American

¹ The issuance and sale of corporate securities is primarily governed by the federal securities laws. *Securities Act of 1933, U.S. Statutes at Large* 48 (1933): 74–95; *Securities Exchange Act of 1934, U.S. Statutes at Large* 48 (1934): 888–901.

² Lucian Arye Bebchuk and Assaf Hamdani, “Federal Corporate Law: Lessons From History,” *Columbia Law Review* 106 (2006): 1804–7.

³ The Sarbanes-Oxley Act of 2002 imposed new obligations on corporate gatekeepers such as auditors, securities analysts, and outside legal counsel. *Sarbanes-Oxley Act of 2002, U.S. Statutes at Large* 116 (2002): 745–810. For discussion of corporate gatekeeping, see generally John C. Coffee, *Gatekeepers: The Role of the Professions and Corporate Governance* (Oxford: Oxford University Press, 2006).

⁴ The management of employee retirement plans is broadly regulated under federal law. *Employee Retirement Income Security Act of 1974, U.S. Statutes at Large* 29 (2012): 829–1035. See Kimberly Weiss, “Directors’ Liability for Corporate Mismanagement of 401(k) Plans: Achieving the Goals of ERISA in Effectuating Retirement Security,” *Indiana Law Review* 38, no. 3 (2005): 815–78.

⁵ See Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance*, 618–19.

⁶ These recent federal regulations were established under the *Dodd-Frank Wall Street Reform and Consumer Protection Act, U.S. Statutes at Large* 124 (2010): 1376–2223. Although President Trump has promised to “dismantle” Dodd-Frank, it is uncertain whether any future reforms will affect the law’s corporate governance provisions. See Jeff Cox, “Why It Won’t Be Easy for Trump to Repeal Dodd-Frank,” accessed May 2, 2017, <http://www.cnn.com/2016/11/21/repeal-dodd-frank-it-wont-be-easy-for-donald-trump-to-end-the-rule.html>.

corporate law has long distinguished it from that of most developed countries, in which business corporations are formed and governed under centralized national legislation.⁷

The federal structure of American corporate law figures centrally in corporate legal scholarship, which is intellectually and programmatically dominated by the relationship between management and shareholders. Inspired by Adolf Berle and Gardiner Means's seminal study of the modern corporation,⁸ and influenced by the development of modern finance theory in the 1960s and 1970s,⁹ legal scholarship on American corporations has focused on this fundamental governance issue. This attention has led to a long-running debate over the merits of state corporate law, particularly regarding the state "competition" that has led to the dominance of the state of Delaware.¹⁰ Many scholars have argued that a "race to the bottom" has degraded corporate governance standards, and that Delaware has attracted corporations by favoring management interests over those of shareholders.¹¹ Others have argued that Delaware's success is instead the result of a "race to the top," and that Delaware has provided the most economically efficient

⁷ A notable exception is Canada, in which corporations can be formed under either federal or provincial law.

⁸ Berle and Means, *The Modern Corporation and Private Property*. Berle and Means were themselves inspired by early-twentieth-century political pluralists. See Dalia Mitchell, "From Pluralism to Individualism: Berle and Means and 20th-Century American Legal Thought," *Law & Social Inquiry* 30 (2005): 179–225.

⁹ Michael C. Jensen and Clifford W. Smith, "The Theory of Corporate Finance: A Historical Overview," in *The Modern Theory of Corporate Finance* (New York: McGraw-Hill Inc., 1984), 2–20.

¹⁰ Since corporations are essentially free to incorporate in any state of their choosing (regardless of geographical presence), certain states have tailored their laws to attract incorporation fees and franchise taxes. Among these states, Delaware has been far and away the most successful. It today serves as the legal home to more than half of all publically-traded U.S. corporations and nearly two-thirds of the Fortune 500. Jeffrey W. Bullock, (Delaware Secretary of State), *Delaware Division of Corporations 2013 Annual Report*, available at https://corp.delaware.gov/Corporations_2013%20Annual%20Report.pdf.

¹¹ See, e.g., Oren Bar-Gill, Michal Barzuza, and Lucian Bebchuk, "The Market for Corporate Law," *Journal of Institutional and Theoretical Economics* 162, no. 1 (2006): 137–41; Lucian Arye Bebchuk, "Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law," *Harvard Law Review* 105, no. 7 (1992): 1440–45; Bebchuk and Hamdani, "Federal Corporate Law: Lessons From History"; William L. Cary, "Federalism and Corporate Law: Reflections upon Delaware," *Yale Law Journal* 83, no. 4 (1974): 663–705; Renee Jones, "Rethinking Corporate Federalism in the Era of Corporate Reform," *Journal of Corporation Law* 29 (2004): 653; Stanley A. Kaplan, "Fiduciary Responsibility in the Management of the Corporation," *The Business Lawyer* 31 (1976): 885–87; Ralph Nader, Mark J. Green, and Joel Seligman, *Taming the Giant Corporation* (New York: W. W. Norton & Company, 1977), 54–61; Donald E. Schwartz, "Federalism and Corporate Governance," *Ohio State Law Journal* 45 (1984): 545–89; Gordon G. Young, "Federal Corporate Law, Federalism, and the Federal Courts," *Law and Contemporary Problems* 41, no. 3 (1977): 151.

balance between shareholder protection and management prerogative.¹² More recently, a number of scholars have questioned the assumption that states compete for corporate charters at all, based on evidence that Delaware has enjoyed an effective monopoly on out-of-state incorporations for several decades (tempered only by the periodic threat of federal legislation).¹³

Regardless of their specific perspectives on the state corporate law debate, most of these scholars share in common two basic intellectual premises: (1) that state law provides the foundational legal rules in which federal policy may selectively intervene; and (2) that corporate law should focus primarily on the economic interests of shareholders. The positive corollaries of these premises—the absence of comprehensive federal corporate law, and the limitation of management’s duties exclusively to shareholders—are largely taken for granted, implicitly portrayed as natural results of the U.S.’s federal system of government.¹⁴

¹² See, e.g., Barry D. Baysinger and Henry N. Butler, “The Role of Corporate Law in the Theory of the Firm,” *The Journal of Law & Economics* 28, no. 1 (1985): 184–90; Robert Daines, “Does Delaware Law Improve Firm Value?,” *Journal of Financial Economics* 62 (2001): 525–558; Frank Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Cambridge: Harvard University Press, 1991); Daniel R. Fischel, “Race to the Bottom Revisited: Reflections on Recent Developments in Delaware’s Corporation Law,” *Northwestern University Law Review* 76, no. 6 (1982): 913–45; Roberta Romano, “Corporate Law as the Paradigm for Contractual Choice of Law,” in *The Fall and Rise of Freedom of Contract* (Durham: Duke University Press, 1999); Roberta Romano, “Law as a Product: Some Pieces of the Incorporation Puzzle,” *The Journal of Law, Economics, and Organization* 1, no. 2 (October 1985): 225–83; Roberta Romano, *The Genius of American Corporate Law* (Washington: American Enterprise Institute Press, 1993); Ralph K. Winter, *Government and the Corporation* (American Enterprise Institute for Public Policy Research, 1978), 28–42; Ralph K. Winter, “State Law, Shareholder Protection, and the Theory of the Corporation,” *The Journal of Legal Studies* 6, no. 2 (1977): 251–92.

¹³ See, e.g., Robert Anderson and Jeffery Manns, “The Delaware Delusion,” *North Carolina Law Review* 93, no. 4 (2015): 1092–94; Lucian Arye Bebchuk and Assaf Hamdani, “Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters,” *Yale Law Journal* 112 (2002): 553–615; Marcel Kahan and Ehud Kamar, “The Myth of State Competition in Corporate Law,” *Stanford Law Review* 55, no. 3 (2002): 679–749; Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance*, 618–19. Increasingly, scholars characterize the market for incorporations as a binary “local versus Delaware” market, in which firms incorporate in either the state in which they are headquartered (for example, a Wisconsin-based corporation incorporating under Wisconsin law) or in Delaware (a Wisconsin-based corporation incorporating under Delaware law). A common view is that no states today (with the possible recent exception of Nevada) even attempt to compete with Delaware for out-of-state incorporations. See Bruce H. Kobayashi and Larry E. Ribstein, “Nevada and the Market for Corporate Law,” *Seattle University Law Review* 35, no. 4 (2012): 1167–68.

¹⁴ It should be emphasized that this naturalized view is the dominant perspective within the *legal* literature. Historians of American business have often conceptualized corporations (and corporate law) much differently. For prominent examples of the variety of historical approaches to corporations, see, e.g., John William Cadman, *The Corporation in New Jersey: Business and Politics, 1791–1875* (Cambridge: Harvard University Press, 1949); Chandler, *The Visible Hand: The Managerial Revolution in American Business*; Colleen Dunlavy, “How Did

In fact, neither premise commanded appreciable support during modern corporate law's formative period. By exploring Progressive Era political debates over federal corporate chartering proposals, Part II shows there was nothing predetermined about the state-based system of corporate governance. At the turn of the twentieth century, in response to a dramatic wave of industrial consolidation, the possibility of federal chartering became a national political issue.¹⁵ Federal chartering proposals, which—in their various forms—would have supplemented, 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. Significantly, the policy concerns of this federalization movement were not the concerns of corporate law today. Rather than focusing on the conflict of interest between professional management and shareholders, Progressive Era reformers addressed themselves to much broader questions of political economy, including the fundamental nature of the corporation's role in modern industrial society. In seeking to regulate large business corporations directly, Progressive Era proposals implicated the power of both managers *and* shareholders, the economic interests of which were only rarely differentiated. Given their broad regulatory ambitions, had Progressive Era reformers been successful in passing federal chartering legislation, the institutional structure of American business would look much different than it does today.

Part II centers on the historical period in which federalization had the strongest political support: the roughly two-decade period beginning with the “Great Merger Movement” of 1895–1904 and ending with the creation of the Federal Trade Commission in 1914.¹⁶ These years were marked by deep public

American Business Get so Big?,” *Audacity*, spring 1994; Colleen Dunlavy, “Social Conceptions of the Corporation,” *Washington and Lee Law Review* 63 (2006): 1347–88; Handlin and Handlin, “Origins of the American Business Corporation”; Lamoreaux, *The Great Merger Movement in American Business, 1895–1904*; Kenneth Lipartito and David Sicilia, eds., *Constructing Corporate America* (Oxford: Oxford University Press, 2004); Charles W. McCurdy, “American Law and the Marketing Structure of the Large Corporation, 1875–1890,” *Journal of Economic History* 38, no. 3 (September 1978): 631–49; Porter, *The Rise of Big Business, 1860–1920*.

¹⁵ On the growth of nationwide industrial corporations, see Chandler, *The Visible Hand: The Managerial Revolution in American Business*; Lamoreaux, *The Great Merger Movement in American Business, 1895–1904*; Dunlavy, “How Did American Business Get so Big?”

¹⁶ See Lamoreaux, *The Great Merger Movement in American Business, 1895–1904*; James C. Lang, “The Legislative History of the Federal Trade Commission Act,” *Washburn Law Journal* 13 (1974): 6–25.

anxiety over the rise of massive, nationwide corporations and by a strong sense among American policymakers of confronting unprecedented economic change. In examining Congress's responses to this change, Part II follows several prior studies of the ambitious regulatory efforts of the period: In addition to the canonical historiography of the Progressive Era itself,¹⁷ historians such as Gabriel Kolko, Martin Sklar, and Melvin Urofsky have specifically addressed progressive efforts to federalize corporate law.¹⁸ My research moves beyond these studies in two important respects, however. First, I pay greater attention to the legal details of the period's specific reform proposals. Second, by comparing these proposals with more recent developments in conceptions of the corporation, I more clearly reveal that federalization efforts did *not* represent a unified political movement, but rather embodied divergent conceptions of corporations' role in society. Melvin Urofsky, for example, who has authored the most detailed study on the federal incorporation movement, is unable to satisfactorily explain *why* the movement failed, arguing only that "a consensus on broad goals could not be translated into agreement on specific details."¹⁹ Instead, I show that federal incorporation proposals were in fact characterized by fundamental *dissensus* and that different reformers often advocated irreconcilable policy goals. This

¹⁷ The classic work on the Progressive Era (as well as the Populist movement and the early New Deal) remains Richard Hofstadter, *The Age of Reform* (New York: Vintage, 1960). Other important works include Hays, *The Response to Industrialism, 1885–1914*; Michael McGerr, *A Fierce Discontent: The Rise and Fall of the Progressive Movement in America, 1870–1920* (New York: Free Press, 2003); Daniel T. Rodgers, *Atlantic Crossings: Social Politics in a Progressive Age* (Cambridge: Harvard University Press, 1998); Robert H. Wiebe, *Businessmen and Reform: A Study of the Progressive Movement* (Cambridge: Harvard University Press, 1962); Robert H. Wiebe, *The Search for Order, 1877–1920* (Hill and Wang, 1966). For historical accounts of the business changes of the period, see Chandler, *The Visible Hand: The Managerial Revolution in American Business*; Lamoreaux, *The Great Merger Movement in American Business, 1895–1904*; Elizabeth Kimball MacLean, "Joseph E. Davies: The Wisconsin Idea and the Origins of the Federal Trade Commission," *The Journal of the Gilded Age and Progressive Era* 6, no. 3 (2007): 248–84.

¹⁸ Gabriel Kolko, *The Triumph of Conservatism* (New York: The Free Press, 1963), 113–38, 159–89; Martin J. Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916* (Cambridge: Cambridge University Press, 1988), 238–83; Melvin I. Urofsky, "Proposed Federal Incorporation in the Progressive Era," *The American Journal of Legal History* 26, no. 2 (1982): 160–83. See also Theodore H. Davis, "Corporate Privileges for the Public Benefit: The Progressive Federal Incorporation Movement and the Modern Regulatory State," *Virginia Law Review* 77, no. 3 (1991): 603–30.

¹⁹ Urofsky, "Proposed Federal Incorporation in the Progressive Era."

political dissensus better explains the federalization movement's ultimate failure—and the resulting entrenchment of the state law system in the absence of federal legislation.

Specifically, by drawing on the historical record of federal chartering proposals, I present three central arguments: First, although federal chartering as an abstract concept enjoyed broad political support, it was undermined by a fundamental conflict between “restrictive” and “permissive” corporate ideologies.²⁰ As discussed herein, reformers holding a “restrictive” ideology were opposed to economic concentration and believed the government should strictly limit the size and power of corporations. These reformers sought passage of federal legislation to preempt *lenient* state corporation laws. On the other hand, reformers holding a “permissive” ideology viewed large corporations as natural and inevitable and saw legislative attempts to constrain their growth as harmful to economic progress. These reformers sought passage of federal legislation to preempt *constrictive* state corporation laws. Second, notwithstanding this core ideological conflict, many reformers on both sides of the debate believed corporate regulation should protect the public interest and were therefore at most only secondarily concerned with the economic interests of shareholders. At a time in history in which public shareholding remained far less prevalent than today, the conflict of interest between management and shareholders was less significant of a policy issue. Finally, it was the conflicted nature of the political support for federal chartering legislation, not any specific policy preference for maintaining corporate law federalism, that ultimately ensured the continued existence of the state-based corporate law regime. In other words, the subnational structure of American corporate law was a default outcome, not an active choice.

Together, these three arguments instantiate the broader thesis of this dissertation—that institutional features of the American economy are often shaped *not* by popular will, technocratic expertise, or even special interest preferences, but simply by the contingent nature of legislative politics. Whether or not Delaware law is economically superior to its alternatives (a question this Part II does not

²⁰ In this context, my use of the term “permissive” should not be confused with “laissez faire” or “free market.” Pro-corporate reformers held a “permissive” ideology in that they opposed legal obstacles to corporate consolidation. As discussed below, this view of corporations could entail substantial government regulation.

address), its prominence was hardly dictated by the genius of American federalism. Had debates over federal chartering occurred under different political circumstances, in which either side of the political debate were more consistent or better organized, the evolution of corporate law would likely have unfolded differently.

Before proceeding, a note on terminology: In order to capture the full range of proposals to impose federal standards on corporate law, this Part II employs a catholic definition of federal “chartering” proposals. Specifically, I include within the term “chartering” any legislative proposal to (1) require or permit business enterprises to incorporate under federal law, (2) require or permit business enterprises to obtain federal corporate licenses, or (3) impose comprehensive federal standards on the governance of state corporations. Although distinct in form, these various legislative proposals were often similar in substance, as each sought to replace—in whole or in part—the wide variety of state laws with federal standardization. A mandatory corporate licensing system requiring compliance with federal standards, for example, is little different from imposing those standards directly through federal incorporation. Therefore, Part II includes each type of proposal as part of a single federal chartering movement.

Following this introductory chapter, the remainder of Part II proceeds as follows. Chapter 6 discusses the rise of corporate chartermongering and early calls for federal reform. This chapter explores the diversity of perspectives that characterized early federalization proposals. Chapter 7 examines the major federalization proposals debated during the Theodore Roosevelt administration. This was the moment at which the political conflict between the restrictive and permissive attitudes was most stark. Chapter 8 discusses the continued failure of federalization proposals under the Taft administration, and the effective end of the chartering movement following the election of Woodrow Wilson. Chapter 9 concludes, assessing the relevance of federalization efforts to current U.S. corporate law.

CHAPTER 6: CORPORATE CHARTERMONGERING AND CALLS FOR FEDERAL REFORM

Since the earliest history of the United States, the formation of corporations has been the subject of state law. At the Constitutional Convention, James Madison had proposed empowering Congress “to grant charters of incorporation where the interest of the U.S. might require & the legislative provisions of individual States may be incompetent.” Madison’s proposal was rejected, however, on the grounds that federally chartered corporations might lead to national monopolies.²¹ Thus, although the federal government has (amidst great controversy) chartered specific corporations under the Necessary and Proper Clause, including the first and second Banks of the United States, the first transcontinental railroads, and the Tennessee Valley Authority, general incorporation of private businesses has remained limited to the states. To this day, nearly all American corporations are chartered under state law, a distinctive feature of the American constitutional system.

During the nineteenth century, individual states facilitated incorporation to promote local economic development.²² The economic and technological advances of the post-Civil War decades allowed locally incorporated businesses to grow increasingly national in scope. As markets expanded and geographical distances shrank, the states encountered constitutional obstacles to regulating “foreign” or out-of-state corporations.²³ Not only did the Commerce Clause limit state interference with interstate commerce, but, under established case law, a corporation’s internal affairs were governed by its state of incorporation, regardless of the geographical location of its business, assets, or operational headquarters.²⁴ Since corporate promoters were perfectly willing to incorporate outside their home jurisdictions, and

²¹ “Madison Debates, September 14, 1787,” *The Avalon Project*, accessed May 7, 2017, http://avalon.law.yale.edu/18th_century/debates_914.asp#16.

²² Cadman, *The Corporation in New Jersey*; Handlin and Handlin, “Origins of the American Business Corporation”; Hurst, *The Legitimacy of the Business Corporation in the Law of the United States, 1780–1970*; William C. Kessler, “Incorporation in New England: A Statistical Study, 1800–1875,” *The Journal of Economic History* 8, no. 1 (1948): 43–62; Seavoy, *The Origins of the American Business Corporation, 1784–1855*.

²³ See, e.g., *Norfolk & W.R. Co. v. Pennsylvania*, 125 U.S. 114 (1890), invalidating a Pennsylvania tax on foreign corporations.

²⁴ For analysis of the historical origins of the corporate internal affairs doctrine, see Frederick Tung, “Before Competition: Origins of the Internal Affairs Doctrine,” *Journal of Corporation Law* 32, no. 1 (fall 2006): 33–101.

since states collected fees and taxes for the granting of corporate charters, the circumstances emerged for states to compete to attract out-of-state incorporations.²⁵ New Jersey was the first and most successful of these states, attracting the majority of the largest combinations formed during the Great Merger Movement.²⁶ At the turn of the century, certain states—such as Delaware, Maine, and West Virginia—attempted to compete with New Jersey by liberalizing their corporation laws.²⁷ But other states—such as Ohio, Illinois, and Massachusetts—continued to maintain their traditional restrictions on corporations’ size and business activities.²⁸ These restrictions sometimes had significant consequences for in-state corporations. In one of the most notable examples, Standard Oil Company was sued—and nearly dissolved—by the Ohio attorney general for corporate actions considered “ultra vires” under Ohio’s corporation law. The lawsuit charged that by participating in an anticompetitive trust, Standard Oil Company had acted outside the authority of its Ohio corporate charter. Standard Oil Company subsequently reorganized under the holding company Standard Oil Co. of New Jersey, availing itself of the more permissive New Jersey corporation act. As discussed below, this diversity in state law contributed to the conflicted nature of the federal chartering movement: Simply put, certain proponents of federal legislation were opposed to the restrictive laws of states such as Ohio, while other proponents of federal legislation were opposed to the permissive laws of states such as New Jersey.

²⁵ “Promoters” was the historical term for the owners, managers, and financial intermediaries who organized incorporations, particularly large industrial combinations.

²⁶ For a listing of all “trusts” existing as of 1904, the majority of which were incorporated in New Jersey, see John Moody, *The Truth About the Trusts: A Description and Analysis of the American Trust Movement* (New York: Moody Publishing Company, 1904), 453–75. For detailed figures on incorporations in New Jersey, see also Christopher Grandy, “New Jersey Corporate Chartermongering, 1875–1929,” *The Journal of Economic History* 49, no. 3 (September 1989): 678–85; Charles M. Yablon, “The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910,” *Journal of Corporation Law* 32, no. 2 (winter 2007): 377–80. For background on New Jersey corporate law, see Cadman, *The Corporation in New Jersey*.

²⁷ Yablon, “The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910,” 359–67. In this context, “liberal” means minimal intervention in private ordering.

²⁸ For contemporaneous discussions of relatively restrictive state laws, see Industrial Commission, *Preliminary Report on Trusts and Industrial Combinations, Together with Testimony, Review of Evidence, Charts Showing Effects on Prices, and Topical Digest* (Washington: Government Printing Office, 1900), 297–330, 1035, 1133–34.

A. New Jersey Chartermongering

New Jersey was the initial winner of the “race” to attract incorporations. In 1846, New Jersey enacted a general incorporation law intended to facilitate capital formation. Although not the first of its kind, this law provided corporations with greater organizational freedom than the existing general incorporation laws of many larger industrial states.²⁹ Although New Jersey corporations could also be formed by the traditional practice of special legislative act, revisions to the law in 1875 streamlined general incorporation while eliminating the special legislative option.³⁰ In addition to its liberal corporation statute, New Jersey also offered incorporators low taxes and a well-regarded conservative judiciary.³¹ For these reasons, New Jersey had become an attractive destination for corporations even before the 1880s.³² Building on its existing reputation as a corporate-friendly jurisdiction, New Jersey emerged as the earliest state to actively promote its incorporation statute to out-of-state capital.³³

Legislative reforms in the late 1880s and 1890s solidified New Jersey’s position as the jurisdiction of choice for large-scale industrial corporations. The most significant of these reforms were devised by James B. Dill, a talented and ambitious Wall Street attorney who lived across the river in New Jersey. In 1890, Dill suggested to Leon Abbett, the Democratic governor of New Jersey (and a former

²⁹ See Edward Keasbey, “New Jersey and the Trusts,” in *Chicago Conference on Trusts: Speeches, Debates, Resolutions, Lists of the Delegates, Committees, Etc.* (Chicago: Franklin H. Head, 1899), 383–94.

³⁰ *Ibid.*, 386. Historically, incorporation by a specific legislative act had been the typical means of forming a corporation, but this practice fell into public disfavor by the middle of the nineteenth century. During the Jacksonian era, many Americans viewed special incorporation as a tool of privilege and monopoly, and nearly every state eliminated the practice by the latter decades of the century. See Gregory A. Mark, “The Role of the State in Corporate Law Formation,” in *International Corporate Law Annual*, vol. 1 (Oxford: Hart Publishing, 2000), 5–9.

³¹ New Jersey’s corporate franchise tax was levied at a maximum rate of 0.1% of paid-in capital, with decreasing marginal rates for increasingly greater capitalizations. For large corporations, this resulted in a lower effective tax rate than in (for example) New York. For contemporaneous discussion of New Jersey’s corporation taxes, see *Hearings Before the Industrial Commission on the Subject of Trusts and Industrial Combinations* (Washington: Government Printing Office, 1899), 21, 975, 1077. According to the journalist Lincoln Steffens, the New Jersey judiciary was highly regarded by Wall Street lawyers. Lincoln Steffens, “New Jersey: A Traitor State,” *McClure’s Magazine*, April 1905, 658.

³² See Yablon, “The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910,” 332–36.

³³ *Ibid.*, 328.

corporate attorney himself), that New Jersey further revise its corporation law to provide even greater benefits to corporate promoters.³⁴ At the time, Abbett was in search of additional tax revenue to balance New Jersey's budget, while Dill was seeking a favorable mechanism for organizing his clients' businesses—the two men quickly agreed on a mutually beneficial reform program.³⁵ Pursuant to Dill's plan, which Abbett recommended to the state legislature, New Jersey revised its corporation act in 1893 so as to clearly authorize New Jersey corporations to acquire the stock and/or assets of out-of-state firms.³⁶ Three years later, in 1896, the entire act was fully recodified by a revision commission chaired by Dill.³⁷ This recodification, which significantly streamlined the act's requirements, is widely considered the first modern “enabling” corporation statute, as opposed to the restrictive statutes that had constituted the historical norm.³⁸ The new statute played an important role in facilitating corporate mergers, as reflected by New Jersey's leading position in the growing national merger movement: Between 1895 and 1904, approximately 50% of all industrial consolidations were incorporated in New Jersey;³⁹ between 1896 and 1901, the state's annual incorporations increased nearly 200%;⁴⁰ and by 1904,

³⁴ Urofsky, “Proposed Federal Incorporation in the Progressive Era,” 163.

³⁵ See “The Lawyer Who Earned Title of Being Father of the Trusts,” *Wall Street Journal*, December 28, 1907. The facts suggest that Abbett and other New Jersey politicians were also able to reap personal financial benefits from Dill's reform plan. Together with Dill, Abbett was a stockholder in the Corporation Trust Company of New Jersey, a company founded by Dill to facilitate New Jersey incorporations. Urofsky, “Proposed Federal Incorporation in the Progressive Era,” 163.

³⁶ Chapter CLXXI, *N.J. Laws* 1893 (1893) 301 (providing for general intercorporate stockholding). Although scholars as esteemed as Alfred Chandler have stated that New Jersey's first “holding company” laws were passed in 1888 and 1889, these earlier laws were actually of only narrow application. See Chapter CCLXIX, *N.J. Laws* 1888 (1888) 385 (providing, redundantly, that corporations “authorized by law to own and hold shares of stock and bonds of corporations” could hold and dispose of the same); Chapter CCXCV, *N.J. Laws* 1888 (1888) 445 (providing for intercorporate stockholding by certain real estate and transportation corporations). A law passed in 1889 was broader, but seemed limited to mining and manufacturing companies. Chapter CCLXV, *N.J. Laws* 1889 (1889) 412. Additional industry-specific laws were passed in 1891. The 1893 law was the first unambiguous authorization to purchase and hold the stock of any corporation, in any industry, whether or not formed in New Jersey.

³⁷ Urofsky, “Proposed Federal Incorporation in the Progressive Era,” 163–64.

³⁸ See Yablon, “The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910,” 349–53. The new statute was enacted as *An Act concerning corporations*, *N.J. Laws* 1896 (1896) 277.

³⁹ Ralph L. Nelson, *Merger Movements in American History, 1895–1956* (Princeton: Princeton University Press, 1959), 67.

all seven of John Moody's "greater industrial trusts" had incorporated in New Jersey.⁴¹ This activity had a major effect on New Hersey's corporate tax revenue, which more than tripled from less than one million dollars in 1895 to nearly three million dollars in 1905.⁴² By any measure, Dill's plan was a remarkable success.

As New Jersey attracted an increasing share of the nation's largest corporations, other states took notice. Hoping to capture a portion of New Jersey's rising incorporation revenues, states including Maine, South Dakota, and West Virginia passed corporation laws even less restrictive than New Jersey's.⁴³ Delaware adopted a corporation act nearly identical to the New Jersey statute, attempting to compete for corporations by charging lower fees and franchise taxes.⁴⁴ Even highly industrialized states such as New York and Massachusetts were forced to revise their corporation laws to avoid losing corporations to New Jersey.⁴⁵ With several states actively vying to attract and retain corporations, this period represented the historical peak of state corporate law competition.

This state competition alarmed many contemporary observers. At the turn of the century, antitrust sentiment was strong, and the liberalizing reforms of individual states were seen as enabling

⁴⁰ Urofsky, "Proposed Federal Incorporation in the Progressive Era," 164.

⁴¹ Moody, *The Truth About the Trusts: A Description and Analysis of the American Trust Movement*, 453. These firms were Amalgamated Copper Company, American Smelting and Refining Co., American Sugar Refining Co., Consolidated Tobacco Co., International Merchant Marine Company, Standard Oil Company, and United States Steel Company.

⁴² See Grandy, "New Jersey Corporate Chartermongering, 1875–1929," 682.

⁴³ See Yablon, "The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910," 358–67.

⁴⁴ Grandy, "New Jersey Corporate Chartermongering, 1875–1929," 685. Although the two acts were very similar (Delaware lawyers expressly marketed their act as based upon the New Jersey act), Delaware law was more permissive with respect to the sale of stock, the location of corporate meetings, and certain other specific provisions. See Civic Federation of Chicago, *Chicago Conference on Trusts: Speeches, Debates, Resolutions, Lists of the Delegates, Committees, Etc.* (Chicago: Franklin H. Head, 1899) (hereinafter *Chicago Conference on Trusts*) 503–5 (comments of William Jennings Bryan). Indeed, when New Jersey introduced strict antitrust provisions to its corporation law in 1913, Delaware quickly replaced New Jersey as the preferred incorporation jurisdiction. Grandy, "New Jersey Corporate Chartermongering, 1875–1929," 685–91.

⁴⁵ See Yablon, "The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910," 358–67, 370–71.

monopolistic trusts. At the Congressional level, the Sherman Act of 1890 prohibited efforts to monopolize,⁴⁶ but many observers feared permissive state laws were nevertheless encouraging monopolistic corporations. A famous example of this perspective was the muckraking journalism of Lincoln Steffens, whose 1905 *McClure's Magazine* article, “New Jersey: A Traitor State,” accused the New Jersey legislature of betraying the American public in exchange for local tax revenues.⁴⁷ As Steffens saw it, New Jersey was facilitating national monopolies in order to maximize tax collections—a specific example of a broader phenomenon of corrupt, parochial-minded state government that Steffens sought to expose. Fearing the economic and political effects of permissive state corporation laws, many Americans began to call for stricter federal standards.

Given the historical context, this political agitation is easy to understand. During the final years of the nineteenth century, Americans experienced considerable anxiety regarding the economic changes occurring around them. The traditional economic model of small, independent businesses—central to the economic ideology of nineteenth-century America—was rapidly ceding to a new reality of large, integrated corporations, many of which had risen to dominate their industries in the span of only a few short years. Public concern over the power of these corporations led to state and federal antitrust legislation as well as to calls for the federal government to assume direct control over corporations themselves. In this respect, federal chartering proposals and the larger antitrust movement were closely interconnected. Although today the word “antitrust” connotes anti-monopoly policy—suggesting “trusts” were necessarily economic monopolies—the popular meaning of both of these terms was significantly broader during the Progressive Era.⁴⁸ In both the popular and political vernacular of the time, a “trust”

⁴⁶ *Sherman Act, U.S. Statutes at Large* 26 (1890): 209.

⁴⁷ Steffens, “New Jersey: A Traitor State.”

⁴⁸ The term “trust” was originally derived from the practice of organizing large businesses as actual legal trusts. Hans Thorelli, *The Federal Antitrust Policy: Origination of an American Tradition* (Baltimore: Johns Hopkins Press, 1955), 76–80. This practice was discouraged by the passage of the Sherman Act and obviated by the liberalization of state corporate law, after which most trusts reorganized as corporations. The general public continued to refer to all large businesses as trusts, however.

was simply any large corporation, while “corporation” could refer to any large trust. The “trust” issue in American politics was therefore synonymous with the “corporation” issue; both referred to any business that operated on a national scale. As stated by James B. Dill in 1902, the popular (if legally inaccurate) understanding of the term “trust” was simply “a corporate aggregation engaged in business other than merely local, and not confined in its operations and scope to the state of its creation.”⁴⁹

At the federal level, Congress had responded to growing antitrust sentiment with the Sherman Act of 1890, which prohibited (1) any “combination in the form of trust or otherwise” in restraint of trade or commerce,⁵⁰ and (2) efforts to “monopolize, or attempt to monopolize” any area of trade or commerce.⁵¹ Minimal enforcement of the statute’s prohibitions led to equally minimal results, however.⁵² The major effect of the Sherman Act (together with the liberalization of New Jersey law) was simply to encourage industrial trusts to reorganize as corporations. In addition, in the *U.S. v. E. C. Knight Co.* decision of 1895, the Supreme Court interpreted the Sherman Act as *not* prohibiting a corporate acquisition resulting in a 98% monopoly because the monopoly in question was in the manufacture of a good, rather than in “interstate commerce.”⁵³ This controversial holding significantly limited the ability of the Sherman Act to prevent the industrial monopolies that arose during the Great Merger Movement.⁵⁴

As concern over the trust issue continued to mount and as state laws appeared increasingly ineffective, many public figures began to advocate more ambitious policy alternatives. In the late 1890s, these calls led to serious discussions among public officials and private citizens of the desirability and

⁴⁹ James B. Dill, “National Incorporation Laws for Trusts,” *Yale Law Journal* 11, no. 6 (1902): 273–95.

⁵⁰ *Sherman Act*, § 1.

⁵¹ *Sherman Act*, § 2.

⁵² While outright cartelization declined, industrial consolidation significantly *increased* in the decade following passage of the Sherman Act. See Thorelli, *The Federal Antitrust Policy*, 285–308.

⁵³ *U.S. v. E. C. Knight Co.*, 156 U.S. 1 (1895).

⁵⁴ For discussion of the limitations on antitrust enforcement imposed by the Supreme Court, see Lamoreaux, *The Great Merger Movement in American Business, 1895–1904*, 163–66. See also McCurdy, “American Law and the Marketing Structure of the Large Corporation, 1875–1890,” 163–66.

constitutionality of a federal corporate chartering act. The two most prominent venues of this emerging debate over federal chartering—each highlighting a different perspective on the fundamental goals of corporate regulation—were the Chicago Conference on Trusts, held in 1899, and the proceedings of the U.S. Industrial Commission, from 1898 to 1902.

B. The Chicago Conference on Trusts

In the context of the Great Merger Movement and amidst increasing antitrust concern, the Civic Federation of Chicago, a major business reform organization, convened the “Chicago Conference on Trusts” late in the summer of 1899.⁵⁵ The conference assembled a broad range of figures from politics, government, academics, journalism, labor, the legal profession and elsewhere to discuss potential legal and political responses to the rise of national trusts. The conference’s stated objective was not to attack the trusts, but merely to facilitate the exchange of ideas. As stated by Franklin Head, president of the Civic Federation, “it is not a trust or an anti-trust conference, but a conference in search of truth and light.”⁵⁶ In this spirit, an impressive variety of ideological perspectives was represented at the conference, from socialists to laissez-faire conservatives and everything in between. National political and intellectual figures, including William Jennings Bryan, Bourke Cockran, Samuel Gompers, John Bates Clark, Jeremiah Jenks, and even James B. Dill himself, each presented their views on the nature of the problem and how best to address it. Notwithstanding this diversity, federal incorporation or licensing of corporations emerged as a common policy proposal. The conference was thus the first occasion for sustained discussion of federal chartering, laying the groundwork for subsequent developments in the legislative and executive branches of the federal government.

The general sense of the conferees was that the existing system of state corporate law was seriously inadequate. Regardless of their specific perspectives on the dangers or benefits of large corporations, most conferees agreed that some form of federal regulation was necessary. What animated

⁵⁵ See Dunlavy, “How Did American Business Get so Big?”

⁵⁶ *Chicago Conference on Trusts*, 7.

this feeling, as a general matter, was *not* concern for corporate investors, whose economic interests were significantly closer to those of corporate management than they are today. In 1899—still the early days of dispersed public shareholding—the separation of ownership and control was a less prominent feature of American corporations.⁵⁷ While participants at the conference had various reasons for supporting federal legislation, a common concern was protecting the public from concentrated economic power. Indeed, 1899 was the year of peak activity during the Great Merger Movement, with the formation of 63 industrial consolidations.⁵⁸ Given the liberalization of state corporate law and the rapid growth of national combinations, many conferees feared that individual state governments had abandoned their responsibility to the public interest.

This fear reflected an understanding of corporations much different from that of modern legal scholarship. Rather than viewing the corporate form as an enabling device for private enterprise—the dominant academic view of corporations today—many at the time continued to view corporations as quasi-public instruments of the state, whose legal privileges were fundamentally predicated on provision of a public benefit. According to several conferees, corporations had become dangerous because they were no longer limited to public purposes: Authorized by states such as New Jersey to engage in *any* lawful business, corporations’ statutory legal advantages (limited liability, continual existence, etc.) were allowing them to dominate the American economy.⁵⁹ For example, conference participant Henry White, representing the United Garment Workers of America, believed national incorporation “suggests a way of uniformly regulating corporations, by limiting their operations to the definite purpose for which they are chartered, instead of the unsatisfactory state regulation which has led to such grotesque results.”⁶⁰ John

⁵⁷ Dunlavy, “Social Conceptions of the Corporation,” 1351–63. Although the Great Merger Movement represented the beginning of public shareholding of industrial corporations, truly widespread public shareholding would not emerge until the 1920s. See Baskin and Miranti, *A History of Corporate Finance*, 193–97.

⁵⁸ Lamoreaux, *The Great Merger Movement in American Business, 1895–1904*, 2.

⁵⁹ See, e.g., the comments of Dudley Wooten, Henry White, and John B. Conner, *Chicago Conference on Trusts*, 42–53, 323–29, 340–43.

⁶⁰ Comments of Henry White, *Chicago Conference on Trusts*, 323.

B. Connor, chief of the Indiana Bureau of Statistics, called for a return to legal conditions in which “the idea and principle of advantage to the public were both the purposes of the law authorizing corporations and their limitations.”⁶¹ Finally, Texas state representative Dudley Wooten, criticizing the growth of corporations beyond their traditional statutory limits, proposed “allowing no company to be chartered for any other than a quasi-public purpose.”⁶² This conception of corporations as instruments of public policy—and the implicit rejection of private profit as the sole legitimate public policy goal—would significantly influence the political debate over the proper purposes of federal chartering.

The “public policy” conception of corporations informed the chartering proposals of the conference’s most celebrated attendee, the once and future presidential candidate William Jennings Bryan. While many speakers at the Chicago conference made general calls for federal reform, Bryan presented a specific framework for a federal corporate licensing system. Speaking before a packed, enthusiastic audience the morning of September 16, Bryan began by outlining the failings of the existing system of state corporate law.⁶³ Citing the example of Delaware, which was eagerly attempting to compete with New Jersey, Bryan claimed that irresponsible state governments were fostering dangerous economic concentration. In Bryan’s dramatic rhetoric, states were sacrificing the interests of “God-made man” to unnatural corporations, “the man-made man.”⁶⁴

To emphasize his point, Bryan read his audience an advertisement from a Delaware incorporation service extolling the lack of legal restrictions in Delaware’s general corporation act.⁶⁵ Bryan argued that such brazen appeals to trust promoters were clear evidence that state governments were disregarding the public interest. According to Bryan, since Delaware and other chartermongering states empowered

⁶¹ Comments of John B. Connor, *Chicago Conference on Trusts*, 340.

⁶² Comments of Dudley Wooten, *Chicago Conference on Trusts*, 51.

⁶³ Bryan was an extremely popular orator, a fact remarked upon on by other speakers at the conference. The notes of the conference describe the enthusiasm with which Bryan’s speech was received. See, e.g., *Chicago Conference on Trusts*, 496, 514.

⁶⁴ Comments of William Jennings Bryan, *Chicago Conference on Trusts*, 510–11.

⁶⁵ *Ibid.*, 503–05.

corporations in exchange for tax revenue, “protection of the public from the greed and avarice of great aggregations of wealth” required *national* legislation.⁶⁶ This view was closely intertwined with a “public” conception of corporations—Bryan believed “that a corporation is created by law, that it is created for the public good and that it should never be permitted to do a thing that is injurious to the public.”⁶⁷

In line with this conception, Bryan proposed enactment of federal legislation requiring all corporations in interstate commerce to apply for and maintain a federal license.⁶⁸ In order to control the “man-made man,” this license would be predicated on three requirements: (1) licensees would be prohibited from having any “watered” stock in their capital structure;⁶⁹ (2) licensees would be prohibited from having a “monopoly” in any line of business; and (3) licensees would be required to disclose the details of their business operations.⁷⁰ Each of these conditions was intended to protect the public, rather than investors—Bryan spoke in general terms of the dangers of “corporations” and made no distinction between investors and management. To modern readers, requiring financial disclosure and prohibiting the sale of overvalued stock may seem like investor protection measures, but this was not Bryan’s goal. In the view of Bryan and many of his contemporaries, these measures would actually prevent investors from profiting at the public expense.

This becomes clear in the controversy over “watered stock.” This term referred to the practice of selling stock at an aggregate price exceeding a corporation’s book value. The central concern over watered stock was *not* that investors were being defrauded, as one might assume today. Rather, since dividend payments were often set at a fixed percentage of nominal par value, inflated capital values increased pressure to maximize profits, in order to provide the cash necessary to pay higher fixed

⁶⁶ Ibid., 508.

⁶⁷ Ibid.

⁶⁸ This interstate commerce requirement was significant—few at the time believed Congress had the power to regulate purely intrastate business.

⁶⁹ The sale of “watered” stock—stock issued in excess of the value of a corporation’s assets—was one of the most controversial corporate practices of the period.

⁷⁰ Comments of William Jennings Bryan, *Chicago Conference on Trusts*, at 506–08.

dividend obligations.⁷¹ This pressure to pay dividends on inflated capital, according to many critics, was the reason for (allegedly) monopolistic prices.⁷² Although there was also a worry that outside shareholders might be deceived by inflated stock values, the greater concern was that elevated dividends, though their effect on prices, were effectively a wealth transfer from consumers to investors. Again, this historical understanding of corporate finance is significantly different from the modern view, which is primarily concerned with corporate management *failing* to maximize investor returns. Indeed, there is even an ironic parallel between this early conception of dividend obligations and the claim of modern financial economists that debt service obligations can discipline management.⁷³

The requirement of corporate disclosure, referred to by Bryan as “publicity,” was also conceived as a means of protecting the public welfare. Bryan was not alone in calling for disclosure—“publicity” was a major goal of reformers throughout the Progressive Era.⁷⁴ Unlike the modern conception of corporate disclosure, however, publicity was not viewed as a form of investor protection, but rather as a mechanism for preventing monopolistic profits. Bryan stated confidently that publicity would benefit the consuming public and asserted that corporate publicity would represent a “long step toward the destruction of monopoly.”⁷⁵ The basis for this prediction was not entirely clear, but Bryan’s rhetoric implied that once the American public learned the true extent of corporate profits, it would no longer

⁷¹ The payment of dividends on common stock was not a legal obligation. However, given the fact that early stock investors had little information regarding publically-traded corporations (a situation referred to in economics as “information asymmetry”), steady payment of fixed dividends was an important signal to investors of corporate financial health. See Baskin and Miranti, *A History of Corporate Finance*, 56.

⁷² See, e.g., comments of Cyrus Luce, William Jennings Bryan, and T. B. Walker, *Chicago Conference on Trusts*, 231–32, 506–08, 539–41.

⁷³ The theory that debt obligations can discipline management was first advanced by Michael C. Jensen and William H. Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,” *Journal of Financial Economics* 3, no. 4 (1976): 305–60. Although not uncontroversial, this theory remains influential in financial economics.

⁷⁴ For extended discussion of publicity-oriented state and federal railroad regulation during the Progressive Era, see Thomas K. McCraw, *Prophets of Regulation: Charles Francis Adams, Louis D. Brandeis, James M. Landis, Alfred E. Kahn* (Cambridge: Belknap Press, 1984), 1–79.

⁷⁵ Comments of William Jennings Bryan, *Chicago Conference on Trusts*, at 508.

tolerate excessive prices.⁷⁶ Contemporaries of Bryan were rarely clearer in justifying publicity's importance, though they often presented it as a panacea for a host of economic issues. As a general matter, restrictive reformers were often vague in explaining the benefits of their proposals, which often entailed unacknowledged conflicts between the economic interests of consumers and investors.

Given his influence within the Democratic party and his broader prominence in American politics, Bryan serves as an important example of the restrictive attitude toward corporations. Many other participants at the Chicago conference also expressed similar views. To name but a few: Representative Francis G. Newlands (D-NV), who would subsequently introduce several federal chartering bills, argued that only the federal government could control corporate power and that state regulation of national corporations was "impossible."⁷⁷ Henry C. Adams—professor of political economy at Cornell and statistician for the Interstate Commerce Commission—strongly criticized state corporation laws for failing to protect the public welfare.⁷⁸ According to Adams, "the theory of law which now prevails respecting industrial corporations should be so changed that the public element is again brought into prominence."⁷⁹ A. E. Rogers—professor of constitutional law at the University of Maine—issued similar criticisms of state corporate law and called for the imposition of federal standards.⁸⁰ Anticipating the "race to the bottom" literature of the twentieth century, Rogers argued that certain states were "ready to prostitute their sovereign power for sake of revenue," sacrificing the public welfare for "short-sighted selfishness."⁸¹

⁷⁶ Ibid. A more economically plausible theory is that disclosure of high profits would attract new competition, thus lowering prices. This theory (expressed in somewhat inchoate language) was occasionally advanced by other Progressive Era reformers.

⁷⁷ Comments of Francis Newlands, *Chicago Conference on Trusts*, 305–09.

⁷⁸ Comments of Henry C. Adams, *Chicago Conference on Trusts*, 35–42.

⁷⁹ Ibid., 40.

⁸⁰ Comments of A. E. Rogers, *Chicago Conference on Trusts*, 409–22.

⁸¹ Ibid., 421.

In their preference for federal over state legislation, these speakers were more concerned with protecting the public than with protecting investors. In the words of Indiana attorney R. S. Taylor, “the interests of investors in the shares of [trusts] is a small consideration beside the interest of the general mass of people whose food, clothing, and transportation are controlled by them.”⁸² As William Howe, the chairman of the conference, remarked upon the closing of discussions, nearly every participant—whatever their political views—agreed on the importance of national standards. Howe summarized the conference as having established the necessity of (1) strong, uniform antitrust legislation, (2) centralized control over the formation of corporations, (3) stricter regulation of the sale of stock and bonds, and (4) a uniform system of corporate publicity.⁸³ According to Howe, the message of the conference was that corporations should be controlled “as we control steam and electricity, which are also dangerous if not carefully managed, but of wonderful usefulness if rightly harnessed to the car of progress.”⁸⁴

The Chicago Conference on Trusts was an important event in the national discussion of the corporation issue, but it was only one of many sources of federal chartering proposals. Moreover, despite the efforts of the conference’s organizers to achieve political and ideological diversity, the conference included few representatives of large corporations themselves—one of the most important constituencies in debates over corporate reform. Of 94 invited speakers, only 10 represented the business community, and none of them held management positions in dominant industrial corporations.⁸⁵ Partly for this reason, the prevailing theme of the Chicago conference was constraining the power of corporations, and the balance of speakers was decidedly weighted toward the restrictive ideology.

⁸² Comments of R. S. Taylor, *Chicago Conference on Trusts*, 72.

⁸³ Comments of William Howe, *Chicago Conference on Trusts*, 624–25. Note, however, that in light of the Chicago conference’s ecumenical philosophy, the committee on resolutions declined to adopt any official resolutions. *Ibid.*, 625–26.

⁸⁴ *Ibid.*

⁸⁵ Three of the speakers were railroad company executives, and one was a founder of Studebaker Brothers Manufacturing Company. *Chicago Conference on Trusts*.

Overlapping with and continuing beyond the Chicago conference, the investigative hearings of the U.S. Industrial Commission, which spanned the years 1898–1902, fostered a different outlook on federal chartering. These hearings featured much greater involvement from the business community, including executives of several of the nation’s largest firms. Surprisingly, many of these businessmen⁸⁶ also supported federal chartering legislation, though for much different reasons than the restrictive reformers so vocal at the Chicago conference.

C. The Industrial Commission

Like the Chicago Conference on Trusts, the U.S. Industrial Commission was a response to the dramatic economic changes of the era. Unlike the Chicago conference, however, which had no formal connection to the federal government, the Industrial Commission came into being through Congressional legislation.⁸⁷ Its mandate was also broader, encompassing not just trusts, but a wide range of economic issues facing the United States at the turn of the century. The commission was formed in 1898 to “investigate questions pertaining to immigration, to labor, to agriculture, to manufacturing, and to business,” and to recommend appropriate legislation.⁸⁸ It was composed of a somewhat ungainly roster of nine presidential appointees (drawn primarily from business and labor), five sitting U.S. senators, and five sitting U.S. representatives.⁸⁹ Drawing inspiration from the British Royal Commissions of the 1890s, the Industrial Commission conducted investigations, held numerous hearings, and ultimately issued 19 volumes of official reports.⁹⁰ The commission’s work on the specific subject of “trusts and industrial

⁸⁶ Without any exception that I have discovered, the businesspeople involved in these debates were men.

⁸⁷ *An act authorizing the appointment of a nonpartisan commission to collate information and to consider and recommend legislation to meet the problems presented by labor, agriculture, and capital, U.S. Statutes at Large 30 (1898): 476.*

⁸⁸ Simon North, “The Industrial Commission,” *North American Review* 168 (1899): 709.

⁸⁹ *Ibid.*, 708.

⁹⁰ *Ibid.*

combinations” included a comprehensive survey of state corporation laws,⁹¹ a detailed study of corporate business practices,⁹² and extensive testimony from corporate owners and managers.⁹³ This testimony is particularly relevant to the issue of federal chartering, as it reveals that although many businessmen favored federal chartering legislation, their reasons had little to do with limiting corporate power.

Unlike the restrictive reformers who believed state laws were too lenient, many witnesses before the Industrial Commission believed state laws were too burdensome. As discussed below, although these “permissive” reformers were generally in favor of federal standardization, their ideal vision of federal law was more in line with the law of New Jersey. Notwithstanding the freedom of promoters to incorporate in any state of their choosing, the antitrust laws of certain states reached all activities within their jurisdiction, creating legal risks for corporations operating on a national basis. Business leaders hoped that national legislation would preempt these troublesome state laws, eliminating the danger of legal attack by state attorneys general and private plaintiffs. More ambitiously, they also hoped that federal legislation would protect their businesses from *federal* antitrust law by creating a legal process through which corporations could apply for and receive federal regulatory approval.

The witnesses questioned by the Industrial Commission represented many of the country’s largest corporations. Perhaps the most notable was Standard Oil, among the most powerful—and controversial—of all American industrial combinations.⁹⁴ The commission questioned several members of Standard’s senior management on a range of issues related to conditions in the oil industry. Although most of this questioning focused on the details of Standard’s business practices, three Standard witnesses

⁹¹ Industrial Commission, *Trusts and Industrial Combinations (Volume II of the Industrial Commission’s Reports)* (Washington: Government Printing Office, 1900).

⁹² Industrial Commission, *Trusts and Industrial Combinations (Volume XIII of the Industrial Commission’s Reports)* (Washington: Government Printing Office, 1901).

⁹³ Industrial Commission, *Preliminary Report on Trusts and Industrial Combinations, Together with Testimony, Review of Evidence, Charts Showing Effects on Prices, and Topical Digest*.

⁹⁴ “Standard Oil” was formally “Standard Oil Co. of New Jersey,” the holding company of what had existed as the “Standard Oil Trust” until 1892. Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power*, paperback ed. (New York: The Free Press, 1991), 82–84.

were also asked for their views regarding the advisability of federal incorporation: John D. Rockefeller, the co-founder of the company; John D. Archibald, the company's de facto chief executive; and Henry H. Rogers, another important senior manager. In their responses, each of these men supported federalization as a means of reforming, rationalizing, and standardizing corporate law.

Despite being semi-retired from active management,⁹⁵ John D. Rockefeller was questioned in writing regarding the history and structure of the American oil industry. Responding to written interrogatories in late 1899, Rockefeller suggested that the federal government *encourage* the process of industrial consolidation. He staunchly defended his company's domination of the oil industry and was unequivocal that industrial combinations benefited American consumers. His response to the question of a potential federal corporation law was brief but definitive, calling for "federal legislation under which corporations may be created and regulated."⁹⁶ If federal legislation proved politically impossible, Rockefeller recommended uniform state law as a second-best alternative. The critical issue for Rockefeller was that corporate reform, whether at the federal or state level, be directed toward "encouraging combinations of persons and capital," and "not of a character to hamper industries."⁹⁷ Although he criticized federal antitrust legislation as fundamentally misguided, Rockefeller was nonetheless open to the concept of federal regulation and control. Like William Howe at the Chicago Conference on Trusts, Rockefeller compared industrial combinations to the instrumentality of steam power: potentially dangerous if employed irresponsibly, but immensely beneficial if properly governed. Just as "steam is necessary and can be made comparatively safe," he wrote, "combination is necessary and its abuses can be minimized."⁹⁸

⁹⁵ Ibid.

⁹⁶ Industrial Commission, *Preliminary Report on Trusts and Industrial Combinations, Together with Testimony, Review of Evidence, Charts Showing Effects on Prices, and Topical Digest*, 797.

⁹⁷ Ibid.

⁹⁸ Ibid.

John D. Archbold—Standard Oil’s chief executive—took a similar position on federalizing corporate law.⁹⁹ Archbold believed that the natural “next step” in American business was “national or federal corporations.”¹⁰⁰ According to Archbold, “lack of uniformity in the laws of the various states, as affecting business corporations, is one of the most vexatious features attending the business life of any great corporation.”¹⁰¹ Standardizing corporate law would not only benefit “great” corporations, but could also encourage new competition to enter existing markets. Archbold claimed that, if a federal corporation law were passed, “any branch of business could be freely entered upon by all comers, and the talk of monopoly would be forever done away with.”¹⁰² Archibald based this view on the “vexatious” nature of state limitations, which he (apparently) believed were limiting new competition.¹⁰³

Of the three Standard Oil executives who specifically discussed federal chartering, Henry Rodgers, president of Standard’s pipeline subsidiary and a key figure within the larger firm,¹⁰⁴ addressed the issue in greatest detail. Like Rockefeller and Archbold, Rodgers favored enactment of a single national corporation act. Specifically, Rodgers proposed a federal law modeled after the English Companies Acts.¹⁰⁵ Rodgers considered the English law “most desirable in its operation,” as it provided management with substantial flexibility in organizing and running the business, while at the same time providing

⁹⁹ Archibald’s official position was Vice President of Standard Oil Co. of New Jersey, but he effectively controlled the entire firm by 1899. Yergin, *The Prize*, 82–84.

¹⁰⁰ Industrial Commission, *Preliminary Report on Trusts and Industrial Combinations, Together with Testimony, Review of Evidence, Charts Showing Effects on Prices, and Topical Digest*, 565.

¹⁰¹ Ibid.

¹⁰² Ibid.

¹⁰³ Ibid.

¹⁰⁴ Ibid., 581.

¹⁰⁵ English corporate law was set forth in an extended series of parliamentary acts, referred to herein collectively as the “English Companies Acts.” In its flexibility toward corporate governance, English law had a major influence on liberal state corporation acts, most notably that of New Jersey. James B. Dill himself stated the New Jersey corporation act was “largely founded upon the English act.” Ibid., 1082.

outside investors with considerable information rights.¹⁰⁶ Another source of Rogers’s views was his negative experiences with state laws. In particular, Rogers hoped a federal law would reduce the amount of antitrust litigation that could be brought in multiple states.¹⁰⁷ Finally, Rogers was concerned with the economic interests of shareholders, as suggested by his strong support for generous information rights. Although he believed attempts by government to “regulate speculation” would prove futile, he also believed investors should be entitled to accurate financial information.¹⁰⁸ In Rogers’s words: “I think we should say to the public, ‘Here is this property. You can investigate it if you want to, and if you are satisfied with the security you can put your money into it, and if you are not satisfied with the security don’t put the money in.’”¹⁰⁹ In this sense, Rogers anticipated the regulatory philosophy of the federal securities laws, in that he advocated disclosure rather than policing the substance of securities transactions themselves.¹¹⁰

Standard Oil was just one of the firms represented at the commission’s hearings—senior executives of several other corporations also testified on federal chartering.¹¹¹ Many of these executives echoed the willingness of John D. Rockefeller to accept federal regulation in the form of corporate law. A particularly notable example is John W. Gates, chairman of the American Steel and Wire Company. Gates not only recommended federal chartering legislation, but went further by suggesting the federal

¹⁰⁶ Ibid., 585.

¹⁰⁷ Ibid.

¹⁰⁸ Ibid., 586.

¹⁰⁹ Ibid.

¹¹⁰ Under the regulatory system established by the Securities Act of 1933 and the Securities Exchange Act of 1934, the price and terms of securities transactions are not directly regulated. Instead, issuing companies are required to publicly disclose detailed business and financial information.

¹¹¹ In addition to Standard Oil, the corporations represented at the commission’s hearings on trusts and combinations included the American Smelting and Refining Company, American Steel and Wire Company, American Steel Hoop Company, American Sugar Refining Company, American Thread Company, American Tin Plate Company, Distilling Company of America, Federal Steel Company, Glucose Refining Company, International Silver Company, National Shear Company, National Starch Company, National Steel Company, Pittsburg Coal Company, and many others. Industrial Commission, *Preliminary Report on Trusts and Industrial Combinations, Together with Testimony, Review of Evidence, Charts Showing Effects on Prices, and Topical Digest*.

government take an active role in supervising industrial markets. Like many businessmen, Gates viewed federal chartering primarily in terms of limiting state law: Under his proposal, corporations would be protected from the corporate laws of the various states in exchange for “substantial” chartering fees payable to the federal government.¹¹² In addition, Gates’s proposal extended beyond mere legal protection. Drawing on his observations of German industrial syndicalism, Gates envisioned the federal government taking an active role in managing key industries, overseeing (and subsidizing) America’s largest corporations. Keenly aware of European competition, Gates believed government leadership was necessary to ensure American dominance in increasingly globalizing markets.¹¹³ Certainly, Gates’s statist vision of industrial policy was considerably more ambitious than that of his fellow witnesses. As discussed in Chapter 7, however, the cooperative conception of government-business relations illustrated by Gates’s proposals would become a major feature of legislative efforts during the Theodore Roosevelt administration.

Although corporate executives were the primary advocates of federal chartering before the Industrial Commission, support for federal chartering was not unanimous, even among corporate interests. A significant minority of corporate representatives opposed federalization altogether. William H. Moore, the successful trust promoter,¹¹⁴ believed that, although American corporate law should emulate the English Companies Acts, replacing state law with federal legislation was both unnecessary and undesirable. According to Moore, competition among the states would force jurisdictions with restrictive corporation laws to liberalize or lose their domestic corporations to permissive states such as New Jersey. This prediction was similar to that of many restrictive activists, the key difference being that

¹¹² Ibid., 1022.

¹¹³ Ibid., 1016–18.

¹¹⁴ Moore, a former judge and noted horse breeder, was involved in the creation of United States Steel and several other large industrial combinations. Obituary, *New York Times*, January 12, 1923.

Moore *welcomed* state competition.¹¹⁵ Similar testimony was given by the corporate attorney Francis L. Stetson—a close associate of J.P. Morgan and legal counsel to several Morgan corporations—who also viewed a national corporation law as unnecessary, as well as unconstitutional. In Stetson’s view, even if the federal government had the constitutional authority to control corporations (which he doubted), regulation of monopoly was best left to natural economic forces. In terms strikingly similar to those of later free-market economists, Stetson reasoned that, even if a corporation were able to monopolize a particular market (Stetson used the specific example of the Havemeyer Sugar Trust), supra-competitive pricing would naturally attract new competition, and the problem would resolve itself without any need for government involvement.¹¹⁶ Finally, the attorney John Dos Passos—another prominent Wall Street lawyer and, incidentally, counsel to the Havemeyer Sugar Trust—also advised a hands-off approach to the question of federal corporate law. According to Dos Passos, issues of corporate governance were best left to private decision making, into which federal legislation would only constitute unhelpful interference. Quoting Edmund Burke, Dos Passos admonished the federal government to avoid involvement in private affairs—be they family, business, or otherwise—unless its legal authority was unambiguous and the policy necessity was overwhelming.¹¹⁷ Neither condition was satisfied in Dos Passos’s conception of the chartering issue. It should be noted that during this era of broad enthusiasm for government reform, in which even members of the business community often supported federal regulation, Dos Passos’s (as well as Moore’s and Stetson’s) *laissez-faire* perspective, now so familiar, was a minority view.

A final witness of special note is James B. Dill, the primary drafter of New Jersey’s permissive corporation act. In light of his personal involvement in drafting the New Jersey statute, one might have

¹¹⁵ Industrial Commission, *Preliminary Report on Trusts and Industrial Combinations, Together with Testimony, Review of Evidence, Charts Showing Effects on Prices, and Topical Digest*, 994–96.

¹¹⁶ *Ibid.*, 980. Stetson would soon abandon this free-market position, however, as he became deeply involved in federalization efforts under the Roosevelt administration. See Chapter 7.

¹¹⁷ *Ibid.*, 1162–63.

expected Dill to oppose federal chartering legislation. In fact, both in his testimony before the Industrial Commission and in his published legal writing, Dill was a strong *supporter* of federal incorporation. Dill seems to have sincerely believed in the liberal governance principles of the English Companies Acts, which he had endeavored to incorporate into in the New Jersey statute. Dill was so convinced of the legal advantages of the English approach (and, thus, the New Jersey approach) that he sought its implementation on a nationwide basis. During his testimony, Dill passionately defended the New Jersey act on the merits. He emphasized its requirement that financial information be made available to shareholders, but conceded that the requirement was not always respected in practice.¹¹⁸ He also lauded its provision that stock could be issued only in exchange for cash or property¹¹⁹ and its fair and predictable system of chartering fees and taxes.¹²⁰ In order to secure New Jersey's advantages for *all* corporations across the country, and to prohibit discrimination on the part of more restrictive jurisdictions, Dill recommended that a liberal corporation law be enacted at the federal level. Dill believed federal legislation would prevent the worst corporate abuses, while at the same time providing every corporation "the right to do as it sees fit" with respect to internal governance.¹²¹

Dill's advocacy of federal chartering was not limited to his commission testimony. Three years later, Dill presented a more detailed proposal before the Harvard Economics Seminary.¹²² In his Harvard address, Dill set forth his outline for a federal incorporation act intended to protect corporations from the vagaries of state laws while also ensuring minimum standards of publicity and capitalization. Like many other commentators at the time, Dill warned that the states themselves were incapable of coordinating corporate law: The political and financial rewards of attacking successful "foreign" corporations—or,

¹¹⁸ Ibid., 1079.

¹¹⁹ Ibid., 1080–81. This condition prohibited corporations from issuing stock in exchange for services. It was actually a fairly restrictive provision, even compared to other states at the time.

¹²⁰ Ibid., 1086–87.

¹²¹ Ibid., 1087.

¹²² Dill, "National Incorporation Laws for Trusts."

alternatively, of luring corporations with overly lenient corporation acts—were far too great to lead to convergence on optimal corporate governance standards.¹²³ Dill’s own view, of course, was that the optimal standard was that of New Jersey, and his suggestions for drafting a federal law traced the substance of New Jersey act. Specifically, Dill recommended federal legislation that would (1) allow corporations the *option* of incorporating under federal law (without expressly preempting state corporation acts), (2) shield federally chartered corporations from state lawsuits, supervision, and taxation, and (3) assure corporations the privileges and immunities of natural persons under the Constitution.¹²⁴ Unlike reformers of the restrictive view, who sought to limit the power of interstate corporations, Dill called upon the federal government to facilitate their expansion.

Thus, although speakers at the Chicago conference and witnesses before the Industrial Commission shared a common goal of federalizing corporate law, their economic assumptions and political motivations were fundamentally different. Economic populists such as William Jennings Bryan saw federal legislation as the cure for irresponsible state laws. Representatives of big business, such as Rockefeller, Gates, and Dill, saw federal legislation as the cure for overreaching state laws. Given their very different political perspectives on the nature of the corporation—a threat to economic freedom, versus the engine of economic progress—their desires for federal legislation would prove mutually incompatible.

Disclosure of corporate financial information to the government and/or the general public was the one specific policy goal on which nearly all commentators agreed. Among restrictive reformers, “publicity” was generally considered a defense against monopolistic pricing (though again, the mechanism of this defense was rarely articulated in detail). Shareholder protection was not a primary concern, though it was sometimes cited as an additional benefit of corporate publicity. Interestingly, it was actually permissive reformers (many of whom were corporate insiders) who tended to take a greater

¹²³ Ibid., 278–95.

¹²⁴ Ibid., 294–95.

interest in providing financial information to investors. Even staunchly pro-business conservatives who opposed federal legislation entirely (John Dos Passos, for example) often supported the general concept of mandatory corporate disclosure.¹²⁵ Why, one might ask, would corporate insiders favor disclosure rules? The most likely explanation is that mandatory disclosure could help sound, profitable corporations differentiate themselves from lower-quality rivals in financial markets. Firms able to credibly demonstrate their financial health would enjoy more favorable access to investors and a lower cost of capital. At the turn of the century, American stock markets remained underdeveloped and opaque. By reducing the information asymmetries between corporations and outside investors, mandatory disclosure could provide a distinct financial advantage to well-governed corporations.¹²⁶ Although this reasoning was not expressly articulated by any witness before the Industrial Commission, many witnesses made disparaging comments regarding unsound, ill-conceived corporations, reflecting not only the historical reality that many corporations were entirely speculative, but also the fact that profitable firms were eager to differentiate themselves.¹²⁷

In the end, the Industrial Commission itself recommended mandatory corporate publicity, even as it declined to endorse federal incorporation. In its final report to Congress, the commission took a moderate position on federal legislation, recommending mandatory disclosure, federal corporate taxation, and stronger federal antitrust law, but rejecting federal incorporation as too radical a policy measure.¹²⁸ According to the commission's report, not only were the practical advantages of federalization uncertain,

¹²⁵ *Hearings Before the Industrial Commission on the Subject of Trusts and Industrial Combinations*, 1168–69. Francis L. Stetson and Elbert H. Gary (president of Federal Steel) also favored corporate publicity. See “Talk for Corporations: Stetson and Gary Before the Industrial Commission,” *Chicago Daily Tribune*, October 20, 1899.

¹²⁶ For an extended analysis of information asymmetry in the early history of the American stock market, see Baskin and Miranti, *A History of Corporate Finance*, 189–97, 305–11.

¹²⁷ For just a few examples of these comments, see Industrial Commission, *Preliminary Report on Trusts and Industrial Combinations, Together with Testimony, Review of Evidence, Charts Showing Effects on Prices, and Topical Digest*, 68–69, 586, 975–76, 997, 1070–74, 1154. Even James B. Dill admitted that many corporations were formed for purely speculative purposes. *Ibid.*, 1079–81.

¹²⁸ Industrial Commission, *Final Report of the Industrial Commission* (Washington: Government Printing Office, 1901), 643–52.

its political implications merited a cautious legislative approach.¹²⁹ Specifically, the commission feared federal incorporation would prove “centralizing to a degree to most people unthought of, in connection with our form of government.”¹³⁰ Nevertheless, the report admitted that federal chartering might prove necessary in the future, if more conservative measures proved ineffective in achieving desired goals.¹³¹

Indeed, further consideration of federal incorporation would not be long in coming—over the next decade, the federal chartering question would play an important role in national politics, moving from the realm of abstract proposals to specific Congressional legislation. But as politicians grappled with how best to regulate corporations, the restrictive and permissive perspectives would continue to define the debate, ultimately preventing any agreement on a federal corporation law.

¹²⁹ Ibid., 645.

¹³⁰ Ibid.

¹³¹ Ibid.

CHAPTER 7: REFORM EFFORTS DURING THE ROOSEVELT ADMINISTRATION

The attention brought to the chartering issue by the Chicago Conference on Trusts and the Industrial Commission hearings, both of which were widely covered in the national press, led to a number of legislative proposals during the first decade of the twentieth century. As early as 1900, in the immediate wake of the Chicago conference, Congress considered the first federal licensing bill, as well as a constitutional amendment granting the federal government general incorporation powers.¹³² Although additional bills soon followed, chartering legislation would not become viable until it received the political backing of the Roosevelt administration. From the beginning of his presidency, following the assassination of William McKinley, regulation of big business was a major focus of Roosevelt's administration, and as the years passed, corporate law became increasingly central to Roosevelt's legislative agenda. Despite his reputation as a trustbuster, Roosevelt actually held a decidedly permissive conception of corporations, viewing them as an essential feature of modern economic life, to be attacked by government if and only if they abused their economic power. Over the course of his presidency, Roosevelt sought a cooperative relationship between the government and large corporations, to be implemented and supervised by an empowered federal executive.¹³³ This vision was in direct conflict with many restrictive-minded Democrats, who feared *any* concentration of economic power, even (and perhaps especially) if supervised by the federal government. Thus, the stage was set for continued disagreement over the direction of corporate law, as the permissive agenda of the Roosevelt administration clashed with the restrictive proposals of both the Democratic opposition and the insurgent wing of the Republican party.¹³⁴ In the end, despite Republican control of both houses of Congress for

¹³² H.R. 5756, 56th Cong. (1900); H. J. Res. 138, 56th Cong. (1900). Neither proposal was successful.

¹³³ For a detailed history of the Roosevelt administration's perspective on corporate regulation, see Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 184–85.

¹³⁴ In the politics of the era, "insurgent" Republicans were a significant faction within the Republican party who advocated a progressive economic, social, and political agenda. Perhaps the most famous example is Wisconsin's Robert La Follette, Sr. For the most comprehensive study of the insurgent Republican movement, see James Holt, *Congressional Insurgents and the Party System, 1909–1916* (Cambridge: Harvard University Press, 1967).

the entirety of Roosevelt's presidency, not one of the federal chartering bills proposed during his administration would pass.

A. Roosevelt's Early Approach to Corporations

While perhaps more conservative than the most ambitious reformers of the Progressive Era, Roosevelt was in many ways the quintessential progressive, deeply committed to social progress and confident in the managerial abilities of government. Following his sudden ascent to the presidency in September 1901, Roosevelt became the leader, not only of the United States, but also of the Republican party's legislative and regulatory agenda. Motivated by his personal belief in the government's competence to regulate business, encouraged by the pro-regulation views of many leading businessmen, and pressured by the antitrust rhetoric of his Democratic opponents, Roosevelt embarked on an extended effort to establish federal regulation of corporations. This effort, which initially focused on publicity, would soon lead to the creation of the federal Bureau of Corporations, an agency tasked with studying and (potentially) supervising interstate corporations. As discussed below, the Bureau would provide positive reinforcement for Roosevelt's regulatory agenda, eventually leading to his direct support for federal chartering legislation.

In the early years of his presidency, Roosevelt faced strong antitrust feeling on the part of the American public and calls from leading Democrats to substantially limit corporate power.¹³⁵ William Jennings Bryan had been the Democratic presidential candidate in 1900, and the Democratic party's platform called for legislation similar to Bryan's licensing proposals.¹³⁶ Although Bryan lost the election, his calls for strict control of corporations retained considerable public appeal, all the more so as the Great Merger Movement continued unabated.¹³⁷ Moreover, federal chartering was not just a partisan issue—

¹³⁵ For discussion of early twentieth-century antitrust politics, see Hofstadter, *The Age of Reform*, 213–69.

¹³⁶ *Democratic Party Platform of 1900*, <http://www.presidency.ucsb.edu/ws/index.php?pid=29587>.

¹³⁷ Hofstadter, *The Age of Reform*, 225–54.

pro-business publications such as the *Wall Street Journal* strongly favored federal incorporation¹³⁸ and the constitutional amendment effort in 1900 had been led by Republicans.¹³⁹ These pressures, combined with Roosevelt's own personal enthusiasm for federal business regulation, ensured that corporate law would be an important part of the administration's policy agenda.

In his first message to Congress in December 1901, Roosevelt struck a cautious tone on the subject of corporate legislation, while at the same time outlining policy proposals that would later be incorporated into specific chartering bills. Implicitly criticizing restrictive reformers, Roosevelt warned that attacking large corporations would weaken American industry, especially relative to the European powers with which the United States was increasingly competitive. Roosevelt reserved particular scorn for populists who opposed all concentrated wealth, warning that their broad denunciations of industrial combinations “appeal especially to hatred and fear ... precisely the two emotions, particularly when combined with ignorance, which unfit men for the exercise of cool and steady judgment.”¹⁴⁰ According to Roosevelt, large corporations were an inevitable result of global economic forces—their rise was not a product of overly permissive laws, but rather of “natural causes in the business world, operating in other countries as they operate in our own.”¹⁴¹ Roosevelt believed it was futile to attempt to turn back economic progress. Instead, he argued that “combination and concentration should be, not prohibited, but supervised and within reasonable limits controlled.”¹⁴²

Roosevelt's specific proposals for effecting this control were threefold: The first was corporate publicity, a goal with broad, bipartisan support. Significantly, however, Roosevelt called for the federal government to “inspect and examine” corporations—rather than requiring corporations to disclose

¹³⁸ “Proposed National Incorporations,” February 21, 1903; “Federal Laws for Corporations,” October 12, 1903; “The Needed Reform: A Federal Law for Corporations,” May 23, 1904.

¹³⁹ See note 132 above and accompanying text.

¹⁴⁰ First Annual Message (December 3, 1901).

¹⁴¹ *Ibid.*

¹⁴² *Ibid.*

information to the public.¹⁴³ The second proposal addressed the “utter lack of uniformity in the State laws” by recommending that the federal government “assume power of supervision and regulation over all corporations doing an interstate business.”¹⁴⁴ Roosevelt claimed that this would not constitute “interfering with the power of the States in the matter itself,” but this proposal would evolve into more intrusive efforts during Roosevelt’s second term.¹⁴⁵ Finally, given the increasingly national scope of the economy, Roosevelt recommended the creation of a cabinet-level Department of Commerce. Although Roosevelt left the exact responsibilities of this new department unspecified, its authority would include “all matters affecting the great business corporations.”¹⁴⁶

Roosevelt’s basic outlook—that large corporations were socially beneficial, if properly regulated by the federal government—was wholly compatible with that of many business leaders. Roosevelt had little sympathy for laissez-faire conservatism, on the other hand. In an address to the Boston business community in August 1902, Roosevelt sharpened his case for regulation by criticizing those who opposed federal action. While admitting it was often difficult to precisely identify corporate evils, he criticized “those gentlemen of large means, who deny that the evils exist.”¹⁴⁷ This criticism ran parallel to Roosevelt’s emerging distinction between “good” and “bad” trusts—i.e., “good” trusts cooperated with government regulation, while “bad” trusts attempted to oppose it.¹⁴⁸ At root, Roosevelt was less concerned with any “evils” of corporations than with the risk that a lack of government action might fuel

¹⁴³ Ibid.

¹⁴⁴ Ibid.

¹⁴⁵ Ibid.

¹⁴⁶ Ibid.

¹⁴⁷ “One Law for All, Says Roosevelt,” *Chicago Daily Tribune*, August 25, 1904.

¹⁴⁸ The upshot of this distinction was that the federal government could cooperate with publically-responsible “good” trusts, while legal action should be reserved for publically-abusive “bad” trusts. For discussion of Roosevelt’s attitudes toward trusts, see Kolko, *The Triumph of Conservatism*, 127–32.

support for socialism.¹⁴⁹ Roosevelt thus struck a careful balance in denouncing “destructive” or “radical” legislative proposals, while at the same time answering the public’s call for some form of federal control.¹⁵⁰

This balance between corporate accountability and economic practicality was favorably received by the American public.¹⁵¹ Although Roosevelt’s proposals were not immune from criticism, few commentators fundamentally opposed the basic concept of federal supervision.¹⁵² Unsurprisingly, populist Democrats such as William Jennings Bryan criticized the president for being soft on corporations,¹⁵³ but nearly all observers accepted the inevitability of federal legislation.¹⁵⁴ While specific questions of scope and emphasis remained subject to debate, the broader need for federal intervention stirred little in the way of controversy.

In fact, even as the Roosevelt administration was formulating its own proposals, the 57th Congress was already considering several bills to regulate interstate corporations. In late 1901, for example, Representative Charles Littlefield (R-ME) introduced federal legislation imposing extensive publicity

¹⁴⁹ This concern was a common one in Roosevelt’s approach to business regulation, and indeed, among progressives generally. See Hofstadter, *The Age of Reform*, 225–54.

¹⁵⁰ This moderation would drift leftward later in Roosevelt’s political career. In a 1910 speech, Roosevelt would declare that “the true friend of property, the true conservative, is he who insists that property be the servant and not the master of the commonwealth.” Osawatomie speech, Aug. 31, 1910. The next year, Roosevelt declared “we must abandon definitely the laissez-faire theory of political economy, and fearlessly champion a system of increased Governmental control, paying no heed to the cries of the worthy people who denounce this as socialistic.” “One Law for All, Says Roosevelt.” For general discussion of Roosevelt’s changing political stance, see Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 334–64.

¹⁵¹ “Country Backs Roosevelt in Trust Fight,” *Chicago Daily Tribune*, October 10, 1901. For general discussion of the popularity of Roosevelt’s moderate approach to corporations, see Hofstadter, *The Age of Reform*, 225–54.

¹⁵² However, see “Mr. Roosevelt and the Corporations,” *The Independent ... Devoted to the Consideration of Politics, Social and Economic Tendencies, History, Literature, and the Arts (1848-1921)*, December 17, 1903. (reporting that Roosevelt’s approach was disfavored by certain industrialists as hostile to capital).

¹⁵³ “Mr. Cockran Welcomed by Tammany’s Hosts,” *New York Times*, July 5, 1902; “Bryan in Johnson Circus: Nebraskan Speaks in Ohioan’s Tent at Toledo,” *Chicago Daily Tribune*, September 14, 1902; “Trusts Called Foes of People,” *Chicago Daily Tribune*, July 19, 1903.

¹⁵⁴ See Joseph Auerbach, “President Roosevelt and the Trusts,” *North American Review* 175 (1902): 877–94.

requirements on newly-formed corporations.¹⁵⁵ Littlefield’s bill found inspiration in both the Chicago Conference on Trusts and the Industrial Commission, as well as in Roosevelt’s calls for corporate regulation. Littlefield championed the view, expressed repeatedly at the Chicago Conference on Trusts, that publicity was a powerful weapon against inflated dividends and monopolistic pricing.¹⁵⁶ Littlefield also cited the Industrial Committee testimony of both John D. Rockefeller and James B. Dill in support of corporate publicity.¹⁵⁷ When the House Judiciary Committee reported Littlefield’s bill was, the committee emphasized that many states had inadequate publicity requirements and that remedial action would only be effective if taken at the federal level.¹⁵⁸ The Democratic minority, while supporting corporate publicity, criticized its portrayal by the Republican majority as a panacea for the trust problem. The Democrats on the Judiciary Committee called for direct limits on corporate power, including mandatory bankruptcy proceedings against “overcapitalized” corporations (i.e., corporations that had issued watered stock), confiscation of goods shipped in violation of the antitrust laws, and, perhaps most importantly, an end to the protective tariff.¹⁵⁹ Despite these misgivings, however, the Democratic minority recommended passage. Ironically, the Littlefield bill proved too strict for pro-business Republicans; the legislation passed the House, but Senate Republicans refused to allow a vote.

The same year, Representative Ashton C. Shallenberger (D-NE) introduced more ambitious legislation.¹⁶⁰ His bill provided for the creation of a “Foreign and Internal Commerce Commission,” similar in organizational structure to the Interstate Commerce Commission created in 1887.¹⁶¹ This new

¹⁵⁵ H.R. 17, 57th Cong. (1901).

¹⁵⁶ H.R. Rep. No. 57-3375, 19–25 (1903).

¹⁵⁷ H.R. Rep. No. 57-3375, 2–6 (1903). *See also* Thorelli, *The Federal Antitrust Policy*, 538–39.

¹⁵⁸ *Ibid.*, 17–19.

¹⁵⁹ H.R. Rep. No. 57-3375 (Part 2), 4–6 (1903). The tariff was a central issue in the debate over corporations, as many critics believed it protected domestic monopolies. *See* Dunlavy, “How Did American Business Get so Big?”

¹⁶⁰ H.R. 6521, 57th Cong. (1901).

¹⁶¹ *Ibid.*

commission would be empowered to grant (and withhold) federal charters for interstate corporations.¹⁶² Under the bill, corporations conducting interstate business without a federal charter would face a punitive tax on their capital stock, creating a strong motivation to adopt a federal charter.¹⁶³ Like the Littlefield proposal, Shallenberger's bill also imposed disclosure requirements on chartered firms. More so than Littlefield, however, Shallenberger was explicit as to whom this disclosure was meant to protect, investors not being among them. Alleging that dividends on watered stock enriched shareholders at the expense of consumers, Shallenberger disclaimed any concern for the economic interests of investors. In his view, it was entirely incumbent upon investors themselves to investigate securities before they purchased them.¹⁶⁴ Shallenberger made very clear that his proposal was "not to protect the interests of investors," but was instead for "protecting the interests of the public."¹⁶⁵ Ultimately, Shallenberger's bill stalled and died in the Republican-controlled Judiciary Committee, but many lawmakers shared his attitude toward investor protection. During an era in which corporate ownership remained concentrated in private hands, corporate disclosure was often viewed as a tool for preventing excess profits and was therefore framed in implicit tension with the economic interests of shareholders.

The Littlefield and Shallenberger bills were representative of early chartering proposals.¹⁶⁶ Essentially the products of individual Congressmen, they reflected the widely felt need for federal intervention, but lacked the cohesiveness of a broader legislative program. This situation changed with

¹⁶² Ibid., § 5. In the bill's original text, the legal significance of this charter—i.e., the specific rights it granted corporations and the specific duties it imposed on them—was unclear. Shallenberger was apologetic regarding the imprecisions in his bill, emphasizing that he was "not a lawyer." House Judiciary Committee, *Hearings Before the Subcommittee on Trust Legislation*, 57th Cong., 2nd sess. (1902): 24.

¹⁶³ H.R. 6521, 57th Cong., § 7 (1901).

¹⁶⁴ House Judiciary Committee, *Hearings Before the Subcommittee on Trust Legislation*, 57th Cong., 2nd sess. (1902): 22–23.

¹⁶⁵ Ibid.

¹⁶⁶ For other federal chartering proposals, see H.R. 66, 58th Cong. (1903); H.R. 8883, 58th Cong. (1904); S. 6238, 58th Cong. (1905); H.R. 473, 59th Cong. (1905); H.R. 10704, 59th Cong. (1906); H.R. 13095, 59th Cong. (1906); S. 6287, 59th Cong. (1906). Subsequent proposals (discussed below) would feature the direct involvement of the Bureau of Corporations.

the creation of the Bureau of Corporations in 1903, which used its investigative powers to develop a comprehensive regulatory agenda. As discussed below, the Bureau's recommendations—backed by the prestige and authority of the president—would eventually take a central role in debates over federal chartering.

B. The Bureau of Corporations

The Department of Commerce and Labor—proposed by Roosevelt upon taking office—was finally established by Congressional legislation in February 1903.¹⁶⁷ Pursuant to discussions between Roosevelt and Congressional Republicans, the department included within it a Bureau of Corporations, tasked with investigating the practices of corporations engaged in interstate commerce.¹⁶⁸ The Bureau's mandate reflected the importance of publicity to corporate reformers. Specifically, the Bureau was empowered to make “diligent investigation into the organization, conduct, and management of the business of any corporation, joint stock company or corporate combination,” and to report its findings to the president for the purpose of recommending legislation.¹⁶⁹ Consistent with the administration's evolving regulatory preferences, the president's recommendations would soon encompass direct federal supervision.

The Bureau's mandate reflected Roosevelt's strong belief in executive power.¹⁷⁰ As originally drafted, the legislation creating the Bureau required it to make its investigative findings publically available.¹⁷¹ When the legislation reached the conference committee, however, Senator Knute Nelson (R-MN), acting at Roosevelt's behest, introduced an amendment requiring the Bureau to report its findings

¹⁶⁷ *An Act to Establish the Department of Commerce and Labor, U.S. Statutes at Large* 32 (1903): 825. Roosevelt's original proposal had referred to a Department of Commerce and Industries, the authority of which would include “among many other things whatever concerns labor.” First Annual Message (December 3, 1901).

¹⁶⁸ *An Act to Establish the Department of Commerce and Labor*, § 6. See Kolko, *The Triumph of Conservatism*, 69–72. For more general discussion of Roosevelt's regulatory philosophy, see Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 334–64.

¹⁶⁹ *An Act to Establish the Department of Commerce and Labor*, § 6.

¹⁷⁰ See Kolko, *The Triumph of Conservatism*, 69–78.

¹⁷¹ Thorelli, *The Federal Antitrust Policy*, 552.

directly to the president. The president would then unilaterally determine whether to make such information available to the public.¹⁷² This change reflected three characteristics of Roosevelt's approach to corporations. First, by placing the Bureau's investigative findings under the direct control of the president, it accorded with Roosevelt's expansive view of presidential authority.¹⁷³ Second, by granting the president the practical option to either act on the Bureau's findings or keep them private, it was consistent with Roosevelt's political distinction between "good" and "bad" industrial trusts.¹⁷⁴ Finally, by preventing the Bureau itself from releasing its findings to the public, it underscored the fact that investor disclosure was not one of the administration's priorities.

Pursuant to the final version of the act, the Bureau was led by a Commissioner of Corporations appointed by and reporting to the president.¹⁷⁵ The Bureau's first Commissioner was James R. Garfield (son of the late President James A. Garfield), a friend and advisor to President Roosevelt who shared many of his views on corporate regulation.¹⁷⁶ Garfield envisioned the Bureau taking an active role in investigating corporations, but he also considered its central mission was to "cooperate with, not antagonize, the business world."¹⁷⁷ During its first year of existence, the Bureau embarked on an ambitious program of investigations that addressed not only specific firms and industries, but also included a thorough survey of state corporate law, released in 1904.¹⁷⁸ The conclusions Garfield drew from this study—that differences among state corporation laws amounted to legal "anarchy," that states'

¹⁷² Ibid., 553–54.

¹⁷³ See Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 334–64.

¹⁷⁴ See note 148 above and accompanying text.

¹⁷⁵ *An Act to Establish the Department of Commerce and Labor*, § 6.

¹⁷⁶ Kolko, *The Triumph of Conservatism*, 72–73.

¹⁷⁷ See *Report of the Commissioner of Corporations*, 1904, 36.

¹⁷⁸ Ibid., 16–42.

attempts to regulate corporations had been “unequal and disastrous,” and that state competition to attract corporations was “thoroughly vicious”—led naturally to recommendations to federalize corporate law.¹⁷⁹

Based on its findings, the Bureau proposed that the federal government exert control over corporate regulation by requiring all corporations in interstate commerce to receive (and maintain) a federal license.¹⁸⁰ In the Bureau’s 1904 report, Garfield dismissed the possibility of the states reforming corporate law themselves. It was “obviously impossible,” he noted, “that forty-five jurisdictions should agree on anything like a uniform system in so important a matter.”¹⁸¹ Having rejected state-level action, the report then discussed direct federal incorporation. Although Garfield believed the federal government had sufficient power under the Constitution to incorporate firms active in interstate commerce—and, conversely, could bar firms not so incorporated *from* interstate commerce—he was less confident that Congress could seize power over firms engaged purely in manufacturing.¹⁸² Thus, while Garfield considered federal incorporation a potential means of regulation, he worried that it was overly fraught with constitutional uncertainties. The approach that Garfield more strongly recommended, and that the administration eventually endorsed, was the substantively similar option of comprehensive federal licensing.

Although not constituting federal incorporation per se, the Bureau of Corporation’s licensing proposal would have nevertheless placed interstate corporations under federal authority. As set forth in the Bureau’s 1904 report, any corporation engaged in interstate commerce would be required to maintain a federal license. Grant of this license would be conditioned on two requirements: (1) providing the

¹⁷⁹ Ibid., 37–40.

¹⁸⁰ Ibid., 44–48.

¹⁸¹ Ibid., 44. State coordination may have been more feasible than Garfield believed—the National Association of Attorneys General would be created in 1907 to address antitrust issues related to the Standard Oil empire. “NAAG History,” accessed May 8, 2017, http://www.naag.org/naag/about_naag/naag-history.php.

¹⁸² *Report of the Commissioner of Corporations*, 1904, 44–45. Although essentially nonexistent today, the constitutional distinction between “commerce” and intrastate manufacturing was an important (and controversial) issue during the Progressive Era. This distinction had been the basis of the Supreme Court’s rejection of the antitrust case against E. C. Knight Co. in 1895.

government with “reports and returns” regarding business and financial information and (2) satisfaction of “all necessary requirements as to corporate organization and management.”¹⁸³ This second condition meant that corporate governance for firms engaged in interstate commerce would effectively be federalized, even if the state-level incorporation process remained nominally intact. In its report, the Bureau proposed that the licensing system leave only local matters to the states—e.g., protecting health and welfare, adjudicating commercial contracts, and all matters concerning real property. Federal control over internal corporate governance was made even clearer in an appendix, which laid out the Bureau’s plans for future legislation in detail. In addition to providing “reports and returns,” licensed corporations would be required to conform their capitalization, management structure, and even commercial business practices to federal standards.¹⁸⁴ Taken as a whole, the Bureau’s licensing proposal was federal incorporation by another name.

Even before the release of the Bureau’s report, Roosevelt had announced his strong support for the direction of the Bureau’s work in his annual message to Congress in 1904. In an era of national industry, Roosevelt argued, federal legislation was a matter of common sense. Free from the political pressures of state competition for corporations, federal law was uniquely capable of transcending the race toward “easy terms,” while at the same time avoiding any harmful expression of “intemperate, destructive, or demagogic spirit.”¹⁸⁵ In his praise of “moderation, good sense, the earnest desire to avoid doing any damage,” Roosevelt’s stance on corporations mirrored his broader economic philosophy: Concentrated wealth, in and of itself, was inevitable in industrial society and should be limited by government if and only if used to the detriment of the general public.¹⁸⁶ As Roosevelt saw it, “[g]reat corporations are necessary, and only men of great and singular mental power can manage such

¹⁸³ Ibid., 45.

¹⁸⁴ Ibid., 56–60.

¹⁸⁵ Fourth Annual Message (December 6, 1904).

¹⁸⁶ Ibid.

corporations successfully, and such men must have great rewards.”¹⁸⁷ At the same time, however, he also believed that “corporations should be managed with due regard to the interest of the public as a whole.”¹⁸⁸ Without specifically endorsing the Bureau’s proposals (which had not yet been released to the public), Roosevelt expressed confidence that the Bureau had struck the correct political balance, seeking as it did to regulate “by co-operation, not antagonism; by making constructive legislation, not destructive prosecution.”¹⁸⁹ Agreeing with Garfield that state law was inadequate, but that federal legislation should be “cooperative” and “constructive,”¹⁹⁰ Roosevelt appeared fully prepared to support the Bureau’s recommendations.

Once these recommendations were actually published in the Bureau’s inaugural report, however, Roosevelt was slow to commit to any specific regulatory structure. Although he consistently recommended that Congress pass some form of corporation law, he tended to emphasize the need for legislation, rather than its specific details. In his 1905 annual address to Congress, for example, Roosevelt stressed that national corporations could only be effectively regulated by the national government. He urged the passage of legislation “in some manner which the wisdom of the Congress may suggest,” without addressing the specific form (incorporation, licensing, or otherwise) he thought such legislation should take.¹⁹¹ Although he criticized “negative” antitrust prohibitions and advocated their replacement by “affirmative” regulation, Roosevelt was not yet ready to propose specific legislation, and seemed to prefer further deliberation before committing to any reform program.¹⁹²

¹⁸⁷ Ibid.

¹⁸⁸ Ibid.

¹⁸⁹ Ibid.

¹⁹⁰ See *Report of the Commissioner of Corporations*, 1904, 13–14.

¹⁹¹ Fifth Annual Message (December 5, 1905).

¹⁹² Ibid.

This lack of urgency was partly due to the regulatory activity of the Bureau itself, which had already entered into “constructive” agreements with many of the nation’s largest corporations.¹⁹³ Behind the scenes, Garfield had entered into investigative relationships with several major corporations that were willing to share internal records in exchange for deferring stricter antitrust enforcement. These informal relationships are suggestive of how a formal licensing system would have operated in practice. Between 1904 and 1906, the Bureau reached agreements with a number of major industrial firms whereby it was granted access to internal business and financial records. In return, the cooperating corporations were protected from antitrust enforcement—if the Bureau determined that a disclosing corporation were in violation of federal law, it would warn management in advance, allowing the firm to alter its practices and avoid enforcement action.¹⁹⁴ These agreements were made particularly (though not exclusively) with corporations controlled by J.P. Morgan & Co., with which the administration had cordial relations and whose firms were therefore considered “good” trusts. Only firms that failed to comply with the administration were considered “bad” trusts. Cooperation, rather than legal enforcement, was the ideal. As Garfield characterized the Bureau’s activities, a “policy of obtaining heavy cooperation rather than arousing the antagonism of business and industrial interests has been followed.”¹⁹⁵

Notwithstanding its informal regulatory actions, the Bureau remained committed to enactment of a formal licensing system. In his Bureau reports of 1905 and 1906, Garfield reiterated the need for formal licensing legislation, emphasizing the advantages of “preventive rather than remedial” law.¹⁹⁶ This emphasis was supported by other members of the administration, including Roosevelt himself, who endorsed licensing in late 1906. In his annual address to Congress that year, Roosevelt affirmed that the

¹⁹³ Kolko, *The Triumph of Conservatism*, 79–87.

¹⁹⁴ *Ibid.*, 74–76; Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 187–92; Wiebe, *Businessmen and Reform*, 45–47.

¹⁹⁵ See Kolko, *The Triumph of Conservatism*, 75.

¹⁹⁶ See *Report of the Commissioner of Corporations*, 1905, 7–9; *Report of the Commissioner of Corporations*, 1906, 5–7.

time had come for federal control over business corporations, such control to be implemented “by a national license law or in other fashion.”¹⁹⁷ Consistent with his broader economic outlook, Roosevelt called for preventing the evils of the minority of abusive corporations, while protecting the business and legal environment for the majority of beneficial corporations. Sounding a familiar chord, Roosevelt portrayed corporate licensing as the surest defense against socialism, which he warned could be easily inflamed by unchecked corporate excess.¹⁹⁸ Roosevelt chastised conservative businessmen who resisted government regulation. “[I]t is these reactionaries and ultraconservatives,” he proclaimed, “who are themselves most potent in increasing socialistic feeling.”¹⁹⁹ As evidenced by his abiding concern to defuse the threat of socialism, Roosevelt saw federal regulation as a means of protecting *all* corporate stakeholders, including labor, consumers, and even capitalists themselves.²⁰⁰

Roosevelt’s most forceful call for legislation came in late 1907, when he argued in support of a major licensing bill drafted in part by the Bureau of Corporations.²⁰¹ Repeating themes from earlier addresses, including the “ineffective chaos” of state corporate law, Roosevelt laid even stronger emphasis on the need for a federal solution.²⁰² Following the Bureau’s proposals, the president recommended a licensing system combining (1) publicity, (2) securities regulation, and (3) broad prohibition of “unhealthy competition” (including price discrimination, predatory pricing, and exclusive dealing requirements).²⁰³ In keeping with Roosevelt’s permissive philosophy, however, combinations and pricing

¹⁹⁷ Sixth Annual Message (December 6, 1906).

¹⁹⁸ Ibid.

¹⁹⁹ Ibid.

²⁰⁰ Ibid.

²⁰¹ This legislation is discussed in detail below.

²⁰² Seventh Annual Message (December 6, 1907).

²⁰³ Ibid.

agreements would be permitted under federal law, so long as they were pre-approved by the federal government.²⁰⁴

The administration's proposals received a range of political responses. Many of the nation's major newspapers supported federal chartering, as did smaller, more specialized publications catering to the business and financial community.²⁰⁵ Notably, the editorial board of the *Wall Street Journal* consistently supported the administration's plans. In a number of editorials, the Journal argued that state corporate law was obsolete and that federal legislation, in the form proposed by the president, would help, not hinder, American corporations.²⁰⁶ Emphasizing the business advantages of simplifying corporate law, the Journal argued that federal incorporation would cure "the confusion and abuses which result from the incorporation of companies under the laws of forty-five different states."²⁰⁷ Many political figures who supported more restrictive measures, including William Jennings Bryan, agreed with this assessment. They considered it an argument *against* the president's proposals, however, given their fundamental mistrust of corporate power.²⁰⁸ From yet another perspective, many permissive reformers who supported federal chartering nevertheless found the administration's proposals overly restrictive. James B. Dill, for example, who continued to support federal incorporation, believed the mandatory nature of the

²⁰⁴ Ibid.

²⁰⁵ See, e.g., "Corporation Oversight," *New York Tribune*, December 22, 1904; "Mr. Garfield and the Corporations," *Cleveland Plain Dealer*, December 24, 1904; "Conservative, Not Radical," *Duluth News-Tribune*, January 8, 1905; John C. Richburg, "Need of a National Incorporation Law," *Chicago Daily Tribune*, December 30, 1906; "National Control," *Los Angeles Times*, October 27, 1907; "Federal Corporations," *Cleveland Plain Dealer*, June 3, 1908; "Federal Incorporation," *Ohio State Journal*, June 16, 1908.

²⁰⁶ "Federal Incorporations," *Wall Street Journal*, December 19, 1904; "Federal Incorporations or Licenses," *Wall Street Journal*, December 22, 1904; "National Regulation of Corporations," *Wall Street Journal*, December 18, 1905; "The Nation and the States," *Wall Street Journal*, August 27, 1907; "Federal Incorporations," *Wall Street Journal*, May 22, 1908.

²⁰⁷ "Federal Incorporations," December 19, 1904.

²⁰⁸ Bryan, who was preparing to run for president in 1908, emerged as a major critic of the administration's proposals, which he warned were overly permissive toward business and would emasculate state antitrust regulations. This position was somewhat ironic given that Bryan had long supported federal licensing. See "Attacks Idea of President," *Los Angeles Times*, October 7, 1907; "Bryan Opposed to Roosevelt's Plan," *Baltimore American*, October 11, 1907; "Bryan the Star at Peoria Show," *Chicago Daily Tribune*, September 10, 1908.

president's proposals would place undue burdens on national firms. Dill preferred that federal chartering be optional for corporations, allowing them to remain organized under permissive state statutes (such as that of New Jersey) if they chose.²⁰⁹ Finally, a minority of conservative commentators opposed all federal legislation entirely, as unwarranted interference in business. This position received consistent support from the editorial board of the *New York Times*, one of the more conservative major newspapers of the era.²¹⁰

Each of these perspectives would factor in the looming battle over federal chartering, a political conflict that would reach its height in the final years of the Roosevelt presidency. As Roosevelt pushed for federal legislation near the end of his second term, he faced an ironic political situation: Nearly all major political interests supported the concept of federal chartering, but disagreed as to the fundamental goals that chartering legislation was meant to accomplish. Restrictive corporate reformers, best typified by Bryan Democrats, sought to strictly limit the economic power of all large corporations. They therefore distrusted the administration's plans for supervising (and protecting) "good" trusts. For their part, permissive corporate reformers sought to empower corporations, but were also beginning to grow suspicious of the administration's regulatory agenda. As he attempted to guide legislation through Congress, Roosevelt would eventually alienate both of these perspectives. Even though his own approach sought to protect large corporations, his increasing interventionism alarmed both conservatives and Democrats. As discussed below, the administration would fail to navigate the political hazards in Congress, running aground between the restrictive and permissive corporate reform positions.

²⁰⁹ "For Federal Franchise, but Optional—J. B. Dill," *New York Times*, December 23, 1904; "Dill on the Garfield Report: His View of Federal Franchises," *Wall Street Journal*, December 24, 1904. Dill apparently quieted his opposition to the administration's proposals once becoming a judge of the New Jersey Court of Errors and Appeals in 1905. "James B. Dill a Judge of Errors and Appeals," *New York Times*, July 7, 1905. His public commentary on corporate matters largely ceased following his appointment.

²¹⁰ This assessment is based on my own reading of dozens of New York Times editorials. See, e.g., "State or Federal Control?," *New York Times*, December 27, 1904; "Groping for Remedies," *New York Times*, August 8, 1904; "Editorial," *New York Times*, September 5, 1907.

C. The Hepburn Bill

Late in Roosevelt's second term, as the president and the Bureau of Corporations pressed the case for federal chartering, several licensing, registration, and incorporation bills were introduced in Congress. As discussed below, the most important of these proposals—supported by a broad range of corporate reformers—was the so-called “Hepburn bill,” which was drafted by the Roosevelt administration in cooperation with business interests and introduced in Congress by administration ally Representative William Hepburn (R-IA). Among the many chartering bills introduced during the Progressive Era, the Hepburn bill initially appeared the most likely to become law. Once in Congress, however, the bill foundered in the committee process, as the various interests supporting the legislation split over its core provisions. As it represents the Progressive Era's most serious attempt at chartering legislation, the history of the bill provides a telling example of the difficulties of corporate reform.

At the same time that the administration was intensifying its calls for legislation, private interests were also exploring the potential advantages of federal law. In October 1907, the National Civic Federation held a “National Conference on Trusts and Combinations” for the purpose of developing private opinion on government responses to the trust issue.²¹¹ The NCF was the successor to the Civic Federation of Chicago, and the National Conference on Trusts and Combinations, also held in Chicago, was a conscious revisiting of the issues addressed at the Chicago Conference on Trusts in 1899. Since the original conference had failed to agree on an official policy position, and since new momentum for corporate legislation seemed to be building in Washington, the second conference was conceived as an opportunity for businesses to express their policy views and hopefully influence the substantive content of any forthcoming legislation.²¹² Like the first conference, most participants at the second conference advocated significant regulatory reform, many recommending some form of direct federal chartering.

²¹¹ See National Civic Federation, *Proceedings of the National Conference on Trusts and Combinations* (New York: The McConnell Printing Co., 1908). For discussion of the conference's purposes, see Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 203–11.

²¹² *Ibid.*, 206–11.

This time, however, the balance of recommendations was heavily weighted toward a permissive approach, owing to a narrower curation of political views on the part of the NCF. Hoping to avoid the inconclusive outcome of the 1899 conference, the NCF leadership abandoned the goal of ideological diversity and instead ensured that most invitees generally supported pro-business regulation.²¹³ Due in part to this ideological cohesiveness, the Chicago conference had a significant influence on the Roosevelt administration's policymaking efforts: Following the conference, the NCF would become directly involved in the legislative drafting process, and many of the positions expressed at the conference would be incorporated into the Hepburn bill itself.²¹⁴

Although the conference was marked by broad support for federal legislation, the specific form such legislation should take remained subject to dispute. Federal chartering—whether licensing or incorporation—was specifically called for by several conferees, but different speakers had different conceptions of what federal chartering would specifically accomplish. The permissive view of corporate chartering was exemplified by Representative Henry W. Palmer (R-PA), who spoke at the conference in support of optional federal incorporation. Although Palmer did not think Congress should preempt state law, he believed that, if a federal incorporation alternative became available, most firms would choose the federal option to avoid the “limitations, exactions, and annoyances imposed on them by the states.”²¹⁵ Approvingly citing the English Companies Acts, Palmer argued that “proper control and regulation” should entail no hostility to honest business.²¹⁶ The investment banker Edwin Seligman (brother to the famous public finance economist, Edwin R. A. Seligman) took a similar view; federal incorporation, he maintained, would be “desirable in the interests of the corporations themselves.”²¹⁷ Seligman believed

²¹³ Ibid., 208–09.

²¹⁴ See notes 227–235 below and accompanying text.

²¹⁵ National Civic Federation, *Proceedings of the National Conference on Trusts and Combinations*, 361.

²¹⁶ Ibid., 361–62. Palmer's position was similar to that of James B. Dill.

²¹⁷ Ibid., 164.

that a federal statute would “protect such corporations as remain within the law and would defend them from harassment by forty-five separate legislatures.”²¹⁸ Finally, the administration’s views on the issue were represented by Herbert Knox Smith, who had recently succeeded Garfield as Commissioner of Corporations.²¹⁹ Smith argued that federal legislation would solve the many problems of the state-law system, which was “a chaos of conflicting legal conditions resulting in inefficiency and uncertainty.”²²⁰ According to Smith, a centralized body of uniform law would facilitate industrial cooperation, allowing business and government to work together to further national prosperity.²²¹

Not everyone at the conference shared Smith’s optimistic vision, however. Certain conference participants, while not actively hostile to corporations, were less sanguine as to the policy benefits of protecting them under federal law. Wade Ellis, the attorney general of Ohio—one of the stricter corporate law jurisdictions—called for federal legislation to impose minimum standards on corporations.²²² Absent federal standards, Ellis predicted that the race to the bottom in corporate chartering would only continue. His primary criticism was intercorporate stockholding—a practice freely allowed by New Jersey—which Ellis believed should be uniformly prohibited by the federal government.²²³ Bartlett Tripp, a prominent attorney from South Dakota, also believed that federal law should impose national standards. Although he conceded the inevitability of large combinations of capital—“[t]he little red shop around the corner has gone out of business forever”—Tripp believed that states such as New Jersey placed inadequate limits on

²¹⁸ Ibid., 165. Note that Seligman also believed that certain state laws were overly permissive, however.

²¹⁹ Roosevelt appointed Garfield Secretary of the Interior in 1907. Knox had served as Garfield’s deputy at the Bureau of Corporations and shared many of Garfield’s regulatory views. If anything, Knox was even friendlier with large corporations, expanding his predecessor’s informal investigative relationships. See Kolko, *The Triumph of Conservatism*, 117–22; Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 186–88; Wiebe, *Businessmen and Reform*, 47.

²²⁰ National Civic Federation, *Proceedings of the National Conference on Trusts and Combinations*, 296.

²²¹ Ibid., 294–95.

²²² In 1891, Ohio had charged the Standard Oil Company with acting outside the authority of its corporate charter in entering into the Standard Oil trust agreement (precipitating the company’s move to New Jersey). Ohio maintained a relatively strict corporation law at the time of the 1907 conference.

²²³ Wiebe, *Businessmen and Reform*, 41–57.

corporate expansion.²²⁴ He warned: “The means that have brought us wealth and the luxuries of life [i.e., corporations] must not become instruments of oppression and tyranny.”²²⁵ One of the few judges at the conference, Judge Peter Grosscup of the Seventh Circuit Court of Appeals, struck a populist note in his convention comments. Grosscup highlighted the fact that several state governments allowed the formation of corporations without any oversight whatsoever: “Put your nickel in the slot and take out a charter,” as he characterized the incorporation process.²²⁶

Notwithstanding the occasional example of restrictive regulatory sentiment, the majority of participants at the three-day conference expressed relatively permissive views. The conference’s formal resolutions reflected this loose agreement, a consensus which the 1899 conference had been unable to achieve. Even the 1907 resolutions were relatively cautious, however, being limited to the creation of a federal commission to study and recommend corporate reform. Specifically, the conference resolutions advised Congress to consider, through the instrumentality of a federal commission: (1) permitting railroads to agree on “reasonable” freight and passenger rates (subject to approval from the Interstate Commerce Commission); (2) removing labor unions and agricultural collectives from the coverage of the Sherman Act; (3) removing business combinations and industrial agreements “in the public interest” from the coverage of the Sherman Act; (4) enacting a federal corporate licensing or incorporation law; and (5) requiring corporate financial disclosure to the Department of Commerce and Labor.²²⁷

Although the conference recommended that these issues be submitted to study, key figures in the NCF sought to push for legislation immediately. Given the (seemingly) broad consensus at the conference and the supportive attitude of the Roosevelt administration, NCF leaders believed the time

²²⁴ National Civic Federation, *Proceedings of the National Conference on Trusts and Combinations*, 137.

²²⁵ Ibid.

²²⁶ Ibid., 227. Ironically, Grosscup was well known as a pro-business judicial figure, having issued several injunctions against striking labor unions, most notably during the Pullman strike. Richard Hofstadter describes Grosscup as a jurist of “impeccable conservatism.” See Hofstadter, *The Age of Reform*, 222–24.

²²⁷ Wiebe, *Businessmen and Reform*, 453–56.

was right for passage of a federal chartering law. In particular, Seth Low and Ralph Easley, the NCF's president and founder, respectively, sought to advance an activist interpretation of the conference's resolutions.²²⁸ In cooperation with Herbert Knox Smith of the Bureau of Corporations (who spoke at the conference himself), Low, Easley, and other NCF members began preliminary work on a chartering bill in early 1908.²²⁹ The timing seemed fortuitous—Congressional Republicans had indicated their support and several major industrialists had signaled their receptiveness to the president. In February, drafting work began in earnest on what would become the Hepburn bill.²³⁰

The drafting process soon became a highly collaborative effort, involving representatives from business, government, and organized labor. Key contributors included business and political figures with strong permissive sensibilities. Most notably, J.P. Morgan associates George W. Perkins, Francis L. Stetson, and Victor Morawetz were intimately involved in the drafting process. Other representatives of big business who consulted on the bill included Elbert H. Gary of U.S. Steel, Edgar Addison Bancroft of International Harvester Co., and Wall Street bankers August Belmont, Isaac Seligman, and James Speyer, all members of the NCF and supporters of federal chartering.²³¹ Gary and Bancroft were also key figures within the J.P. Morgan financial empire, further strengthening the House of Morgan's influence on the Hepburn bill. National labor leaders including Samuel Gompers, president of the American Federation of Labor, also played an important role. Mainstream, non-radical labor interests organizations such as the AFL strongly supported federal chartering. They were particularly enthusiastic regarding the NCF's recommendation that labor unions be excluded from the antitrust laws, which had been used against unions with greater vigor than they had been used against corporations.²³²

²²⁸ See Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 228–29.

²²⁹ Ibid.

²³⁰ Ibid.

²³¹ Ibid.

²³² Herbert Hovenkamp, *Enterprise and American Law, 1836–1937* (Cambridge: Harvard University Press, 2009), 228–36. The large corporations supporting the bill were willing to accept this provision in order to secure labor's political support. See Kolko, *The Triumph of Conservatism*, 134–38.

Early drafts of the bill were structured as amendments to the Sherman Act, adding a comprehensive system of corporate registration and publicity. Corporations could voluntarily register with the Bureau of Corporations by providing detailed information regarding their business and financial structure. Once registered, corporations would then be enabled to “preclear” mergers and acquisitions by filing the relevant transaction documents with the Bureau in advance. Corporations that chose not to register were not prohibited from merger transactions, but would continue to risk Sherman Act prosecution. This system would provide the federal government with oversight over industrial combinations while also providing large corporations one of their most sought after policy goals: the ability to obtain regulatory clearance *before* consummating major transactions. Essentially, rather than using the Sherman Act as an *ex post* enforcement mechanism, the bill would grant the federal government the power of prophylactic supervision. Finally, unions would be granted significant protections under the bill, allowing them to avoid the prohibitions of the Sherman Act entirely by making specified organizational disclosures. Under this proposed framework, the administration, big business, and organized labor each seemed to be getting what they wanted.²³³

Soon, however, the influence of Stetson and Morawetz—both Morgan-associated corporate attorneys—began to push the bill in an even more pro-business direction. In late February 1908, Stetson and Morawetz submitted a draft limiting Sherman Act prosecution to “unfair” and “unreasonable” agreements and combinations, even for corporations that chose *not* to register with the Bureau of Corporations.²³⁴ This change would have significantly weakened the Sherman Act’s prohibition of agreements and combinations in restraint of trade, which contained no reasonableness exemption as originally enacted. The administration rejected this proposal, which would have undermined its supervisory power, but the bill underwent several revisions as the Morgan interests pressed for advantage.

²³³ Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 231–33; Kolko, *The Triumph of Conservatism*, 134; Wiebe, *Businessmen and Reform*, 80–81.

²³⁴ Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 233–34.

In March, Roosevelt himself became personally involved and wrenched the bill back to his own regulatory vision. Central to this vision was a strong role for the federal government, including the assertion of executive authority over the private decision making of corporations. Roosevelt's involvement restored the bill to a version resembling its initial drafts, but with additional registration requirements and an expanded, quasi-managerial role for the federal government. The bill was finalized in March and transmitted to Representative Hepburn, who introduced it in Congress in early 1908 as the Hepburn amendments to the Sherman Act.²³⁵ Although the administration was surprisingly reserved in its endorsement of the final bill (Roosevelt described it to Congress as a tentative suggestion), political support appeared strong.²³⁶

Once in Congress, however, the bill attracted serious criticism. Much of this criticism centered on the bill's favorable treatment of labor unions. Although large corporations were willing to accommodate labor in order to secure political support, smaller businesses reacted extremely negatively to the protection of unions from the antitrust laws. The National Association of Manufacturers, representing a broad cross-section of American business, strongly opposed the bill, as did dozens of smaller commercial and trade associations.²³⁷ Although the NAM had been supportive of the general concept of federal chartering, it refused to accept any legislation that would strengthen the position of labor unions. This opposition was hardly surprising, as the NAM was a deeply anti-labor organization,²³⁸ yet its intensity seemed to catch the NCF leadership off guard.

General opposition to labor interests was accompanied by a suspicion that the government was protecting dominant trusts at the expense of small and medium-sized enterprises. The National Council

²³⁵ H.R. 19745, 60th Cong. (1908).

²³⁶ Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 239.

²³⁷ Many of these associations were represented before Congress by the attorney and lobbyist James A. Emery. See House Judiciary Committee, *Hearings on House Bill 19745*, 60th Cong., 1st sess. (1908): 470–95, 663–93, 740–47. The hearings on the Hepburn bill also elicited more than 100 letters and telegrams from individual firms and regional trade associations, the majority of which expressed vociferous opposition to any favorable treatment of labor unions. *Ibid.*, 8–9, 432–70.

²³⁸ Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 225–26.

of Industrial Defense, an umbrella group of 130 commercial associations (led by the NAM), voiced this concern to administration officials in April 1908, protesting that powerful unions *and* powerful trusts would unfairly benefit from the legislation.²³⁹ From the opposite end of the political spectrum, restrictive reformers also criticized the bill. The American Antitrust League, which supported the protection of labor unions, feared the bill provided large corporations with undue latitude to consolidate.²⁴⁰ Finally, even permissive reformers who had been personally involved in drafting the legislation had misgivings over the statist direction in which Roosevelt had taken the bill. Corporate lawyers such as Stetson and Morawetz, who had hoped for protective legislation, now faced a more expansive system of supervision and control.²⁴¹

In just a few short weeks, support for the bill unraveled. As soon as Roosevelt realized that his preferred version of the bill was unlikely to pass, he abandoned any serious efforts to promote the legislation in Congress. Although he continued to call for Congressional action, he spent little political capital supporting a bill lacking what he considered its most important feature—executive power to approve or disapprove corporate combinations and horizontal agreements (i.e., agreements among direct competitors).²⁴² Seth Low and other NCF leaders tried to persuade Roosevelt to strengthen his support, but the president grew increasingly disengaged.²⁴³ Without Roosevelt's active backing, and amidst growing criticism from the right and the left, the Hepburn bill stalled in the House Judiciary Committee by late spring 1908.

²³⁹ See *Ibid.*, 266–67.

²⁴⁰ See House Judiciary Committee, *Hearings on House Bill 19745*, 60th Cong., 1st sess. (1908): 336–64.

²⁴¹ See Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 235–53.

²⁴² See Special Message to Congress on Labor (March 25, 1908).

²⁴³ See Kolko, *The Triumph of Conservatism*, 136–38; Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 274–76.

The legislation fared even worse in the Senate, where the Judiciary Committee expressly rejected it in January 1909.²⁴⁴ The committee balked at empowering the president to unilaterally approve or disapprove combinations. Not shying away from dramatic rhetoric, the committee compared the presidential powers granted by the bill to the royal prerogative of James II at the time of the Glorious Revolution. According to the committee, the bill would allow the president to punish or excuse legal violations “without notice or hearing and wholly *ex parte*—a course of procedure that would not be tolerated in any court of our country.”²⁴⁵ The committee was similarly opposed to any weakening of the Sherman Act, which it claimed the bill would “emasculate,” “undermine,” and render “nugatory as a remedial statute.”²⁴⁶ In the Senate Judiciary Committee, at least, restrictive sentiment remained strong.

The Hepburn bill was the Roosevelt administration’s final attempt at corporate legislation, and its collapse represented the broader failure of Roosevelt’s particular vision of corporate reform. Despite the support for federal chartering throughout Roosevelt’s presidency, the political consensus required to pass concrete legislation proved illusory. In a sense, Roosevelt’s proposals contained ideological features of both the permissive *and* restrictive views: His administration sought positive cooperation between government and big business, but also insisted that corporate decision making be subject to governmental control. Rather than achieving political compromise, Roosevelt alienated both camps. Reformers holding the restrictive view, who desired stronger antitrust enforcement, were deeply suspicious of any proposal to selectively facilitate “reasonable” combinations. On the other hand, pro-business conservatives became increasingly uncomfortable with Roosevelt’s regulatory approach, which appeared to reach considerably beyond their preferred level of government control. Finally, favorable treatment of labor unions—included to secure the support of the AFL—probably did more than anything else to ensure the failure of the Hepburn bill. While it is tempting to conclude that the Hepburn bill was undermined by

²⁴⁴ See S. Rep. No. 60-848 (1909).

²⁴⁵ *Ibid.*, 9.

²⁴⁶ *Ibid.*, 11.

Roosevelt's political choices, the succeeding administration would prove no more successful in passing a federal chartering act. As the experience of the Taft administration shows, lack of agreement over the purpose of corporate reform was an insurmountable obstacle to federal chartering.

CHAPTER 8: REFORM EFFORTS DURING THE TAFT ADMINISTRATION

The federal chartering movement did not end with Roosevelt's presidency. Although the Hepburn bill had failed, proponents of federal chartering had high hopes for the Taft administration. As Roosevelt's political protégé and hand-picked successor, Taft shared Roosevelt's outlook regarding the economic necessity of large corporations and the importance of preventing them from abusing their economic power. Many observers considered Taft even more business-friendly than Roosevelt, giving optimism to large corporations lobbying for protective regulation. Once in office, however, Taft disappointed such expectations. While Taft supported federal chartering, his views on corporate regulation proved much more market-oriented than his predecessor's. Most notably, he was less inclined to favor the protections sought after by big business.²⁴⁷ Taft occupied an awkward position between restrictive and permissive corporate reformers and proved unable to build political support for his own (mildly permissive) chartering legislation. The Taft administration did, however, enact a corporation "excise" tax, which incorporated certain regulatory features long called for in chartering debates. In the context of repeated failure to pass a federal chartering bill, this tax satisfied some of the demand for federal action toward corporations, partially relieving the political pressure for more comprehensive legislation.

A. Enactment of the Corporation Tax

Upon taking office in March 1909, Taft appeared likely to continue the agenda of the Roosevelt administration. Like his mentor, Taft believed that large corporations were inevitable under modern conditions and that federal law should concern itself with actual economic abuses, not corporate size per se. Unlike Roosevelt, however, Taft was not a proponent of executive discretion and rejected the use of

²⁴⁷ See Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 364–81. To this day (and despite the best efforts of historians), the popular conception of Roosevelt is that of the aggressive trust buster. Taft, on the other hand, is often viewed as more conservative. For discussion of this phenomenon, see Hofstadter, *The Age of Reform*, 235–53. See also the official White House biography of Roosevelt, lauding his impact as a "trust buster." "Theodore Roosevelt," *The White House, History & Grounds*, accessed May 8, 2017, <https://www.whitehouse.gov/1600/presidents/theodoreroosevelt>. As discussed herein, these popular conceptions of Roosevelt and Taft are both inaccurate in important respects.

informal relationships as a basis for distinguishing between “good” and “bad” trusts. A jurist above all else, Taft was deeply committed to the rule of law and sought consistent enforcement of existing antitrust prohibitions.²⁴⁸ Although he supported federal chartering throughout his administration, Taft invested greater energy in prosecuting trusts under the Sherman Act and, partly for that reason, had little success in promoting chartering legislation in Congress.

Notwithstanding the failure of the Hepburn bill in 1908, the presidential election had primed Washington for further regulatory proposals. The Democratic platform of 1908 called for federal licensing of any corporation controlling “as much as twenty-five percent of the product in which it deals.”²⁴⁹ Although less specific, the Republican platform also called for the regulation of large corporations, recommending the government enforce “greater supervision and control over, and secure greater publicity in, the management of that class of corporations” active in interstate commerce.²⁵⁰ Underscoring the bipartisan support for corporate regulation, Taft referenced both platforms favorably during his campaign, calling for legislation “inducing or compelling” large corporations to submit “to registry and to proper publicity regulations and supervision of the Department of Commerce and Labor.”²⁵¹

²⁴⁸ Taft’s antitrust perspective—i.e., his belief in the jurisprudential wisdom of allowing reasonable restraints of trade, combined with his strong commitment to impartial enforcement of the law—derived directly from his experience as a judge on the Sixth Circuit Court of Appeals, where he was considered a leading expert on antitrust law. His decision in *U.S. v. Addyston Pipe and Steel Co.*, 85 F. 271 (6th Cir. 1898) that ancillary restraints of trade should be subject to a reasonableness standard was later adopted by the Supreme Court. See Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 267–68. This “rule of reason” is today considered one of the most important developments in antitrust law. See Robert H. Bork, “The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,” *Yale Law Journal* 74 (1965): 775–847.

²⁴⁹ *Democratic Platform of 1908*, <http://www.presidency.ucsb.edu/ws/?pid=29589>. A similar licensing proposal was submitted to the Senate Committee on Interstate Commerce by Elbert H. Gary (of U.S. Steel) in 1912. Gary’s proposal provided that no federally licensed corporation whose business constituted more than 50% of its market would be permitted to “purchase the property and business of any other corporation or person engaged in a similar competitive business” without federal preapproval. Senate Committee on Interstate Commerce, *Hearings Before the Committee on Interstate Commerce*, 62nd Cong., 2nd sess. (1912): 2407–12.

²⁵⁰ *Republican Platform of 1908*, <http://www.presidency.ucsb.edu/ws/?pid=29632>.

²⁵¹ Address Accepting the Republican Presidential Nomination (July 28, 1908).

Although these legislative efforts ultimately failed (as discussed in greater detail below), Taft *did* succeed in working with Congress to pass an alternate form of corporate regulation. As recounted in Part I, the Taft administration oversaw passage of a federal corporation tax in 1909, which was soon followed by the personal income tax of 1913.²⁵² While primarily a revenue measure, the 1909 act was also a response to more general demands for corporate reform, and its enactment had the practical effect of reducing demand for broader legislation.

As Marjorie Kornhauser has documented, the corporation tax of 1909 advanced several progressive policy objectives, including mandatory corporate publicity and reducing overcapitalization.²⁵³ Partly for this reason, the tax was an unusual piece of legislation, serving multiple political goals that were often at cross-purposes. Indeed, the tax itself had originally been conceived by conservative Republicans as a means of deflecting political pressure for a federal personal income tax. Facing growing criticism of economic inequality and demands for federal income taxation, many Congressional Republicans believed a (light) corporate income tax was preferable to enactment of a “radical” personal income tax. During the legislative process, however, this deflection strategy became entangled with debates over federal corporate law, and the tax took on an additional aspect as a mild form of corporate regulation.²⁵⁴ Under the new tax law, corporations were required to submit financial information to the federal government, achieving—to at least some extent—the publicity desired by corporate reformers.²⁵⁵ The corporation tax also discouraged overcapitalization and overleveraging by limiting the amount of interest that corporations could deduct from taxable income. Deduction of interest in the 1909 act was

²⁵² *An Act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes*, § 38. Although Congress characterized this tax as a “special excise tax” on corporate profits, it was a corporate income tax for all intents and purposes. See Part I of this dissertation.

²⁵³ Marjorie E. Kornhauser, “Corporate Regulation and the Origins of the Corporate Income Tax,” *Indiana Law Journal* 66 (1990): 53–136.

²⁵⁴ *Ibid.*, 94–114.

²⁵⁵ *An Act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes*, § 38.

limited to debt “not exceeding paid-up capital,” reducing the incentives for corporations to carry large amounts of debt or unpaid stock in their capital structures.²⁵⁶

The tax’s disclosure requirements addressed a variety of alleged corporate evils, including monopolistic pricing, abusive trade practices, and the sale of overvalued stock. Although protecting investors from overcapitalization was an early justification for the act, the final version required disclosure to the government, not disclosure to the public. Earlier drafts had included a provision that corporate tax returns “and all documentary evidence and notes of testimony taken and filed in connection therewith, shall constitute public records and be open to inspection as such.”²⁵⁷ This language providing for public inspection was removed from the final act, however. In addition, the final act prohibited federal officials from disclosing *any* corporate information without authorization from the president. This change was a direct response to lobbying by business leaders who feared disclosure would undermine their competitive advantage. Although many politicians supported publicity, and some specifically supported shareholder disclosure, investor protection was simply not a political priority and was easily discarded as part of the political bargaining process.²⁵⁸

As enacted, the corporation tax satisfied some of the demand for broader federal regulation, but it was by no means a substitute for comprehensive corporate law. Many progressive lawmakers had sought considerably broader publicity requirements and were therefore disappointed with the final version of the act. More to the point, the tax provided little in the way of substantive regulation, and beyond providing the information necessary for assessing a corporation’s tax liability, it was unclear as to what purpose its reporting provisions were meant to serve. The best evidence of the act’s inadequacy in the view of many

²⁵⁶ Ibid.

²⁵⁷ Kornhauser, “Corporate Regulation and the Origins of the Corporate Income Tax,” 113.

²⁵⁸ Ibid., 113–18.

corporate reformers was the fact that federal chartering legislation continued to be introduced in Congress.²⁵⁹

Nevertheless, the tax was an important symbol. It demonstrated that the Republican-controlled government was willing to enact corporate legislation, while at the same time assuring the business community it would not enact anything radical. Despite restrictive reformers' disappointment with the tax's weak substantive provisions, it likely diffused at least some of the energy behind more ambitious chartering proposals. The enactment of additional reforms under the Woodrow Wilson administration—combined with the seeming impossibility of agreement on federal chartering—would eventually lead to the end of chartering as a Congressional legislative priority. Before that end arrived, however, Congress would consider additional legislation introduced during the Taft administration, again falling along familiar permissive and restrictive lines.

B. Permissive Proposals

Having succeeded with the corporation tax, the Taft administration refocused its efforts toward federal chartering during its second year. In early 1910, after the corporation tax had become law, Taft endorsed an incorporation proposal covering all firms in interstate commerce capitalized at \$100,000 or more.²⁶⁰ This proposal, introduced in Congress as the “Clark-Parker bills,”²⁶¹ would have protected large corporations from state and federal antitrust laws. Taft heralded the proposal as beneficial to both individual corporations and the broader economy, emphasizing the economic benefits of industrial consolidation.²⁶² For their part, business interests praised Taft's proposal and the legal certainty it finally

²⁵⁹ Nor did the corporation tax placate federal income tax proponents. Following the successful ratification of the Sixteenth Amendment, a personal income tax was enacted in 1913.

²⁶⁰ Urofsky, “Proposed Federal Incorporation in the Progressive Era,” 180–81.

²⁶¹ The Clark-Parker bills were named after the administration allies who sponsored the legislation: Senator Clarence Clark (R-WY), who introduced Senate bill S. 6186, and Representative Richard Wayne Parker (R-NJ), who introduced the same bill as H.R. 20142. As discussed below, Parker's support is particularly notable, as he represented the state of New Jersey.

²⁶² Special Message (January 7, 1910).

offered.²⁶³ The measure was opposed by the insurgent wing of the president's own party, however, who desired a stricter, more punitive approach to corporate regulation. Allying themselves with Democrats, these insurgent Republicans demanded an amendment allowing the government to revoke federal charters, which would have provided a means for punishing corporations that acted against the public interest.²⁶⁴ A revocation provision was unacceptable to the permissive reformers supporting the bill, as it undermined the very certainty that business interests most desired.²⁶⁵ The legislation was thus condemned to yet another Congressional stalemate, in which Taft could do little to effectively intervene.

The behavior of New Jersey politicians with respect to the Clark-Parker bills is intriguing. Richard Parker, a long-serving Republican Representative from New Jersey, sponsored the legislation in the House and chaired the Judiciary Committee that oversaw its progress. The Congressional debates and contemporary journalistic coverage offer no evidence that either he or any other New Jersey politician attempted to impede federal legislation in any way. Given the state's financial interest in attracting and maintaining corporate charters, which would have been jeopardized by federal legislation, one might have expected active opposition on the part of New Jersey political figures. The actions of Parker, however, suggest that at least some New Jersey politicians were motivated by more than parochial interests. This suggestion is further strengthened by the manner in which New Jersey lost its chartering crown to Delaware, when the New Jersey legislature passed several strict antitrust provisions in 1913.²⁶⁶ These actions seem puzzling: Why did New Jersey political figures fail to protect the state's golden goose? The complacency of New Jersey politicians in the face of threats to the state's chartering leadership may have

²⁶³ "Topics on Wall Street," *New York Times*, January 14, 1910.

²⁶⁴ "Hard Fight Ahead on Taft Trust Bill," *New York Times*, January 14, 1910; "Has Repeal Clause," *New York Tribune*, January 22, 1910; "Taft's Trust Bill Put in Final Form," *New York Times*, January 28, 1910.

²⁶⁵ "Incorporation Bill Will Not Be Pushed," *Los Angeles Times*, February 8, 1910.

²⁶⁶ These provisions, known as the "seven sisters," had been advocated by outgoing governor Woodrow Wilson—a political figure with a distinctly national (rather than local) political agenda. The immediate result of these provisions was to drive corporations to relocate in Delaware. See Grandy, "New Jersey Corporate Chartermongering, 1875–1929," 688–91.

reflected the decreasing importance of franchise taxes to the state's budget.²⁶⁷ According to the economic historian Christopher Grandy, a developing industrial economy and rapidly increasing population meant that corporate taxes were shrinking as a portion of New Jersey's total revenues, particularly as the state funded infrastructure spending with inheritance, property, and railroad taxes.²⁶⁸ As the state became less reliant on corporation revenues, legislators became more amenable to Wilsonian progressivism.²⁶⁹

Following the failure of the Clark-Parker bills, Taft continued to call for federal legislation, but his efforts would best be described as dutiful, rather than enthusiastic. Comprising only two sentences, his request for a federal chartering act in his second annual address to Congress was perfunctory at best, seeming to acknowledge the unlikelihood of successful Congressional action. Reminding Congress that he had recommended legislation in a previous address, Taft merely stated: "I renew my recommendation in that behalf."²⁷⁰

Large corporations and their political allies continued to lobby for a corporation act, however. These lobbying efforts remained intensive throughout the remainder of Taft's administration, eventually leading to further consideration of the chartering issue in Congress. The NCF led these efforts, presenting a survey of over 16,000 "representative Americans" (actually weighted toward businesspeople and other professionals) who, in the organization's view, overwhelmingly supported federal incorporation.²⁷¹ In 1911, the Senate Committee on Interstate Commerce responded to this lobbying by conducting hearings

²⁶⁷ Ibid.

²⁶⁸ Ibid.

²⁶⁹ This is consistent with Roberta Romano's explanation of Delaware's continuing dominance of incorporations. According to Romano, a small state such as Delaware, which funds a significant portion of its revenues with corporation taxes, can more credibly commit to maintaining a favorable corporation law. Romano, "Law as a Product," 235. In addition, it is a recognized phenomenon among scholars of American federalism that state officials do not reliably promote state institutional interests. Developments in New Jersey may have been an example of state officials failing to defend state autonomy because federal regulation advanced their own "partisan, ideological, or constituent interests." Miriam Seifter, "States as Interest Groups in the Administrative Process," *Virginia Law Review* 100 (2014): 983.

²⁷⁰ Second Annual Message (December 6, 1910).

²⁷¹ National Civic Federation, *The Trust Problem* (New York: M. B. Brown Printing & Binding Co., 1912).

on federal control over interstate corporations.²⁷² These hearings addressed a variety of approaches to the corporation issue, with particular emphasis on federal licensing and direct federal incorporation. They featured copious amounts of testimony from NCF-affiliated business representatives, many of whom continued to advocate protective federal law. The federal government should protect corporations not only from antitrust prosecution, they argued, but also from the fierce price competition that characterized many industries. Seth Low, the NCF's president, called for a federal licensing system that would allow horizontal combinations and even explicit price fixing, so long as such combinations and collusive pricing were approved by a federal agency.²⁷³ Elbert Gary of U.S. Steel favored a stricter licensing law than Low, though he also envisioned the federal government approving combinations and pricing agreements (and possibly even setting prices). According to Gary, the Sherman Act subjected business to paralyzing uncertainty, since it was impossible to know prior to an enforcement action whether a given transaction was lawful. Gary also claimed that allowing firms to enter horizontal agreements would benefit the broader economy by reducing economically destructive "unrestrained" competition.²⁷⁴ As a final example, coal industry lobbyist Walter Bogle called for protecting corporations from state statutes, while also permitting them to enter into explicit price fixing agreements. Bogle, like many witnesses before the committee, argued that federal legislation should "eliminate or destroy disastrous competition."²⁷⁵ This anticompetitive attitude—common among businessmen at the time—was due in part to the recent experiences of highly-capitalized industrial firms. Following the financial panic of 1893, major capital

²⁷² This attention was partly due to the *Standard Oil Co. of New Jersey* and *American Tobacco Co.* decisions of 1911. Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 303-04.

²⁷³ Senate Committee on Interstate Commerce, *Hearings Before the Committee on Interstate Commerce*, 62nd Cong., 2nd sess. (1912): 499–557.

²⁷⁴ *Ibid.*, 693–95, 726–30. Gary's enthusiasm for price fixing was not merely academic. Between 1907 and 1911, he had presided over the "Gary dinners," industry gatherings at which American steel companies reached collusive (if informal) pricing agreements. These meetings had enjoyed the tacit blessing of the Roosevelt administration, and were not challenged under the Sherman Act until the stricter antitrust enforcement of the Taft presidency. Gary's statist vision of business regulation was compatible with that of Roosevelt, and the two men maintained a friendly relationship throughout Roosevelt's tenure.

²⁷⁵ *Ibid.*, 2323–24.

investments in high fixed-cost processes had led to below-cost price competition (sometime referred to as “cutthroat competition”) in response to reduced demand.²⁷⁶

These various proposals were coolly received by the Senate Committee on Interstate Commerce, which saw little reason to grant legal protections to already-powerful corporations and which rejected the broadly statist implications of many of the witnesses’ testimony. Indeed, the Senate was more favorably inclined to strengthen the Sherman Act, not weaken its prohibitions.²⁷⁷ To the disappointment of big business, this was the form of legislation enacted under President Wilson in 1914: The Federal Trade Commission Act of 1914 prohibited a number of “unfair” trade practices, while the Clayton Antitrust Act (passed simultaneously) strengthened federal antitrust law by prohibiting certain types of acquisitions as well as “incipient” monopolization.²⁷⁸ This strengthening of federal antitrust law constituted a decisive defeat of the permissive approach.

C. Restrictive Proposals

The Committee on Interstate Commerce also considered restrictive proposals. While the NCF was lobbying for permissive legislation, several bills were introduced by restrictive-minded Democrats and insurgent Republicans. The most politically significant of these bills were inspired by the writings of Robert R. Reed, a New York attorney who had authored an influential incorporation proposal in 1909.²⁷⁹ Reed’s objectives were diametrically opposed to those of the NCF. Unlike permissive reformers, Reed believed monopoly power would only become *more* dangerous if domesticated by the federal government. Seeking to control corporations through centralized federal regulation, he argued, would constitute “the beginning of the end of those sound principals of government which are our special

²⁷⁶ Fligstein, *The Transformation of Corporate Control*, 59–74.

²⁷⁷ See notes 282–285 and accompanying text.

²⁷⁸ *Federal Trade Commission Act, U.S. Statutes at Large* 38 (1914): 717; *Clayton Antitrust Act, U.S. Statutes at Large* (1914) 730.

²⁷⁹ See Robert R. Reed, “American Democracy and Corporate Reform,” *Atlantic*, January 1909, 114.

heritage as a people.”²⁸⁰ Instead, Reed proposed strictly limiting the size and scope of corporations themselves.²⁸¹ Although none of the bills inspired by Reed became law, they illustrate the deep divide between permissive and restrictive ideologies.

Of these bills, the proposal that attracted the greatest support was the so-called Williams bill, introduced in 1911 by Senator John Sharp Williams (D-MS).²⁸² As originally drafted, the Williams bill was not a federal incorporation measure per se, in that it nominally preserved the existing structure of state-based incorporation. However, the bill included strict rules regarding the business activities, governance, and capitalization of any corporation engaged in interstate commerce, such that major aspects of the corporate laws of the several states would be rendered irrelevant. Attracting little attention when first introduced in Congress, the bill received more serious consideration when a revised version was reintroduced in 1912.²⁸³

In presenting his bill to the committee, Williams emphasized Robert R. Reed’s direct influence on the legislation. Not only had Williams drawn inspiration from Reed’s articles, he had corresponded with Reed throughout the drafting process and gave the *New Yorker* substantial credit for the design of the bill.²⁸⁴ The Williams bill reflected both men’s opinion that government and business management should be kept separate, as well as their shared view that corporate regulation should rest on non-discretionary statutory rules, rather than on subjective evaluation of the harms or benefits of particular business outcomes.

Claiming to be an opponent of centralization, Williams insisted that his bill was *not* a federal incorporation measure, despite the fact that its implementation would federalize most aspects of corporate

²⁸⁰ Ibid.

²⁸¹ Ibid., 121–22.

²⁸² S. 1377, 62nd Cong. (1911).

²⁸³ S. 4747, 62nd Cong. (1912).

²⁸⁴ Senate Committee on Interstate Commerce, *Hearings Before the Committee on Interstate Commerce*, 62nd Cong., 2nd sess. (1912): 2503–05.

law. This incongruence notwithstanding, the bill did address Williams's fear of business/government corruption by removing discretionary decision making from the hands of the federal executive. The bill set forth clear, narrow, *ex ante* limits on corporations that no government official was empowered to waive, modify, or negotiate. Criticizing the corporate oversight proposals favored by many Republicans, Williams warned, "I can imagine nothing more dangerous to the American Republic than control of great corporations by a Federal bureau subject in its turn to a political administration of either party."²⁸⁵

Reed himself also testified in support of the Williams bill. Like Williams, Reed insisted the bill did not federalize corporate law. In Reed's view, the real issue was not state versus federal legislation, but rather the distinction between clear, *ex ante* legal rules, which specifically and definitively restricted corporate abuses, and *ex post* administrative discretion over the enforcement of malleable standards, which lent itself to a dangerous mixing of government and corporate power.²⁸⁶ Reed's perspective on corporations was shared by many of the nation's newspapers, and several supportive editorials were entered into the legislative record. The *Indianapolis Star*, for example, criticized regulations behind which "monopoly might contrive to shelter itself," calling instead for a "punitive and prohibitive" federal corporation act.²⁸⁷ The *Grand Rapids Herald* expressed a similar view, praising Reed's plan for "radical reform."²⁸⁸ The *Pittsburg Dispatch* strongly supported vesting corporate law in the federal government, thereby freeing it from state-level corruption and restoring its focus on the public interest.²⁸⁹ This support for Reed's proposals reflected broad public demand for strict, forceful, and public-oriented corporate legislation.

²⁸⁵ Ibid., 2508 (quoting an earlier letter to Congress).

²⁸⁶ Ibid., 448–72.

²⁸⁷ Ibid., 2515.

²⁸⁸ Ibid., 2516.

²⁸⁹ Ibid., 2517.

Yet the Committee on Interstate Commerce declined to report any corporation bill, whether of the NCF or the Williams/Reed variety. Given the major differences of opinion regarding the basic goals of corporate regulation, the committee concluded that federal legislation was “neither necessary nor desirable.”²⁹⁰ In explaining its decision, the committee stressed the intellectual divide between the two sides of the debate, which it characterized as an ideological contest between “competition,” on the one hand, and “regulated monopoly or concentration,” on the other.²⁹¹ “[T]here are many distinguished students and highly trained thinkers who believe that the age of competition is past,” the committee acknowledged, but it nevertheless refused the NCF’s proposals for government sanction of output and pricing agreements.²⁹² While rejecting government-supervised cartels, the committee was also unwilling to support restrictive measures such as the Williams bill. Given the difficulty of reaching political agreement on any form of corporate legislation, the Williams bill was no more viable than the permissive proposals of the NCF. Rather than support either, the committee issued a vague recommendation to convert the Bureau of Corporations into an independent commission, tasked with investigating corporations, enforcing federal antitrust law, and providing advance review of mergers and combinations.²⁹³ That the committee sought to defer any actual policymaking to a hypothetical future commission, the powers of which would be an unlikely combination of both restrictive and permissive reform proposals, is testament to the political difficulties of corporate legislation during the Taft administration. Once again, federal chartering had been rendered politically infeasible—not by support for the existing system of state corporate law, but rather by intractable disagreement over the nature of its replacement. Ultimately, in an era marked by ambitious efforts to reform the national economy, the

²⁹⁰ S. Rep. No. 62-1326, 2 (1913).

²⁹¹ *Ibid.*, 2–3.

²⁹² *Ibid.*, 3.

²⁹³ *Ibid.*, 12–13.

federal chartering movement stands unique. Few other reforms enjoyed such broad support, yet suffered such decisive legislative failure.

CHAPTER 9: CONCLUSION

Woodrow Wilson's victory in the election of 1912 spelled the end of federal chartering as a viable political movement. Despite his political identity as a Democrat and his support among restrictive populists (including William Jennings Bryan), Wilson himself showed little enthusiasm for any form of federal chartering. Like many Congressional Democrats, Wilson rejected the Rooseveltian distinction between "good" and "bad" industrial trusts, and was suspicious of big business's enthusiasm for federal regulation. Unlike his party's populist wing, however, Wilson also accepted the inevitability of large, integrated corporations and declined to support legislative attempts to dramatically limit their economic power.²⁹⁴ Although Wilson's political rhetoric included its share of anti-corporate language, a strict system of federal chartering was simply not on his political agenda.²⁹⁵

The Wilson administration did enact several alternative regulatory measures, however, which had the practical effect of reducing demand for comprehensive corporate legislation. Under Wilson, the Committee on Interstate Commerce's recommendation for an independent regulatory commission finally became reality with the enactment of the Federal Trade Commission Act in September 1914.²⁹⁶ Less than a month later, the Sherman Act was strengthened by enactment of the Clayton Act, which prohibited several types of "unfair" trade practices as well as "incipient" monopolization.²⁹⁷ In tandem, these two acts achieved important goals of both factions of corporate reformers: The Clayton Act appealed to restrictive reformers who wanted stronger antitrust enforcement. The creation of the FTC, on the other hand, was welcomed by many permissive reformers who had long desired the greater certainty of a centralized, administrative (as opposed to judicial) regulatory body. Although neither act could fully

²⁹⁴ See Sklar, *The Corporate Reconstruction of American Capitalism, 1890–1916*, 383–430.

²⁹⁵ The new president endorse none of the seven incorporation proposals introduced in the year following his inauguration. Urofsky, "Proposed Federal Incorporation in the Progressive Era," 383–430.

²⁹⁶ *Federal Trade Commission Act*.

²⁹⁷ *Clayton Act*.

satisfy corporate reformers' conflicting goals, they nevertheless dulled the political momentum behind more ambitious chartering proposals.

The exigencies of World War I eclipsed federal chartering altogether, and the chartering issue remained forgotten during the stock market boom and prosperity of the 1920s. Moreover, with the rise of widespread public shareholding in the decade following the war, corporate law would come to adopt a new and different political character.²⁹⁸ As the public became increasingly involved with corporations as *investors*, their protection as such became the primary goal of federal corporate regulation—a change evidenced by the securities laws of the early 1930s.²⁹⁹

Although the Progressive Era was the historical period of strongest support for federal chartering, similar proposals have subsequently reemerged twice in American history—first during the New Deal and again following the corporate governance scandals of the 1970s. In 1935, as the country struggled to recover from the Great Depression, Senator Joseph O'Mahoney (D-WY) proposed a federal licensing system that explicitly borrowed its core provisions from the Williams bill of 1912.³⁰⁰ Reflecting the political shift toward investor protection, O'Mahoney framed his bill in terms of protecting corporate shareholders. In presenting his bill to the Senate, O'Mahoney explained that his objective was not only “to maintain high standards of living for labor [and] to make possible the adoption of fair methods of competition,” but also “to protect the investor from the obvious abuses of corporate power which the country has suffered for a generation.”³⁰¹ However, O'Mahoney's bill sought to achieve these goals by way of a mandatory federal license that would have required strict adherence with labor, antitrust, and consumer protection standards—many of which were directly at odds with shareholders' economic interests.

²⁹⁸ See Julia C. Ott, *When Wall Street Met Main Street*, 191–213.

²⁹⁹ See Joel Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance* (Boston: Houghton Mifflin, 1982), 1–38.

³⁰⁰ S. 3363, 74th Cong. (1935).

³⁰¹ 79 *Cong. Rec.* 12,551 (1935).

When first introduced in Congress, O'Mahoney's proposal attracted considerable political support and seemed to have a real chance of eventually becoming law. Cast by its supporters as a spiritual successor to the National Industrial Recovery Act—the major New Deal economic legislation that had been declared unconstitutional by the Supreme Court—the proposal was variously endorsed by President Roosevelt, the American Federation of Labor, and the influential Senator William Borah (R-ID), who would co-sponsor a revised version of the bill. As the proposal advanced in Congress, however, it was bitterly opposed by business interests,³⁰² which had set themselves in committed opposition to any and all New Deal legislation. Even the mainstream press harshly criticized the measure, reflecting broader disillusionment with the ambitious policies of the “second” New Deal.³⁰³

Beset by political criticism, the bill became stranded in Congress. In 1938, Roosevelt abandoned the fight for his most controversial economic proposals and instead recommended, as a face-saving measure, creation of the Temporary National Economic Committee, a special investigative body charged with researching and recommending economic legislation. Although the TNEC was chaired by O'Mahoney and formally endorsed his licensing proposal, the onset of World War II again removed corporate reform from the political agenda. After the war, O'Mahoney resumed his campaign to implement the TNEC's legislative recommendations, but given the surprisingly strong postwar economy, there was no longer significant political interest in fundamentally reforming corporate law. Although the decades following World War II saw major tax and antitrust legislation, Congress appeared increasingly willing to leave corporate law to the states.

³⁰² “Borah License Bill Lashed as Dictator Peril,” *Chicago Daily Tribune*, December 2, 1937; “Chamber Denounces Corporation Licensing,” *Los Angeles Times*, January 30, 1938; “Assail License Bill as Doom of Home Rule,” *Chicago Daily Tribune*, February 7, 1938; “Manufacturers Attack Federal Licensing Bill,” *New York Herald Tribune*, February 7, 1938; “Federal Licensing of Trade Opposed,” *New York Times*, February 10, 1938.

³⁰³ “The Licensing Threat,” *New York Herald Tribune*, December 31, 1937; “A Bill to Halt Progress,” *Chicago Daily Tribune*, January 9, 1938; “Out of the Mothballs,” *New York Herald Tribune*, February 8, 1938. Historians refer to Roosevelt's ambitious economic proposals of 1935–1936 as the “second” New Deal (as distinguished from the emergency measures of the original New Deal). Following the onset of a “double dip” recession in 1937–1938, these proposals faced significant political backlash.

Federal chartering's second revival occurred in the mid-1970s, following a rash of corporate governance scandals at major American corporations. Highly publicized instances of fraud, negligence, and managerial incompetence at several major firms—combined with revelations of widespread foreign bribery and illegal campaign contributions—led to new proposals for Congressional legislation federalizing corporate law. In 1974, Columbia law professor and former SEC chairman William Cary called for federal “minimum standards” to be imposed on state corporations.³⁰⁴ In presenting his proposal, Cary specifically criticized Delaware, decrying the state law system “in which a pygmy among the 50 states prescribes, interprets, and indeed denigrates national corporate policy as an incentive to encourage incorporation within its borders.”³⁰⁵ Cary's proposal sparked a vigorous debate among scholars, but ultimately had a greater impact in academia than in politics.³⁰⁶ A more politically salient proposal came in 1976, when the consumer advocate Ralph Nader—together with his associates Mark Green and Joel Seligman—proposed federal incorporation of all major industrial, retail, and transportation firms.³⁰⁷ In addition to federalizing corporations outright, the Nader proposal called for a dramatic restructuring of corporate boards of directors, assigning each director specific oversight over one of several “corporate responsibility” issues, including employee welfare, consumer protection, and environmental responsibility.³⁰⁸ Nader's proposal was published in the form of an accessible, well-written monograph,³⁰⁹ which partly inspired Congressional hearings on federal incorporation in 1976 and

³⁰⁴ Cary, “Federalism and Corporate Law.”

³⁰⁵ *Ibid.*, 701.

³⁰⁶ The major rejoinder to Cary's proposal came from Yale law professor Ralph Winter, who argued that Delaware law provided an economically efficient level of shareholder protection. Winter, “State Law, Shareholder Protection, and the Theory of the Corporation.” This debate over the efficiency of Delaware law has become a defining feature of the corporate law literature. See notes 8–13 above and accompanying text.

³⁰⁷ Nader, Green, and Seligman, *Taming the Giant Corporation*.

³⁰⁸ *Ibid.*, 123–28.

³⁰⁹ Nader, Green, and Seligman, *Taming the Giant Corporation*.

1977.³¹⁰ Although Nader's proposal was not the sole subject of the hearings, it featured prominently in witness testimony (either as an inspiration or as a foil). In any event, the hearings failed to result in any concrete legislation, and the revived interest in federal chartering soon faded from the political scene. Part of the reason for this lack of progress was the ambitious nature of the Nader proposal, which sought to reform, in dramatic fashion, nearly every aspect of corporate law, reaching far beyond the practical limits of what was politically feasible at the time. Perhaps more damning, the various objectives of the Nader plan were often in direct (if unacknowledged) conflict with each other. Nader presented his chartering proposal as protecting the interests of shareholders, for example, while at the same time advocating expansive duties to consumers, labor, and community interests that would have almost certainly reduced shareholders' financial returns. Echoing both the New Deal-era O'Mahoney bill and the Progressive Era chartering movement, Nader's proposal was undermined by mutually inconsistent goals.

Although debates over the merits of Delaware law continue,³¹¹ and proposals for federal incorporation still occasionally appear in the academic literature,³¹² comprehensive federalization of corporate law has not been a serious political issue since the 1970s. This is partly due to the *piecemeal* federalization that has occurred over the last several decades. Developments in federal securities regulation, on the part of both Congress and the SEC, have made increasing inroads into the internal governance of state-chartered corporations, steadily reducing the legal significance of placing corporations under direct federal control.³¹³

³¹⁰ Senate Committee on Commerce, *Hearings on Corporate Rights and Responsibilities*, 94th Cong., 2nd sess. (1976); Senate Committee on the Judiciary, *The Role of the Shareholder in the Corporate World*, 95th Cong., 1st sess. (1977).

³¹¹ See notes 8–13 above and accompanying text.

³¹² Bebchuk, "Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law," 610–14; George W. Dent, "For Optional Federal Incorporation," *Journal of Corporation Law* 35, no. 3 (2010): 499–517; Steven A. Ramirez, "The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top," *Yale Journal of Regulation* 24 (2007): 347–58.

³¹³ See notes 1–6 above and accompanying text.

Even more important has been the long-term shift in both academic and political opinion as to the fundamental policy objectives that corporate law is meant to advance. During the Progressive Era, corporate law was often seen as defining the fundamental relationship between powerful corporations and society. Different political interests conceived this relationship differently, engendering the political conflicts that defined the federal chartering movement. Restrictive reformers believed corporations should be limited to the small, independent businesses that had traditionally composed the American economy. They therefore conceived the purpose of corporate law to be restricting corporations' power. For their part, permissive reformers saw large corporations as an inevitable feature of modern economic life, containing within them the economic potential to benefit all strata of American society. They therefore conceived corporate law as a form of enabling regulation, curbing corporations' excesses, perhaps, but also providing them with certainty and protection. The modern conception of the corporation as a politically neutral nexus of contracts—and the modern focus of corporate law on reducing the agency costs of professional management—simply did not exist, partly due to the closer identity between management and ownership at many large firms, but also due to a fundamentally different political conception of corporations themselves. Rather than simply a legal technology for organizing business and allocating capital, corporations were viewed, whether positively or negatively, as the political embodiment of economic change.

Today, popular hostility to corporations remains a powerful force in American politics, but it no longer plays a major role in corporate lawmaking.³¹⁴ The central issue of corporate law is no longer the corporation's legitimacy as a political institution, but rather the much narrower concern of maximizing

³¹⁴ In general, popular agitation has shifted from the existence of large corporations themselves to more specific manifestations of their economic and political influence. *Citizens United*, corporate tax avoidance, and financial sector regulation have all become causes célèbres among the political left (and among some on the right). Hillary Clinton—widely considered a centrist—addressed each of these issues in her 2016 presidential campaign, illustrating the populist influence on contemporary mainstream politics. See Benjamin Oreskes, “Clinton Pledges Constitutional Amendment to Overturn *Citizens United* Ruling,” *Politico*, July 16, 2016, <http://politi.co/29PhJrh>; Bob Bryan, “Hillary Clinton Rips Wall Street, Corporations, Wells Fargo in Speech,” *Business Insider*, October 3, 2016, <http://www.businessinsider.com/hillary-clinton-rips-wall-street-corporations-wells-fargo-in-speech-2016-10>. Even Donald Trump harshly criticized Wall Street on the campaign trail, though his administration now appears committed to reducing financial regulation. See Brent A. Sutton, “Eight Questions About the Future of Banking Regulation Under Trump,” *Washington Post*, November 23, 2016.

economic returns to shareholders. In an economy in which most Americans are directly or indirectly corporate investors,³¹⁵ this change in the focus of corporate law is entirely understandable. Moreover, assuming that investor returns and social returns are generally correlated, this shift is likely a positive development from a broader economic policy perspective. In terms of our historical understanding of the evolution of corporate law, however, it risks obscuring the much different perspectives of an earlier political era, in which the public interest and the interests of investors were often considered to be in conflict, and in which the former was granted intellectual and political priority over the latter. It is important to remember these earlier perspectives and the regulatory order to which they aspired, if only to realize that modern corporate law could have taken a different form.

Had corporate law been successfully federalized in the early years of the twentieth century, it may have evolved to reflect the same economic concerns that dominate corporate law today, but the institutional structure of American business would surely look much different. At the very least, it would likely be more uniform, less flexible, and subject to stricter national standards. It would likely be more closely attuned to the political priorities of the federal government and therefore beholden to the changing policies of changing political leadership. Finally, the legal issues historically resolved by the Delaware judiciary would likely have been resolved instead by non-specialist federal courts. Whether these institutional differences would have been for better or for worse, it is important to emphasize that their failure to occur was *not* due to any preference for corporate law federalism—a concept of relatively recent vintage espoused by neither side of the chartering debate. Both restrictive and permissive reformers sought to supplant the state-based system, but held fundamentally different notions regarding the nature of its replacement. In the wake of this political conflict between opposing regulatory perspectives, the liberal conception of corporate law as embodied by the New Jersey act—in which size, structure, and business operations are freely determined by private decision making—has evolved into an effective and

³¹⁵ If not through direct exposure to the stock market (mutual funds, pension funds, etc.), then through health, life, or property-casualty insurance. See Judge Leo Strine’s notion of “forced capitalism,” Leo Strine, “Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance,” *Journal of Corporation Law* 33 (2007): 4–5.

(for the most part) stable national system, despite the absence of direct supervision on the part of the federal government. Were they alive to see it, this result would come as a profound surprise to the corporate reformers of the Progressive Era, who saw federalization as the necessary, inevitable future of corporate law.

**PART III: LAW AND ECONOMICS SCHOLARSHIP AND SUPREME COURT ANTITRUST
JURISPRUDENCE, 1950–2010**

CHAPTER 10: INTRODUCTION

As discussed in Part II, American corporate law has evolved from a broadly political enterprise into a narrower set of legal mechanisms for maximizing economic performance. A similar economic focus has affected all areas of business regulation, none more so than antitrust (or competition) law, which has grown increasingly distinct from what practicing lawyers today refer to as “corporate” law. The evolution of antitrust is important to this dissertation for two reasons: First, as the recent history of antitrust policy has been primarily shaped by Supreme Court decisions, it provides a useful comparison to the histories of corporate tax and corporate governance, which have been much more influenced by the legislative and executive branches. Second, antitrust was central to the origins of the law and economics movement, which has broadly recast the role of law in regulating the American economy.¹

Indeed, law and economics—the application of economic theory to legal analysis—is generally considered among the most influential developments in legal scholarship of the past half-century. And while the law and economics movement has influenced nearly every area of American law (from corporate governance to family relations and from contracts to the Constitution), few have been as deeply and as thoroughly “economized” as antitrust. Beginning in the 1970s, antitrust law—traditionally informed by populist hostility to economic concentration—was dramatically transformed by a new and overriding focus on economic efficiency. This transformation was inspired by a provocative new wave of antitrust scholarship, which argued that economic efficiency (or “consumer welfare”) was the sole legitimate aim of antitrust policy.² Much of this scholarship criticized traditional, populist antitrust jurisprudence as ideologically biased, doctrinally incoherent, and (worst of all) harmful to the American

¹ See Steven G. Medema and Nicholas Mercurio, *Economics and the Law: From Posner to Postmodernism and Beyond*, 2nd ed. (Princeton: Princeton University Press, 2006), 51–56.

² This scholarship has traditionally been associated with the University of Chicago. The “Chicago School” of antitrust has included both economists (such as Aaron Director, Ward Bowman, and George Stigler) as well as economically-minded legal scholars (such as Robert Bork, Richard Posner, and Frank Easterbrook). Although the terms “Chicago School” and “law and economics” are often used interchangeably, this Part III argues for a broader conception of law and economics, including scholars who might consider themselves in opposition to the Chicago perspective. It remains true, however, that Chicagoans have been among the most influential proponents of the economic approach to antitrust. The classic (and most doctrinaire) expression of the Chicago perspective is Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (New York: Free Press, 1978).

economy.³ Armed with the analytical tools of neoclassical price theory, many scholars instead advocated a market-based approach to antitrust law, skeptical of the benefits of active government intervention. During the 1970s and 1980s, the U.S. Supreme Court—arguably the most powerful institution in shaping U.S. antitrust policy—seemed to embrace this view, handing down decision after decision rejecting traditional antitrust values and adopting the efficiency norm of the law and economics movement. By century’s end, the populist origins of antitrust had faded into memory, and the professional discourse of the antitrust community (scholars, practitioners, and judges) had become dominated by economic analysis. Not coincidentally—and for better or for worse—the scope and vigor of antitrust enforcement had also significantly diminished.⁴

Although this transformation in antitrust law is the subject of extensive academic commentary, its causes remain poorly understood. Antitrust scholars agree that economics has deeply influenced the field, but have failed to explain precisely how this influence has been achieved. Many scholars assume, sometimes tacitly, that the economic analysis of law and economics scholarship had a direct, educative influence on the Supreme Court.⁵ Under this view, Supreme Court Justices became enlightened by modern economic theory, causing them to reject the interventionism that had characterized earlier

³ The traditional antitrust paradigm, suspicious of a wide range of business practices, has been referred to as antitrust’s “inhospitality tradition.” See Frank Easterbrook, “The Limits of Antitrust,” *Texas Law Review* 63, no. 1 (1984): 4.

⁴ Marc Eisner, *Antitrust and the Triumph of Economics: Institutions, Expertise, and Policy Change* (Chapel Hill: University of North Carolina Press, 1991), 184–282.

⁵ See, e.g., Douglas Ginsburg, “Bork’s Legislative Intent and the Courts,” *Antitrust Law Journal* 79 (2014): 941–51; Douglas Ginsburg, “Originalism and Economic Analysis: Two Case Studies of Consistency and Coherence in Supreme Court Decision Making,” *Harvard Journal of Law and Public Policy* 33 (winter 2010): 217–38; William E. Kovacic, “Failed Expectations: The Troubled Past and Uncertain Future of the Sherman Act as a Tool for Deconcentration,” *Iowa Law Review* 74 (1989): 1105–50; William E. Kovacic, “Out of Control? Robert Bork’s Portrayal of the U.S. Antitrust System in the 1970s,” *Antitrust Law Journal* 79 (2014): 855–79; William E. Kovacic, “The Antitrust Paradox Revisited: Robert Bork and the Transformation of Modern Antitrust Policy,” *Wayne Law Review* 36 (summer 1990): 1413–71; George Priest, “The Abiding Influence of the Antitrust Paradox,” *Harvard Journal of Law and Public Policy* 31 (2008): 455–63; Robert Skitol, “The Shifting Sands of Antitrust Policy: Where It Has Been, Where It Is Now, Where It Will Be in Its Third Century,” *Cornell Journal of Law and Public Policy* 9, no. 1 (fall 1999): 239–66; E. Thomas Sullivan, “Economic Jurisprudence of the Burger Court’s Antitrust Policy: The First 13 Years,” *Notre Dame Law Review* 58, no. 1 (1982): 1–59. See also Eisner, *Antitrust and the Triumph of Economics*.

antitrust jurisprudence. Other scholars have challenged this narrative, arguing that changes in the Court's antitrust jurisprudence reflected changes in its composition, specifically the conservative appointments of the Nixon presidency (Justices Burger, Blackmun, Powell, and Rehnquist), which shifted the ideological balance of the Court.⁶ Under this interpretation, conservative Justices were ideologically predisposed toward business-friendly antitrust decisions, for which the market-based reasoning of law and economics was simply a convenient justification. Robert Bork himself, among the Chicago School's most influential figures, attributed the change to both factors (though he characterized the Nixon appointments as the "decisive cause").⁷ Ultimately, what these different interpretations have in common is their limited evidentiary basis—most are derived from impressionistic reviews of a select number of Supreme Court decisions, rather than systematic analysis of larger historical trends. For their part, few historians have addressed postwar antitrust in any systematic fashion.⁸ Given the focus of the existing literature on the doctrinal features of individual cases, the broader influence of economic theory on the Supreme Court remains unclear.

Part III moves beyond previous scholarship by presenting a comprehensive, quantitative study of every Supreme Court antitrust case from 1950 to 2010, a period including the decades before, during, and after the economic turn in antitrust. To conduct this study, I compiled a database of all of the Court's antitrust cases within the relevant period of interest, coding each decision and each individual Justice's vote for a number of variables relating to law and economics scholarship. Rather than focusing on the

⁶ See, e.g., Andrew Gavil, "A First Look at the Powell Papers: Sylvania and the Process of Change in the Supreme Court," *Antitrust* 17 (fall 2002); Louis Kaplow, "Antitrust, Law and Economics, and the Courts," *Law and Contemporary Problems* 50 (fall 1987): 181–216; Marina Lao, "Ideology Matters in the Antitrust Debate," *Antitrust Law Journal* 79 (2014): 649–85.

⁷ Bork, *The Antitrust Paradox*, x–xiv.

⁸ One of the last political historians to take antitrust seriously was Richard Hofstadter, who wrote that "[historians] ignore antitrust for the same reason the public ignores it: it has become complex, difficult, and boring." Richard Hofstadter, "What Happened to the Antitrust Movement?," in *The Paranoid Style in American Politics and Other Essays* (New York: Alfred A. Knopf, 1965), 189. One of the very few current historians of postwar antitrust is Tony Freyer. Tony A. Freyer, *Antitrust and Global Capitalism, 1930–2004* (Cambridge: Cambridge University Press, 2009); Freyer, *Regulating Big Business: Antitrust in Great Britain and America, 1880–1990*; Tony A. Freyer, "What Was Warren Court Antitrust?," *Supreme Court Review* 2009 (2009): 347–95.

judicial language of only the most pivotal antitrust opinions, the method employed by most previous scholars, I have attempted to identify systematic relationships between specific variables (number of citations to law and economics scholarship, for example) and the Court's broader voting patterns. This approach allows for more generalized conclusions regarding the practical influence of law and economics.⁹

My methodology is inspired by the political science literature on the Supreme Court, much of which emphasizes quantitative analysis over the doctrinal focus of legal scholarship. My project is most directly influenced by the work of Harold Spaeth and Jeffrey Segal; like many studies of the Supreme Court, my database of antitrust cases is derived from Spaeth's much larger U.S. Supreme Court Database.¹⁰ Spaeth and Segal's influence extends beyond methodology; their theory of judicial behavior provides a useful framework for studying antitrust. Spaeth and Segal contrast the traditional "legal" model of Supreme Court voting, in which decisions are made by objective application of legal principles to the facts of a case, with their own "attitudinal" model, in which Justices vote according to ideology in

⁹ Although most studies of changes in antitrust law have relied on traditional qualitative methods, a small number of legal scholars have approached the subject from a quantitative perspective. William Kovacic's statistical analysis of antitrust decisions in the U.S. Courts of Appeals is a particularly impressive example. William E. Kovacic, "Reagan's Judicial Appointees and Antitrust in the 1990s," *Fordham Law Review* 60 (October 1991): 49–124. See also William E. Kovacic, "Judicial Appointments and the Future of Antitrust Policy," *Antitrust* 7 (spring 1993): 8–13. Also, Hillary Greene and Daniel Sokol have conducted a citation analysis of the influence of the Areeda-Hovenkamp antitrust treatise. Hillary Greene and Daniel Sokol, "Judicial Treatment of the Antitrust Treatise," *Iowa Law Review* 100 (2015): 2039–68. The economist Vivek Ghosal has modeled the influence of the Chicago School on Department of Justice antitrust enforcement activity. Vivek Ghosal, "Regime Shift in Antitrust Laws, Economics and Enforcement," *Journal of Competition Law and Economics* 7 (2011): 733–44. Finally, Douglas Ginsburg and Leah Brannon have presented quantitative data on Supreme Court antitrust cases from 1967 to 2007. Leah Brannon and Douglas Ginsburg, "Antitrust Decisions of the U.S. Supreme Court, 1967 to 2007," *Competition Policy International* 3, no. 2 (fall 2007): 3–23. None of these studies have attempted to compile Justice voting data for a complete series of Supreme Court cases.

¹⁰ Harold J. Spaeth. U.S. Supreme Court Judicial Database, Version 2014 Release 1: St. Louis, Washington University. This database—the most widely used in social science studies of the Supreme Court—is the foundation of Spaeth and Segal's empirical research on Supreme Court voting behavior. Jeffrey A. Segal and Harold J. Spaeth, *The Supreme Court and the Attitudinal Model* (Cambridge: Cambridge University Press, 1993); Jeffrey A. Segal and Harold J. Spaeth, *The Supreme Court and the Attitudinal Model Revisited* (Cambridge: Cambridge University Press, 2002).

order to achieve subjective policy preferences.¹¹ Based on their research findings, Spaeth and Segal reject the legal model, claiming the attitudinal model better predicts observed Supreme Court voting patterns.¹²

In the antitrust literature, Spaeth and Segal's legal and attitudinal models are paralleled by the contrasting perspectives on law and economics—one emphasizing its objective persuasiveness, the other emphasizing ideological bias. Although the efficiency arguments of law and economics may not be “legal” in the strictest sense,¹³ they are nevertheless analogous to traditional legal arguments. Under this analogy, the “legal” model would predict that antitrust cases are decided according to the persuasiveness of the parties' economic claims. This perspective assumes that economic questions are susceptible to objective judicial determination. The attitudinal model, on the other hand, would place little significance on the parties' arguments, predicting instead that Justices vote per their preexisting ideological preferences. This perspective assumes that Supreme Court appointees are fundamentally partial in matters of economic policy. The differences between legal and economic reasoning mean that this is not a perfect analogy; given the prominence of economic policy considerations in many Supreme Court cases, one might even conceive of an “expertise” model in place of the more general legal model.¹⁴ Whether conceived as a matter of legal reasoning or as a matter of economic expertise, this central distinction between knowledge and ideology is the question at the heart of my study. Did law and economics provide the Court with a superior analytical framework? Or—as suggested by the attitudinal model—did it merely provide rhetorical cover for Justices' preexisting ideological views?

¹¹ Segal and Spaeth, *The Supreme Court and the Attitudinal Model Revisited*, 48–49. The “legal” model is, of course, the model most familiar to trained lawyers.

¹² See *Ibid.*, 428–35. Spaeth and Segal also discuss a third, “rational choice” model, in which Justices engage in strategic behavior in order to achieve subjective policy preferences. Since the rational choice model is essentially a more complex variation of the attitudinal model, I have chosen to limit discussion to the legal and attitudinal models.

¹³ Law and economics often emphasizes economic efficiency over traditional legal authority. As discussed below, efficiency arguments have proven highly successful in antitrust cases.

¹⁴ The rise of economics as a form of (ostensibly) objective policy expertise is addressed in Eisner, *Antitrust and the Triumph of Economics*.

Based on my research, Part III argues that the Nixon appointments of the late 1960s and early 1970s were the primary cause of major changes in antitrust jurisprudence, but that academic developments have infused these changes with an intellectual legitimacy they might otherwise have lacked, insulating the changes from future shifts in the ideological makeup of the Court. Although the conservative decisions of the Burger Court were—I argue—driven by ideology rather than scholarship, the academic theories used to *justify* these decisions have been influential across the political spectrum. As a result, the entire antitrust community has experienced a rightward shift, not only in specific policy views but also in fundamental value assumptions. Although this complex interrelationship among politics, law, and scholarship has been particularly influential in the antitrust field, similar patterns also exist in other economically-oriented fields of law.¹⁵ The conjunction of knowledge and ideology that has characterized the history of antitrust law therefore speaks to broader developments in recent American legal history.

The conclusions of Part III are subject to certain qualifications. First, and most obviously, the antitrust decisions of the Supreme Court are only one of several sources of antitrust law—even within the judicial branch, they represent but a small fraction of the antitrust cases decided by the federal courts. The vast majority of antitrust cases are resolved by district courts and the U.S. Courts of Appeals, which arguably play a more important role in determining actual antitrust disputes.¹⁶ In addition, antitrust trials in the district courts often feature greater economic content than Supreme Court review, as they regularly include the participation of economists as expert trial witnesses.¹⁷ That said, in light of the final authority of the Supreme Court and its power to shape nationwide antitrust policy—as well as the ready availability

¹⁵ Corporate law and taxation, for example.

¹⁶ See Rebecca Haw Allensworth, “The Influence of the Areeda-Hovenkamp Treatise in the Lower Courts and What It Means for Institutional Reform in Antitrust,” *Iowa Law Review* 100 (2015): 1919–41. Not all antitrust cases are federal, moreover. Indeed, with the retrenchment of federal antitrust enforcement over the past 35 years, state attorneys general have assumed a larger role in antitrust prosecution.

¹⁷ In the federal court system, witness testimony and other fact finding is generally limited to the district courts.

of Supreme Court briefs, oral arguments, and other supporting case materials for research—an exclusive focus on Supreme Court cases can be justified on practical grounds. Second, the aggregate data presented herein does not, in and of itself, convey certain of the most important changes in the Supreme Court’s antitrust caseload, including the end of automatic appeal under the Expediting Act,¹⁸ the reduction in government enforcement actions during the Reagan administration,¹⁹ and changing patterns in the Court’s certiorari process,²⁰ all of which have led to a significant decrease in the number of Supreme Court antitrust cases heard each year. Indeed, this decrease is so significant that comparisons between earlier and later years in the database become difficult. Finally—as discussed in greater detail in Chapter 11—individual coding decisions often entailed subjective judgments, particularly in ambiguous or marginal cases. Although I have tried to be as transparent and consistent as possible in my coding methodology, the very nature of the data means that other researchers using the same evidence would likely code at least some cases differently.²¹

The remainder of Part III proceeds as follows. Chapter 11 presents quantitative findings, together with a discussion of methodology. The general conclusion of these findings is that Supreme Court antitrust decisions are largely (though not exclusively) determined by Justices’ preexisting policy views. Chapter 12 presents three qualitative case studies that illustrate the general patterns discussed in Chapter 11. For this chapter, I have selected three well-known cases dating from before, during, and after the

¹⁸ The “Expediting Act,” enacted in 1903, allowed direct appeal to the Supreme Court in civil antitrust cases in which the government was the plaintiff. *Act of February 11, 1903, U.S. Statutes at Large* 32 (1903): 823. This procedure was repealed in 1974 by the *Antitrust Procedures and Penalties Act, U.S. Statutes at Large* 88 (1974): 1706.

¹⁹ For a detailed study of the reduction in government enforcement actions under the Reagan administration, including the promulgation of revised merger guidelines by the Department of Justice, see Eisner, *Antitrust and the Triumph of Economics*, 184–227.

²⁰ The Supreme Court has discretionary authority to review appeals by granting a writ of certiorari. The Court’s plenary docket has decreased in recent decades, for a variety of reasons. Margaret Cordray and Richard Cordray, “The Supreme Court’s Plenary Docket,” *Washington and Lee Law Review* 58 (summer 2001): 737–94; Ryan J. Owens and David A. Simons, “Explaining the Supreme Court’s Shrinking Docket,” *William and Mary Law Review* 53 (March 2012): 1219–85; Kenneth W. Starr, “The Supreme Court and Its Shrinking Docket: The Ghost of William Howard Taft,” *Minnesota Law Review* 90 (May 2006): 1363–85.

²¹ All data used in Part III are available upon request.

economic turn in antitrust jurisprudence: *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962), *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), and *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). Together, these cases demonstrate how the very conception of antitrust has changed over the decades—not only among Justices, but among scholars and practitioners as well. Chapter 13 concludes, discussing the relevance of these findings to the future direction of Supreme Court antitrust jurisprudence, as well as their significance to broader changes in U.S. legal-economic policy.

CHAPTER 11: QUANTITATIVE DATA ON SUPREME COURT ANTITRUST CASES

The influence of law and economics on U.S. competition policy has been a major concern of antitrust scholarship since at least the 1980s. Scores of articles, lectures, and even entire books have addressed the subject.²² Much of this scholarship has emphasized doctrinal, “internalistic” analysis of the most well-known antitrust cases, while some has limited its focus to only a specific area of antitrust law (e.g., price discrimination, vertical restraints, etc.).²³ This Part III presents a much broader perspective, assessing every Supreme Court antitrust case from 1950 to 2010.

A. Case Selection and Coding

The population of cases included in this study consists of every Supreme Court case (1) directly involving antitrust issues, (2) decided on the merits (i.e., excluding determinations regarding whether to grant certiorari), and (3) decided from the 1950 through the 2010 Court terms.²⁴ Although my primary

²² For but a small sample, see Brannon and Ginsburg, “Antitrust Decisions of the U.S. Supreme Court, 1967 to 2007”; Antonio Cucinotta, Roberto Pardolesi, and Roger van den Bergh, eds., *Post-Chicago Developments in Antitrust Law* (Cheltenham: Edward Elgar, 2003); Ginsburg, “Originalism and Economic Analysis: Two Case Studies of Consistency and Coherence in Supreme Court Decision Making”; Ginsburg, “Bork’s Legislative Intent and the Courts”; Frank Easterbrook, “The Chicago School and Exclusionary Conduct,” *Harvard Journal of Law and Public Policy* 31 (2008): 439–47; Kaplow, “Antitrust, Law and Economics, and the Courts”; Kovacic, “The Antitrust Paradox Revisited: Robert Bork and the Transformation of Modern Antitrust Policy”; Kovacic, “Reagan’s Judicial Appointees and Antitrust in the 1990s”; Kovacic, “Judicial Appointments and the Future of Antitrust Policy”; William E. Kovacic, “The Intellectual DNA of Modern U.S. Competition Law for Dominant Firm Conduct: The Chicago/Harvard Double Helix,” *Columbia Business Law Review* 2007 (2007): 1–80; Kovacic, “Out of Control? Robert Bork’s Portrayal of the U.S. Antitrust System in the 1970s”; Robert Pitofsky, ed., *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust* (New York: Oxford University Press, 2008); Richard A. Posner, “The Chicago School of Antitrust Analysis,” *University of Pennsylvania Law Review* 127, no. 4 (1979): 925–48; Priest, “The Abiding Influence of the Antitrust Paradox”; Ingo Schmidt and Jan B. Rittaler, *A Critical Evaluation of the Chicago School of Antitrust Analysis* (Dordrecht: Springer Science & Business Media, 2012); Sullivan, “Economic Jurisprudence of the Burger Court’s Antitrust Policy: The First 13 Years.”

²³ “Internalism,” a term borrowed from the history of science, refers to the study of ideas purely in the terms of their specific intellectual field. An exception to this somewhat narrow approach is the work of Herbert Hovenkamp, who has written several works on the intellectual history of antitrust law. See, e.g., Herbert Hovenkamp, “Antitrust Policy After Chicago,” *Michigan Law Review* 84 (1985): 213; Herbert Hovenkamp, “Harvard, Chicago, and Transaction Cost Economics in Antitrust Analysis,” *Antitrust Bulletin* 55 (2010): 613–62; Herbert Hovenkamp, “Post-Chicago Antitrust: A Review and Critique,” *Columbia Business Law Review* 2001 (2001): 257–337.

²⁴ The Supreme Court operates on an “October term” system, whereby cases are heard and decided beginning the first Monday in October and continuing to the following spring/summer. For purposes of this study, cases are assigned to the year in which the relevant Supreme Court term began, rather than the calendar year in which the case was decided (if different).

period of interest was originally the 1970s and 1980s, the decades in which I assumed the influence of law and economics was most decisive, I included “extra” decades before and after this period to provide historical baselines for comparison. As it turns out, the data from *after* the 1980s are in certain ways the most interesting.

The first step in constructing my database was to search for all Supreme Court cases between 1950 and 2010 that are assigned the topic “29T” (antitrust and trade regulation) in the Westlaw legal database system. This search yielded 292 cases. Of these, I excluded “pure” trade regulation cases that lacked meaningful antitrust issues. Examples of such excluded cases include FTC actions concerning commercial fraud, false advertising, and other deceptive or unfair trade practices. Excluding these cases left a remaining total of 244 antitrust cases, dating from the 1950 to 2009 October terms (no antitrust cases were decided in the 2010 October term).²⁵

After identifying the population of cases, I pulled them from the U.S. Supreme Court Database and inserted them into my own custom data file. For purposes of this study, the most important information in the U.S. Supreme Court Database was the Justice-level vote data associated with each case. These data permitted analysis of individual Justices’ voting patterns in relation to case-level variables. Unfortunately, few of the case-level variables included in the U.S. Supreme Court Database were relevant to my particular research questions. I therefore coded my own set of variables based on my own analysis of the cases in the database. This required reading each and every decision, as well as the corresponding briefs of the parties and amici curiae, and assigning each case numerical values for several variables relating to law and economics scholarship. Description and analysis of these variables is provided below.

B. Case-Level Patterns

This section discusses case-level patterns—i.e., patterns in the outcomes of Supreme Court cases, rather than the votes of individual Justices. These case-level patterns are not particularly surprising, as

²⁵ The latest case in the dataset is *American Needle, Inc. v. NFL*, which was decided May 24, 2010 as part of the Court’s 2009 term.

they tend to confirm many widely-held assumptions in the literature. Specifically, the data show that during the period under examination, (1) the Court became more likely to issue “market-based” antitrust decisions, (2) the Court, litigants, and amici curiae increasingly cited law and economics scholarship, and (3) antitrust cases became increasingly characterized by the presence of formal economic arguments.

i. Decision Outcomes

The most basic measure of ideational change in Supreme Court antitrust jurisprudence is the extent to which the Court’s decisions have reflected the market logic of law and economics. To assess this change in quantitative terms, I coded each decision in the database as either “market-based” or “interventionist.”²⁶ Decisions coded as “market-based” reflect a narrowly economic view of antitrust, often deferring to market outcomes and emphasizing economic efficiency. Policies associated with market-based decisions include (for example) relative tolerance toward economic concentration, the rejection of *per se* rules²⁷ against practices other than horizontal restraints, and an assumption that unilateral market practices are usually efficient.²⁸ Decisions coded as “interventionist” reflect more traditional antitrust values, emphasizing social and political concerns rather than economic efficiency. Interventionist themes include (again, for example) hostility toward even moderate levels of economic

²⁶ Although these terms are somewhat similar to the “permissive”/“restrictive” distinction drawn in Part II, they more specifically capture the historical intervention of market-based economics in antitrust law.

²⁷ A “*per se*” rule is a Court-created decision rule that certain market practices are illegal *per se* under the antitrust laws. If a plaintiff can establish that a defendant’s actions fall within the scope of a *per se* rule, judicial inquiry ends and the behavior is deemed conclusively illegal, regardless of any economic benefits claimed by the defendant. Bork, “The Rule of Reason and the *Per Se* Concept: Price Fixing and Market Division.” *Per se* rules can be contrasted with the more permissive antitrust “rule of reason.” *Ibid.* The last several decades of antitrust jurisprudence have witnessed a substantial narrowing of *per se* rules. See, e.g., *U.S. Steel Corp. v. Fortner Enter.*, 429 U.S. 610 (1977); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984); *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128 (1998); *Ill. Tool Works, Inc. v. Indep. Ink, Inc.*, 547 U.S. 28 (2006); *Texaco, Inc. v. Dagher*, 547 U.S. 1 (2006); *American Needle, Inc. v. Nat’l Football League*, 560 U.S. 183 (2010).

²⁸ Use of the term “market-based” is potentially ambiguous, as even the Chicago School advocates prohibiting certain market practices, most notably cartel arrangements. Moreover, “interventionist” policy was often inspired by classical economic models of perfect market competition. Despite this overlap between the two terms, I believe a “market-based”/“interventionist” binary is less ambiguous than the commonly-used “conservative”/“liberal” binary.

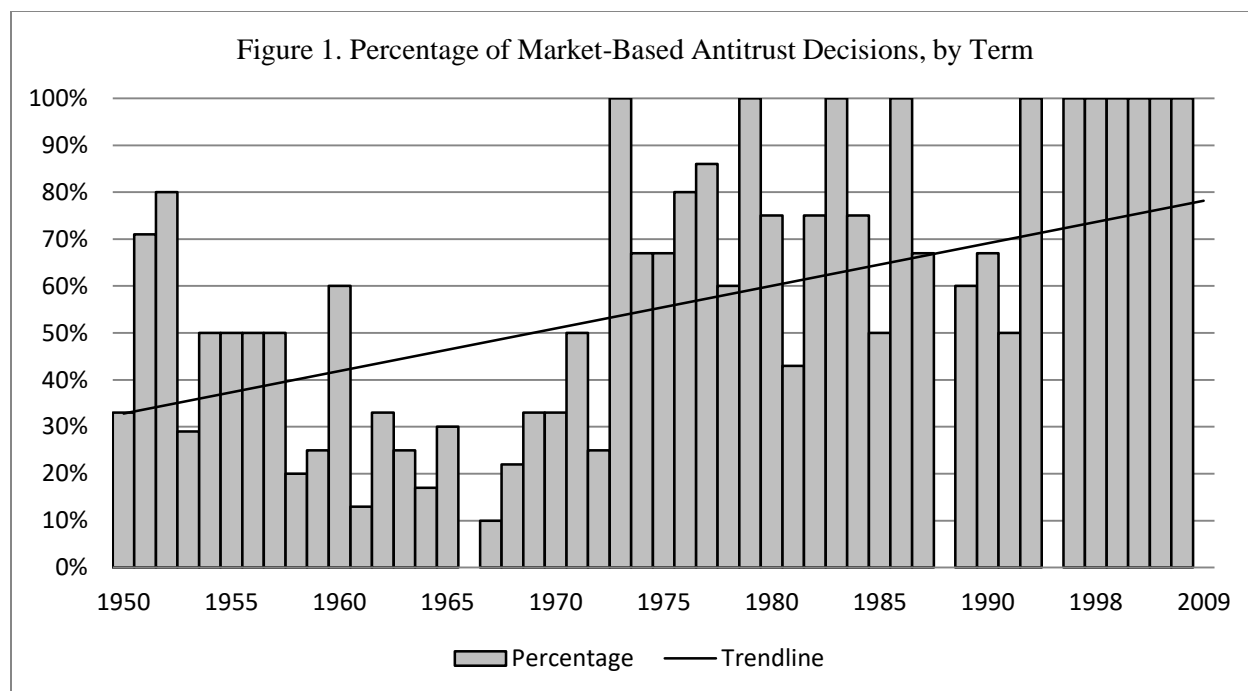
concentration, fundamental suspicion of aggressive market behavior, and the application of per se rules to a wide variety of market practices.

Given the broad scope of these two categories, certain cases in the database could potentially be coded as both. For example, as I have defined them, the “market-based” and “interventionist” positions on horizontal price fixing are essentially the same—both advocate per se prohibition. The two categories are not always mutually exclusive, in other words. Since the focus of my analysis is the Court’s *consistency* with market-based antitrust scholarship, decisions consistent with both categories were coded as market-based.²⁹ Certain decisions were difficult to categorize as either market-based *or* interventionist (cases involving various forms of antitrust immunity, for example). Rather than exclude these cases from the analysis, I simply did the best I could based on a close reading of the particular decision.³⁰

The propensity of the Court to issue market-based decisions in a given term was calculated by dividing the number of market-based decisions by the total number of antitrust decisions that term (thereby normalizing for the varying number of antitrust decisions per term). The resulting percentage data for the 1950–2009 terms are shown in Figure 1 below:

²⁹ This coding rule may result in a bias toward categorizing decisions as market-based. However, it allows an unbiased measure of *change* in the Court’s decision making over time. *See* Figure 1.

³⁰ In the U.S. Supreme Court Database, decisions are coded under the conventional rubric of “conservative” versus “liberal.” In 73% of the cases in my database, this conservative/liberal categorization corresponds with my own market-based/interventionist categorization (i.e., a case coded as “conservative” in the U.S. Supreme Court Database is coded as “market-based” in my own database, or vice versa). The primary source of discrepancies between the two coding schemes is that decisions imposing antitrust liability for horizontal price fixing, market allocation, and other cartel-like arrangements are coded as “liberal” in the U.S. Supreme Court Database and “market-based” in my own database (under the logic that even the Chicago School advocates prohibiting inefficient horizontal restraints).



After the 1992 term, the data become intermittent, as 1992 was the last term the Court consistently decided at least one antitrust case per term.³¹ Although the Court decided fewer antitrust cases after 1992, its likelihood of issuing a market-based decision in any given case continued to increase. Significantly, in six of the eight terms after 1992 in which the Court decided at least one antitrust case, 100% of its decisions were coded as market-based.

As these data illustrate, the general perception that Supreme Court antitrust decisions have become increasingly market-oriented is correct. Although aggregate decision data does not explain what caused this increase, the timing of the shift toward market-based antitrust decisions—most pronounced in the early 1970s—suggests judicial appointments likely played an important role. President Nixon made his first Court appointment in 1969 (Chief Justice Burger), and the 1972 term was the first full term in which all four of Nixon’s appointees (Burger, plus Blackmun, Powell, and Rehnquist) served together on the Court. So composed, the Burger Court was much more likely to issue market-based antitrust decisions than the preceding Warren Court (which was less likely to issue market-based decisions than

³¹ In Figure 1–7, terms in which no antitrust cases were decided are excluded from the bar charts. The time axes are therefore more compressed for the years 1993–2009 than for 1950–1992.

the preceding Vinson Court), as shown in Figure 1. The role of specific Justices is discussed in greater detail below.

ii. Law and Economics Citations

In addition to the outcomes of the cases themselves, another relevant measure of the influence of law and economics is the number of citations by the Court, parties (both plaintiffs and defendants), and amici curiae in their respective case documents. Citations by the Court itself are the clearest indication of influence, but citations in party and amicus briefs are also relevant, for two reasons: First, economic arguments derived from parties' or amici's academic citations may influence the Court's decisions, even in cases where the Court itself does not cite the academic literature. Second, the quantity of law and economics citations in party and amici briefs may suggest the general "state of the law," in that it indicates the type of arguments litigants expect the Court to respond to.³²

For purposes of this study, a "law and economics citation" means any citation to any book or article (1) addressing the subject of competition law and (2) written by (a) an economist or (b) a legal scholar relying on economic theory. In deciding whether to count a citation as a "law and economics citation," I did *not* draw a distinction between "conservative" (or market-based) and "liberal" (or interventionist) scholarship. Any citation to any book or article relying substantially on economic theory

³² A difficulty with citation analysis is controlling for changes in the number of *all* citations over time. If judges and practitioners are simply citing more of everything, an increase in a specific type of citation may not be particularly meaningful. With respect to Supreme Court opinions, recent empirical research indicates that citations to certain types of authority (prior Supreme Court decisions and nonlegal secondary sources) have increased since World War II, for a variety of reasons. See Frank B. Cross et al., "Citations in the U.S. Supreme Court: An Empirical Study of Their Use and Significance," *University of Illinois Law Review* 2010 (2010): 531–40; James H. Fowler et al., "Network Analysis and the Law: Measuring the Legal Importance of Precedents at the U.S. Supreme Court," *Political Analysis* 15 (2007): 333; Frederick Schauer and Virginia J. Wise, "Nonlegal Information and the Delegalization of Law," *The Journal of Legal Studies* 29 (January 2000): 500–503. On the other hand, in their study of citations to nonlegal sources, Schauer and Wise also present evidence that neither the annual page output nor the average number of citations per page of reported Court opinions has significantly changed over the same time period. *Ibid.*, 500–503. Unfortunately, due to practical constraints and a lack of relevant data, I was unable to control for possible changes in total citations. However, as the increase in law and economics citations shown in Figure 2 exceeds the increase in citations to prior Court decisions over the same period (see Fowler et al.), I suspect that the increase in law and economics citations is a largely independent phenomenon. To my knowledge, no research suggests any systematic increase in total citations in party and amici briefs.

was counted, regardless of the political orientation or policy conclusions of the cited author.³³ My decision to treat all economic scholarship equally represents an attempt to determine whether economic analysis, in and of itself, is associated with particular policy conclusions, distinct from the political leanings of particular law and economics scholars.

According to the conventional wisdom, the Chicago School was responsible for introducing economic analysis to antitrust law.³⁴ If correct, this view would imply a correlation in time between the rise of the Chicago School in the 1970s and the prevalence of law and economics citations in case documents. Many commentators have challenged this view, however. According to these commentators, economics has *always* played an important role in antitrust law, and the novelty of the Chicago School was the specific *type* of economics it embodied.³⁵ If the economic approach to antitrust law predates the rise of the Chicago School, as these arguments claim, no such correlation should exist. Given these differing perspectives, the empirical question of how often and when the Court, litigants, and amici curiae have cited law and economics scholarship becomes particularly important.

Beginning with the Court itself, Figure 2 shows the average number of law and economics citations per majority opinion³⁶ for each term.³⁷

³³ A citation to Joe Bain was counted the same as a citation to George Stigler, for example. As a practical matter, the majority of legal-economic citations by the Court, parties, and amici were market-based, particularly in the later years of the database.

³⁴ For an example of this conventional wisdom, see Priest, “The Abiding Influence of the Antitrust Paradox.”

³⁵ See Hovenkamp, “Antitrust Policy After Chicago,” 217–20; Hovenkamp, “Harvard, Chicago, and Transaction Cost Economics in Antitrust Analysis”; Herbert Hovenkamp, “The Harvard and Chicago Schools and the Dominant Firm,” in *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust* (New York: Oxford University Press, 2008); Kaplow, “Antitrust, Law and Economics, and the Courts,” 184–87; Frederick M. Rowe, “The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics,” *Georgetown Law Journal* 72 (1984): 1520–22. Even members of the Chicago School itself acknowledge the importance of the earlier “Harvard School” of antitrust economics. See, e.g., Posner, “The Chicago School of Antitrust Analysis.”

³⁶ This analysis does not include concurrences or dissents, mainly due to personal time constraints.

³⁷ The average (arithmetic mean) of law and economics citations per majority opinion was calculated by summing the law and economics citations in all majority opinions in a given term, then dividing by the number of decisions that term. When summing citations, multiple citations to the same work within a single opinion were each counted as separate citations.

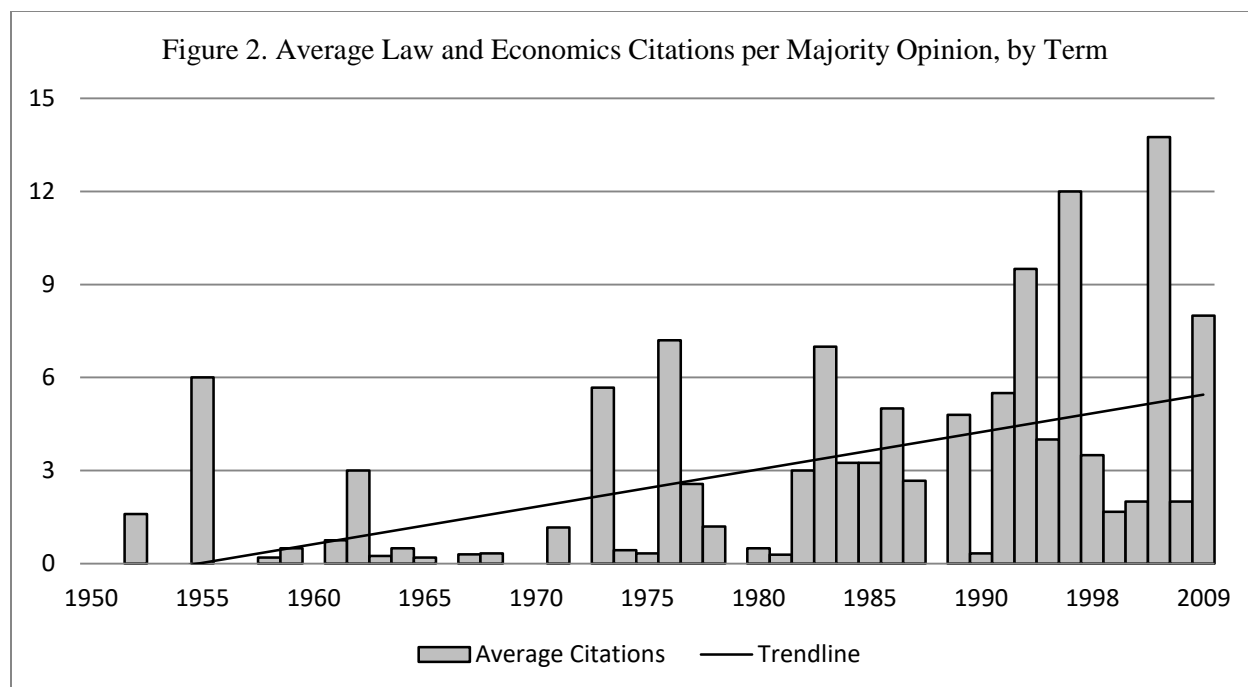
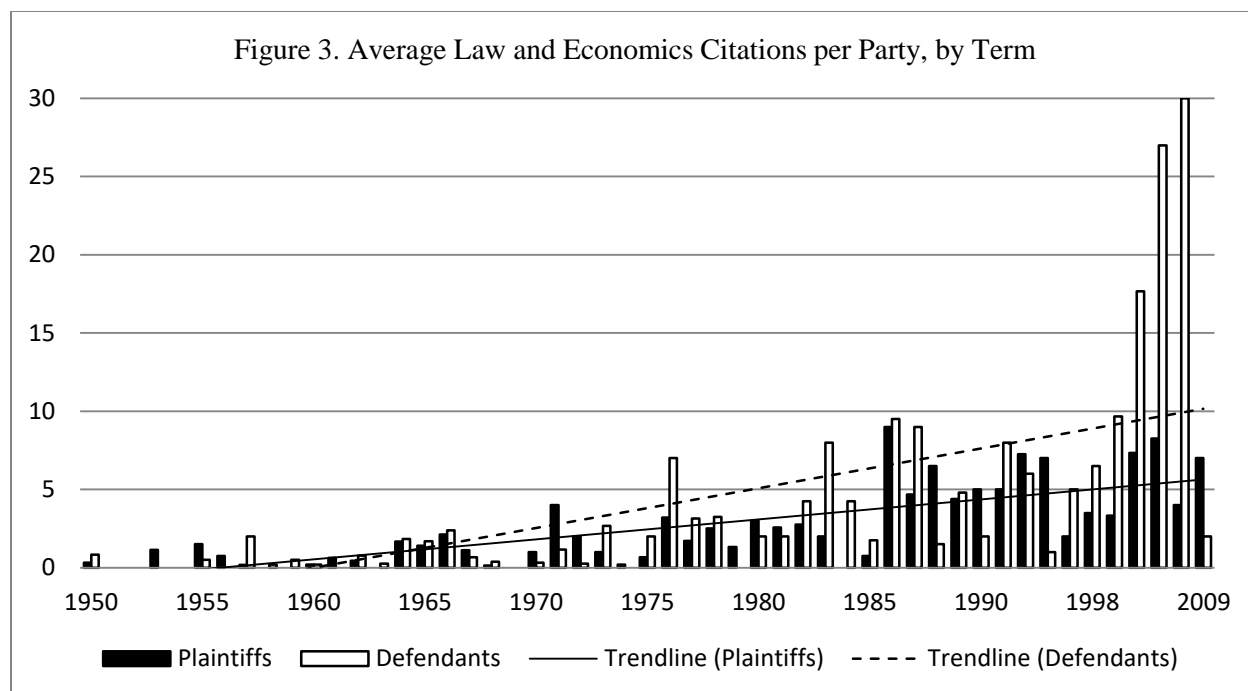


Figure 2 displays a similar pattern as Figure 1: in general, the Court cited law and economics scholarship infrequently prior to the 1970s, while law and economics citations were most common in the last two decades of the time series. Thus, the increase in market-based Court decisions observed in Figure 1 seems to have been accompanied by a similar increase in law and economics citations. Given the relative lack of citations in the first two decades of the time series, these data cast doubt on the argument that economics has always been central to antitrust law.³⁸ Although the structuralist scholarship of these earlier decades may have been influential in academic circles, it was rarely cited by the Court.

Continuing on to plaintiffs and defendants, Figure 3 shows the average combined total law and economics citations contained in (1) the initial brief, (2) the reply brief (if applicable), and (3) the supplemental brief (if applicable) of each party per case, for each term in the database.³⁹

³⁸ See note 30 and accompanying text above.

³⁹ The average (arithmetic mean) of law and economics citations per set of initial, reply, and supplemental briefs was calculated by summing the law and economics citations included in all sets of briefs in a given term, then dividing by the number of cases that term (this procedure was performed separately for plaintiffs and defendants). When summing citations, multiple citations to the same work within a single set of briefs were each counted as separate citations.



Again, law and economics citations increased in the 1970s and 1980s. When the data are plotted as a graph, however, this trend is overshadowed by the very high number of defendant citations in 2005, 2006, and 2008. Although these extreme averages are partly the result of fewer antitrust cases per term (only a single antitrust case was decided in the 2008 term, for example), they also reflect a significant increase in law and economics citations by defendants' counsel. This increase may be a strategic response to the Court's extremely high rate of market-based antitrust decisions since the early 1990s.

Finally, Figure 4 shows the average law and economics citations per amicus brief, broken down by pro-defendant and pro-plaintiff amici, for each term:⁴⁰

⁴⁰ In keeping with the decision to only include cases decided on the merits (and therefore to exclude certiorari determinations), I only examined amicus briefs addressing the merits of the case. Filings by amici recommending or opposing certiorari are not included in Figure 4. The average (arithmetic mean) of law and economics citations per amicus brief was calculated by summing the law and economics citations in all amicus briefs in a given term, then dividing by the total number of amicus briefs filed that term (this procedure was performed separately for pro-defendant and pro-plaintiff amici). When summing citations, multiple citations to the same work within a single brief were each counted as separate citations.

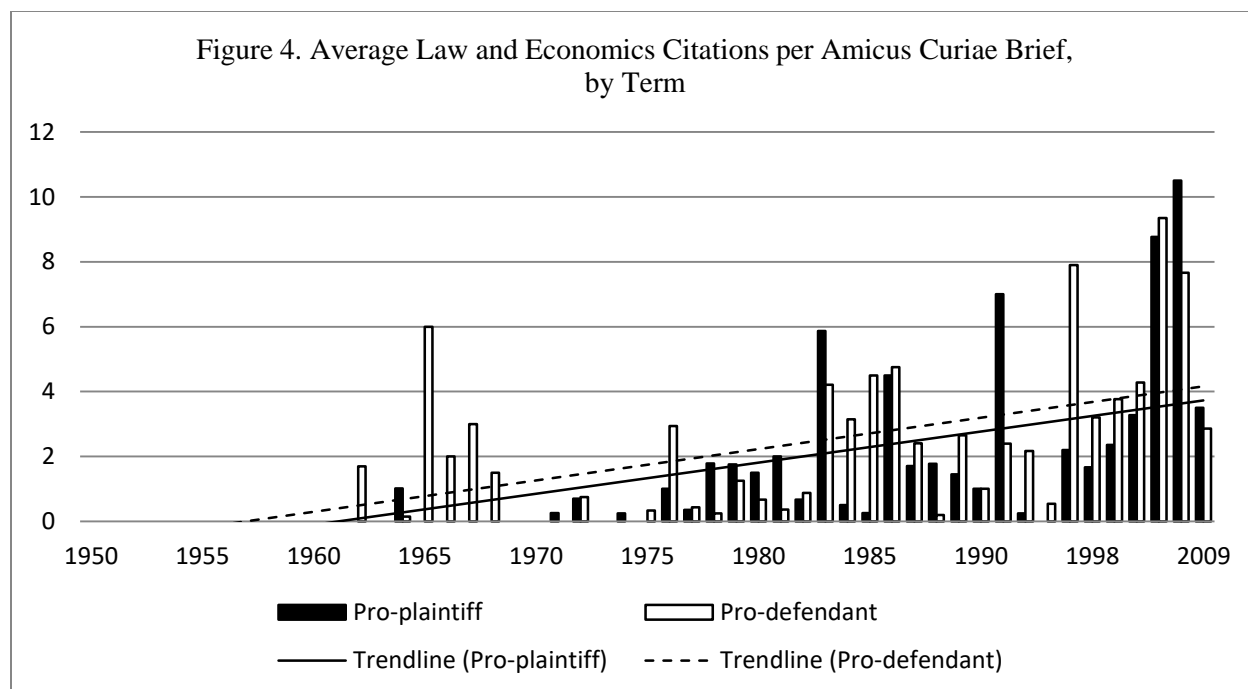


Figure 4 displays the familiar pattern of increasing law and economics citations. Averaging the number of citations per brief obscures two additional trends in amicus practice, however. First, the average number of *filings* per case increased significantly over the time series, from no filings at all during the first several years to a high of 18 in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP* in 2004.⁴¹ The phenomenon of increasing amicus filings is hardly unique to antitrust law—indeed, it pervades nearly every area of the Supreme Court’s docket.⁴² Given the tendency of amici to emphasize economic policy arguments in antitrust cases, however, this phenomenon has been a major source of increasing law and economics citations. Second, aggregate data fails to highlight individual amicus briefs containing very high numbers of law and economics citations. These briefs become particularly notable in the final decade of the time series, in which many cases feature economics-heavy amicus briefs filed by

⁴¹ *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

⁴² For discussion of the general phenomenon of increasing amicus filings, see Paul M. Collins, “Friends of the Court: Examining the Influence of Amicus Curiae Participation in U.S. Supreme Court Litigation,” *Law and Society Review* 38 (December 2004): 807–32; Joseph D. Kearny and Thomas W. Merrill, “The Influence of Amicus Curiae Briefs on the Supreme Court,” *University of Pennsylvania Law Review* 148 (2000): 743–855. See also Kelly J. Lynch, “Best Friends? Supreme Court Law Clerks on Effective Amicus Curiae Briefs,” *Journal of Law & Politics* 20 (winter 2004): 33–75.

business groups, policy institutes, and even rival schools of antitrust scholars. For example, several recent cases feature amicus briefs by scholars advocating stereotypical Chicago School positions as well as briefs from opposing scholars advocating “post-Chicago” positions.⁴³ This direct participation in Supreme Court cases by legal-economic scholars is an important example of the increasing economization of the both practice and discourse of antitrust law.

Figure 2, Figure 3, and Figure 4 indicate that law and economics citations by the Court, parties, and amici curiae were relatively infrequent prior to the 1970s. Citations began to increase thereafter, accelerating in the 1990s. While the infrequency of law and economics citations during the 1950s and 1960s supports the view that economic theory was not yet central to antitrust law, the reasons for the subsequent increase in citations remain open to debate. Since this increase is roughly correlated with the academic rise of the Chicago School, increasing citations may have been a function of the Chicago School’s intellectual influence. On the other hand, the increase begins in earnest only after the arrival of the Nixon appointees, suggesting that increasing citations may also have been a function of a more sympathetic, market-oriented Court. The conflation in time of these parallel developments makes ascribing causation particularly difficult. This difficulty is compounded, moreover, by the even greater increase in economic citations in the 1990s and 2000s, which may be attributable to consolidation of the economic approach to antitrust law or, alternatively, to an increasingly conservative Court. Relying on citation data alone, the only thing that can be said for certain is that law and economics citations have definitely increased. Understanding why requires a broader analysis of additional characteristics of the Court’s antitrust cases.

⁴³ The term “post-Chicago” refers to antitrust scholarship that shares the Chicago School’s normative emphasis on economic efficiency, but criticizes its economic models as being overly simplistic. Post-Chicago scholarship has attempted to add concepts derived from game theory, behavioral analysis, and other forms of dynamic economic modeling to antitrust law. Although post-Chicago scholarship has been influential in the academic world, it has had less influence on Supreme Court jurisprudence, where the Chicago School remains dominant. For a variety of perspectives on post-Chicago antitrust scholarship, see Daniel A. Crane, “A Neo-Chicago Perspective on Antitrust Institutions,” *Antitrust Law Journal* 78, no. 1 (2012): 43–65; Hovenkamp, “Antitrust Policy After Chicago”; Hovenkamp, “Post-Chicago Antitrust: A Review and Critique”; Bruce H. Kobayashi, “Game Theory and Antitrust: A Post-Mortem,” *George Mason Law Review* 5 (1997): 411–21; Bruce H. Kobayashi and Timothy J. Muris, “Chicago, Post-Chicago, and Beyond: Time to Let Go of the 20th Century,” *Antitrust Law Journal* 78 (2012): 505–26; Pitofsky, *How the Chicago School Overshot the Mark*.

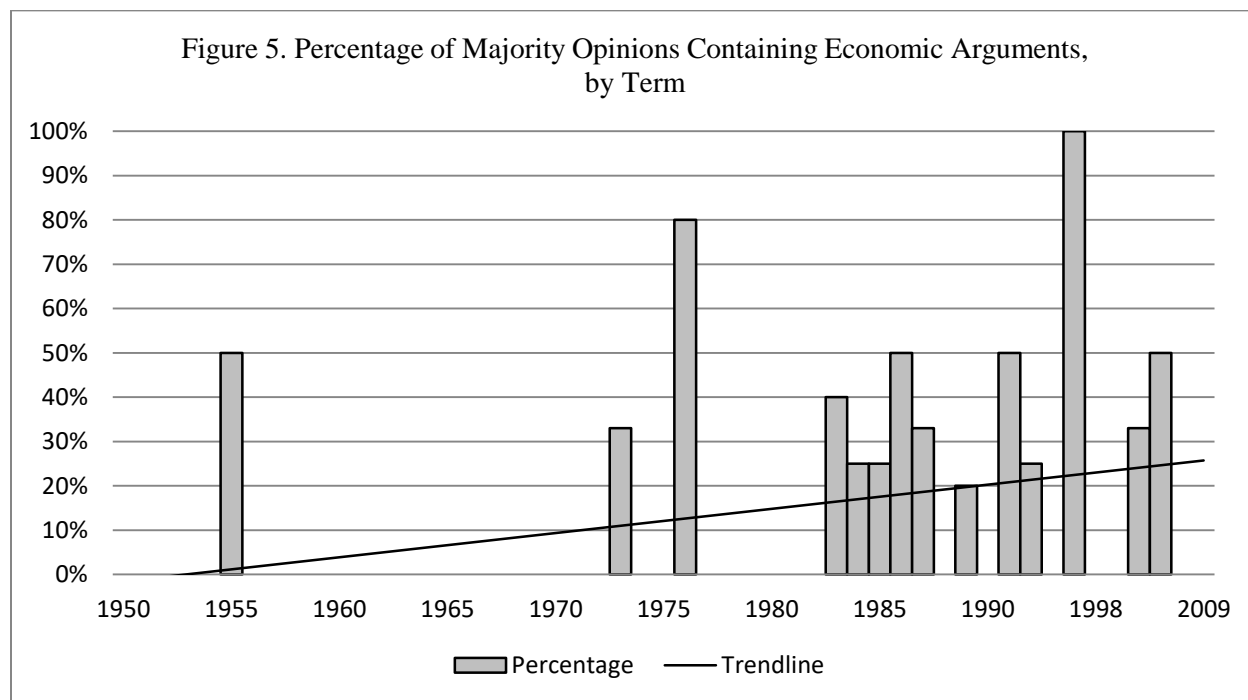
iii. Economic Arguments

Citations to law and economics scholarship increased over the last several decades, but were these citations necessarily tied to substantive economic arguments? Perhaps not—examining Court opinions, party and amici briefs, and other case documents reveals Justices and counsel often use legal-economic citations as a form of “window dressing,” typically to bolster traditional legal arguments with additional (if superficial) academic support. It is rarer to encounter substantive arguments that are genuinely based on economic theory, as opposed to the application of precedent to facts that characterizes traditional legal reasoning. Thus, the prevalence of economic arguments, and whether this prevalence has increased over time, is another important measure of the role of economics in antitrust law.

For purposes of this analysis, an opinion or brief was coded as containing an “economic argument” if it included any specific, detailed, and relatively self-contained argument that application of economic theory compelled a particular decision outcome. As with the citation analysis above, no distinction was drawn between “conservative” (or market-based) and “liberal” (or interventionist) economic analysis. The coding was binary—an opinion or brief was classified as either containing an economic argument or not. As is typical in legal practice, many opinions and briefs contained multiple, independent arguments in support of a given decision outcome. If just *one* of these arguments was economic in nature, the opinion or brief was coded as containing an economic argument. That said, passing references to economic scholarship (i.e., window dressing) were insufficient—to qualify, the argument must have been relatively developed. Overall, the essential distinction that I attempted to draw was between fundamentally *legal* arguments, grounded in the application of legal rules (even if buttressed by economic citations), and fundamentally *economic* arguments, grounded in the application of economic theory.⁴⁴

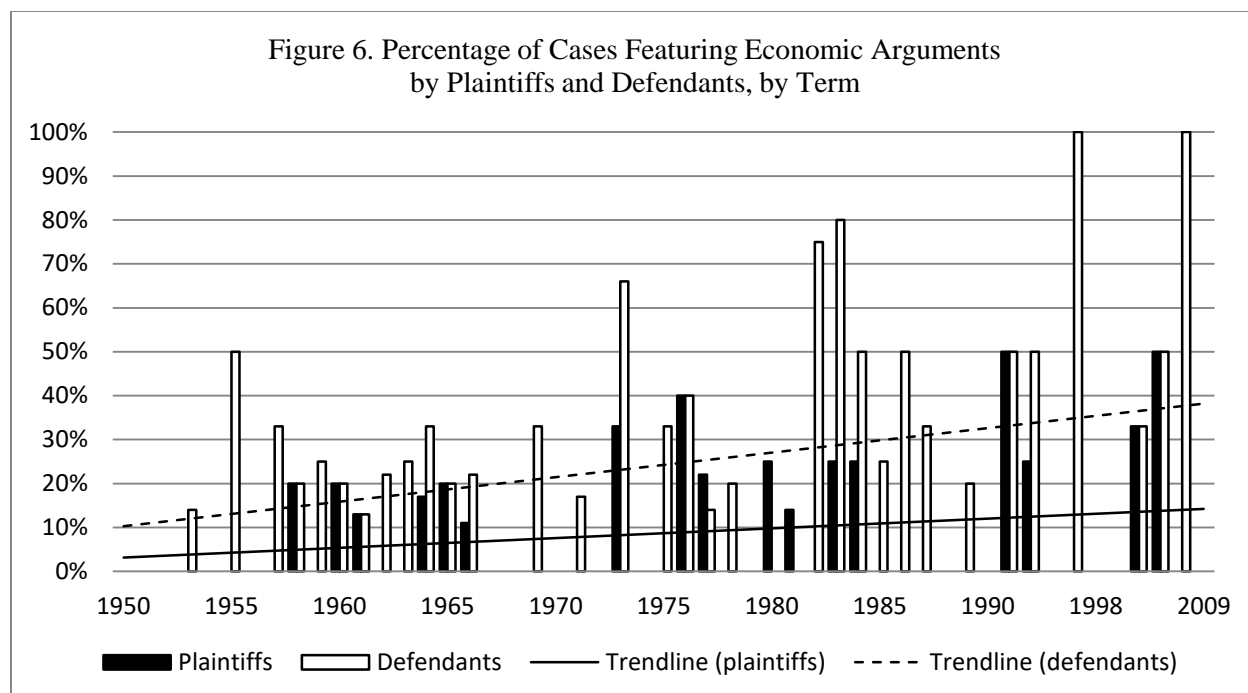
⁴⁴ Obviously, this was often a subjective determination. Even when using consistent criteria, it is not always easy to differentiate a “legal” from an “economic” argument. Given my aim of distinguishing between mere legal-economic citations and substantive economic arguments—as well as the prevalence of casual, non-substantive economic rhetoric in antitrust cases—my standard for what qualified as an economic argument was fairly strict.

Reflecting (and befitting) its nature as a legal institution, the Court's use of economic arguments has been relatively infrequent. Figure 5 shows the percentage of majority opinions containing at least one economic argument, by term:



Although there is a slight upward trend over time, the Court's use of economics arguments can be best described as sporadic. One's impression after reading all the cases in the database is that many Justices have been hesitant to engage in explicitly economic arguments, preferring to justify their decisions in the traditional terms of legal precedent. Even though the Court has become increasingly likely to cite law and economics scholarship (see Figure 2), these citations often provide ancillary support for conventional, precedent-based legal arguments. At least with respect to Supreme Court opinions, antitrust appears more law than economics.

A somewhat different picture emerges from party and amicus briefs. Beginning with the parties, Figure 6 shows the percentage of cases in which plaintiffs and defendants presented economic arguments in their (1) initial brief, (2) reply brief (if applicable), or (3) supplemental brief (if applicable), for each term:



The party data is also sporadic, with significant variation year to year. Figure 6 clearly shows, however, that defendants have used economic arguments more often than plaintiffs. This pattern, visible in the bar graph, is even more evident from reading the briefs themselves. When read side by side, the plaintiffs' and defendants' briefs in many important antitrust cases reveal a striking contrast of differing legal strategies.

These differences are evident in some of the Court's most pivotal antitrust decisions. Beginning in the 1970s, the Court overturned or significantly weakened many of its prior holdings as to the per se illegality of a wide variety of market practices, including vertical restraints,⁴⁵ tying arrangements,⁴⁶ and exclusionary refusals to deal.⁴⁷ In many of these cases, plaintiffs' counsel constructed their arguments in a straightforward, traditional legal fashion. These arguments often proceeded by (1) citing the relevant

⁴⁵ See *Continental T.V., Inc.; Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984); *Bus. Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988).

⁴⁶ See *U.S. Steel Corp. v. Fortner Enterprises, Inc.*, 429 U.S. 610 (1977); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984); *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 547 U.S. 28 (2006).

⁴⁷ See *NW Wholesale Stationers, Inc. v. Pacific Stationary & Printing Co.*, 472 U.S. 284 (1985); *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128 (1998); *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

per se rule, as articulated in established Court precedent, (2) applying the rule to the facts of the case, and (3) concluding that the defendant's conduct was per se illegal.⁴⁸ Only rarely did plaintiffs' counsel make any rigorous effort to explain why prohibiting the defendant's conduct would be economically beneficial. Defendants' counsel, on the other hand, often took an economic approach, explicitly arguing that their clients' practices promoted consumer welfare. These economic arguments invited the Court to reconsider its prior holdings, and to substitute economic theory for the judicial principle of stare decisis.

The significant disconnect between plaintiffs' and defendants' arguments speaks to the transitional nature of the period. In certain cases, the differences between the parties are so pronounced that they seem to be arguing past each other.⁴⁹ As most of these cases were victories for the defendant, the reliance of plaintiffs' counsel on established precedent seems misguided, at least in hindsight. In fairness to plaintiffs' counsel, it is difficult to name any other area of law in which the Court has been so willing to disregard stare decisis. Who could have predicted that economic arguments would so consistently trump established Court precedent? But to invoke Justice Holmes, if "prophecies of what the courts will do in fact, and nothing more pretentious"⁵⁰ is what is meant by the law, then antitrust defendants may have had better, more prophetic lawyers. Whether defendants' counsel were more adept at responding to the Court's economic concerns, or whether defendants' economic arguments were what led the Court to reexamine its prior holdings, is a question taken up below.

I turn now to amicus briefs, in which economic arguments have become the most prevalent. Figure 7 shows the annual percentage of cases in which at least one amicus brief supporting the plaintiff or the defendant contained an economic argument:

⁴⁸ Plaintiff's brief in *Fortner* is a prime example—the brief focuses on establishing a per se tying violation under the Sherman Act, without engaging the underlying policy rationale (or lack thereof) of the per se rule. Brief for the Respondent, *U.S. Steel Corp. v. Fortner Enterprises, Inc.*, 429 U.S. 610 (1977) (No. 75-853).

⁴⁹ For examples, see *Fortner*, *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984), and *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).

⁵⁰ Oliver Wendell Holmes, "The Path of the Law," *Harvard Law Review* 10 (1897): 460–61.

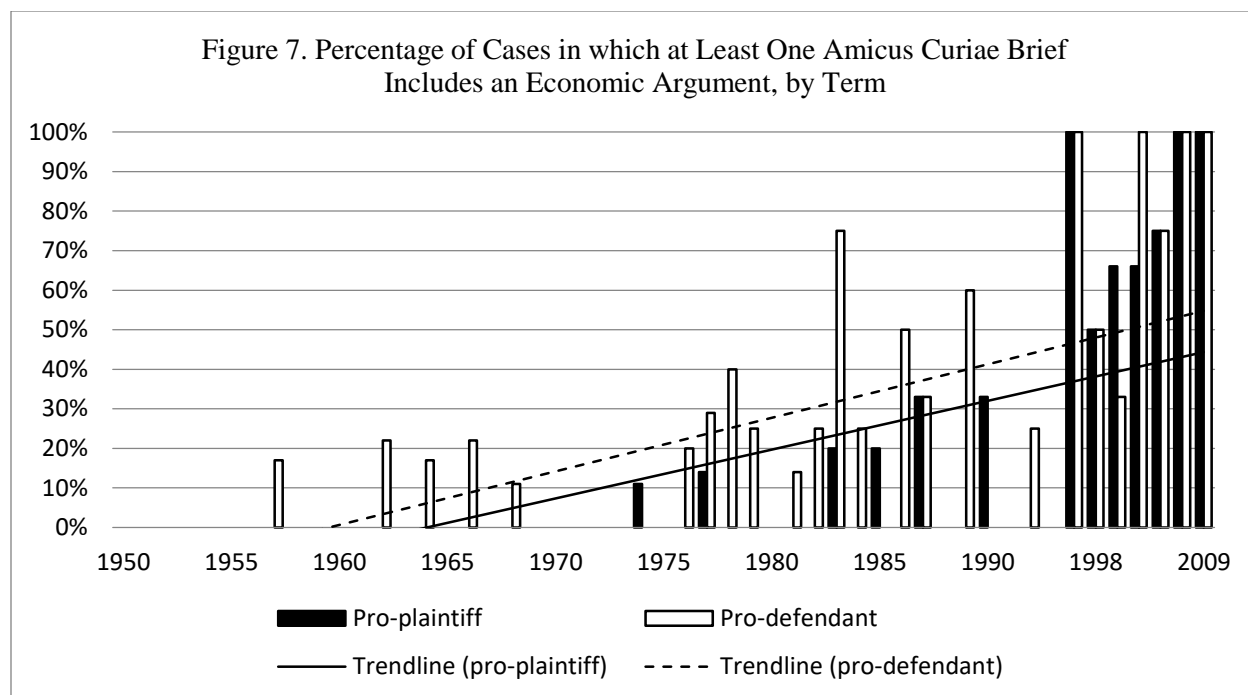


Figure 7 shows a major increase, first with respect to pro-defendant amici, and followed by pro-plaintiff amici. Much of this increase was due to increasing amicus filings per case—while there were zero amicus filings for several years during the 1950s, by the 1990s, ten or more amicus filings per antitrust case had become the norm. Simply as a matter of probability, the higher the number of amicus briefs submitted per case, the greater the likelihood that any one of them would include an economic argument. This is not to say that the level of economic sophistication of the “average” amicus brief remained unchanged, however. As discussed above, the advent of recurrent amicus filings by business groups, policy institutes, and academic scholars meant that the overall content of amicus briefs became increasingly economic over the period.

The U.S. government also contributed to this change. The Department of Justice had been sporadically involved in private antitrust litigation for decades, but its participation as amicus curiae increased significantly during the 1980s. Under the framework of the “Private Action Project,” a program initiated by William F. Baxter, Assistant Attorney General for antitrust under the first Reagan administration, the Department sought to use amicus filings to systematically influence the direction of antitrust law. Under this program, Supreme Court cases in which the existing state of the law could be

clarified or improved (according to the Reagan administration) were identified by the Department's Antitrust Division. Department attorneys then drafted and submitted amicus briefs advocating particular decision outcomes. Given the powerful influence of the Chicago School within the Reagan-era Antitrust Division, these briefs regularly featured highly economic, market-based policy arguments.⁵¹ The Department's arguments often extended beyond the immediate case at hand, explicitly requesting that the Court overturn or modify established antitrust precedents.⁵² Together, each of these three developments—increasing numbers of amicus briefs, the increasingly economic content of individual briefs, and the increasingly aggressive economic advocacy of the U.S. government—amplified the volume of economic arguments to which the Supreme Court was repeatedly exposed.

To summarize, what do these statistical patterns tell us about changes in U.S. antitrust law? At a basic level, they provide confirmation that market-based Court decisions, law and economics citations, and the use of economic arguments have all increased since 1950. At a more granular level, they also show that parties and amici have engaged in economic arguments more often than the Court, and that defendants have historically used economic arguments more often than plaintiffs. Although the data suggest intriguing relationships between these developments and the timing of Supreme Court appointments, case-level statistics only reveal so much regarding the central issue of causality. Was the market-based shift in the Court's decisions a response to economic arguments? Or were the economic arguments of parties and amici a response to the Court's market-based decisions? Resolving this puzzle requires looking beyond the Court as a unitary institution and examining the role of individual Justices in the changing direction of antitrust jurisprudence.

⁵¹ Eisner, *Antitrust and the Triumph of Economics*, 184–227.

⁵² For discussion of the Private Action Project, see *Ibid.*, 207–10. There is reason to believe the government has been a particularly influential amicus curiae. Among the cases in the database, the Court's ruling was consistent with the government's recommendation in 84% of cases in which the government submitted an amicus brief. If one considers only cases during the Reagan years, this figure increases to 90%. For additional discussion of the government's role and influence as amicus curiae, see John Thorne, "A Short Note on Government Amicus Briefs in Antitrust Cases" (American Bar Association, April 1, 2004).

C. Justice-Level Patterns

The statistics presented above support the conventional wisdom—that the substance and rhetoric of antitrust law has become increasingly economic over time. The question of what caused this shift cause remains difficult to answer, however. The timing of the change in the Court’s decisions suggests judicial appointments played an important role (see Figure 1), though without additional evidence it is difficult to say more. Only investigating the voting behavior of individual Justices can reveal the vote-specific factors that shape the Court’s aggregate decision record.

This section provides such an investigation: by comparing the votes of individual Justices against selected case-level variables, it seeks to determine whether Justices’ voting decisions were influenced by economic arguments. As detailed below, the means of conducting this inquiry were twofold. The first method was simply to assess whether individual Justices’ voting records changed over time. The second was to compare the voting records of individual Justices in (1) cases in which one or both parties made an economic argument against (2) cases in which neither party made an economic argument. My findings indicate that, while the antitrust views of certain Justices did evolve over time, economic arguments did not “convert” Justices from their preexisting judicial positions.

i. Individual Justices’ Voting Over Time

As discussed in above, the antitrust decisions of the Supreme Court have become increasingly market-oriented over time. Since Supreme Court decisions are determined by majority voting, fully understanding this increase requires tracking individual votes. From this perspective, the basic inquiry becomes whether the shift in the Court’s antitrust record was due to (1) changes in the voting patterns of incumbent Justices or (2) the replacement of incumbent Justices with more conservative appointees. The simplest method of addressing this question is determining whether individual Justices’ voting patterns changed over time. Such a determination is possible with data derived from the U.S. Supreme Court Database, which includes the votes of individual Justices for every case in the collection. After coding the Court decisions in my own database as either market-based or interventionist, it was straightforward to classify individual votes according to the same schema: For market-based decisions, votes with the

majority (including concurrences) were coded as market-based, while votes with the dissent(s) (if any) were coded as interventionist. Similarly, for interventionist decisions, votes with the majority (including concurrences) were coded as interventionist, while votes with the dissent(s) (if any) were coded as market-based.⁵³

Whether voting patterns changed over time speaks to the question of intellectual influence given the temporal increase in economic references within opinions, briefs, and other case documents. Since economic references increased after the 1960s, a corresponding increase in market-based votes on the part of a given Justice would tend to suggest that exposure to economic ideas had influenced the Justice's voting decisions. On the other hand, if a Justice's voting remained essentially unchanged, it would tend to suggest an absence of influence.

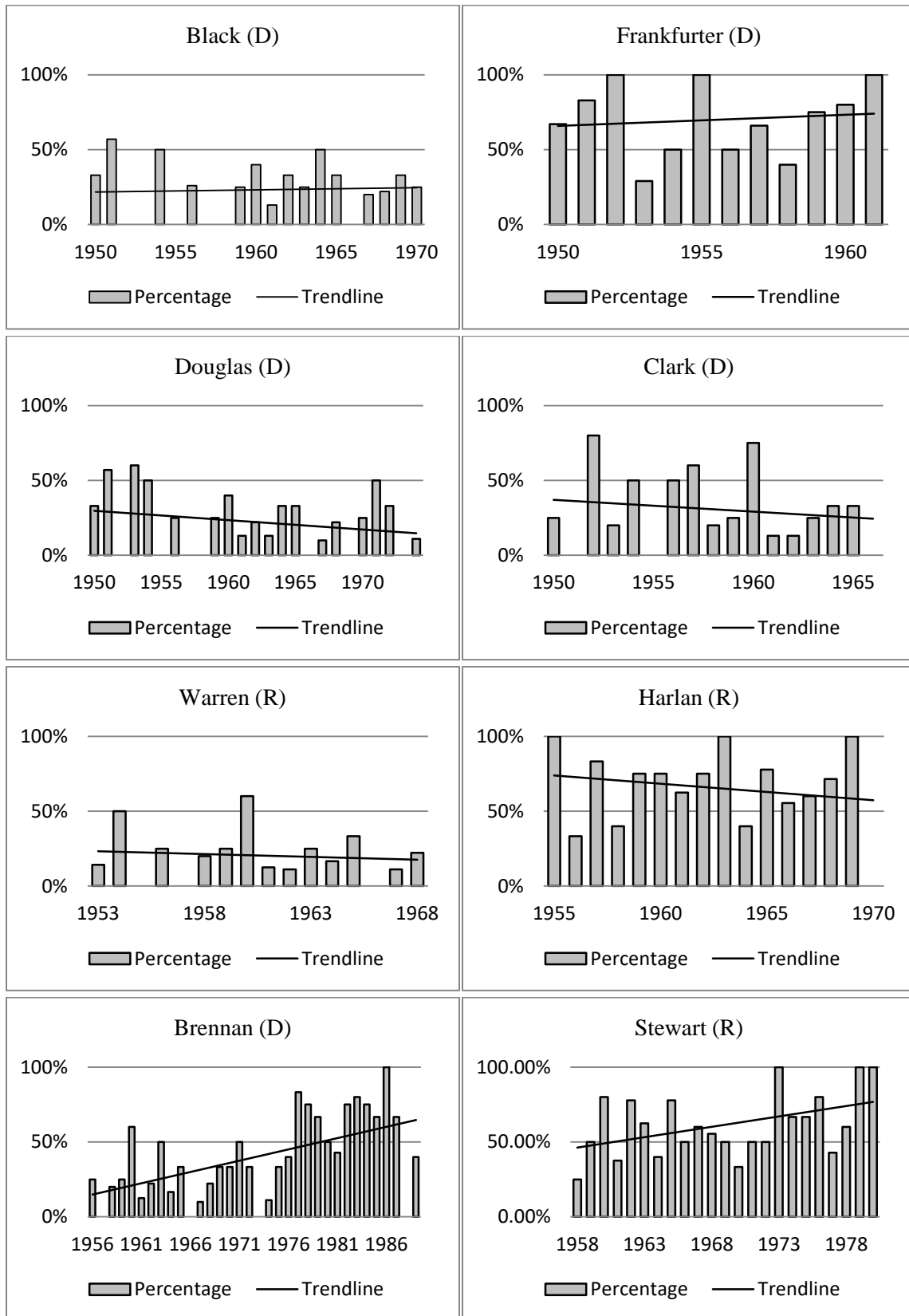
The voting data for individual Justices indicate that most Justices arrived on the Court with stable, preexisting antitrust views. The data also indicate that later appointees to the Court were more market-oriented than their predecessors. To convey these patterns visually, Figure 8 shows the annual percentage of cases in which each Justice⁵⁴ cast market-based votes.⁵⁵

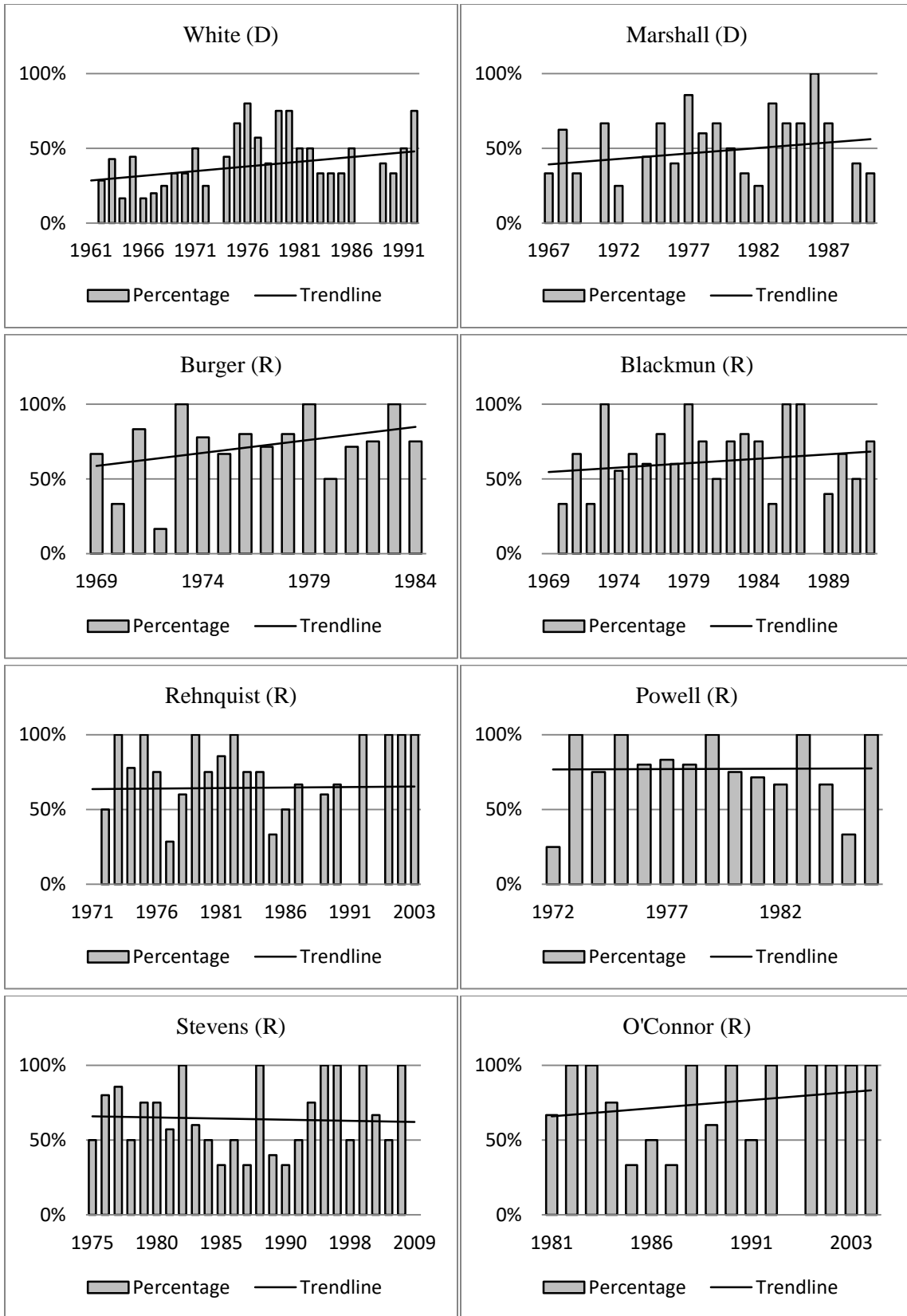
⁵³ There are a few odd exceptions in the database. In certain cases, based on my reading of the opinions, both the majority and dissenting votes were coded the same (i.e., market-based or interventionist), or concurring votes were coded differently from the majority.

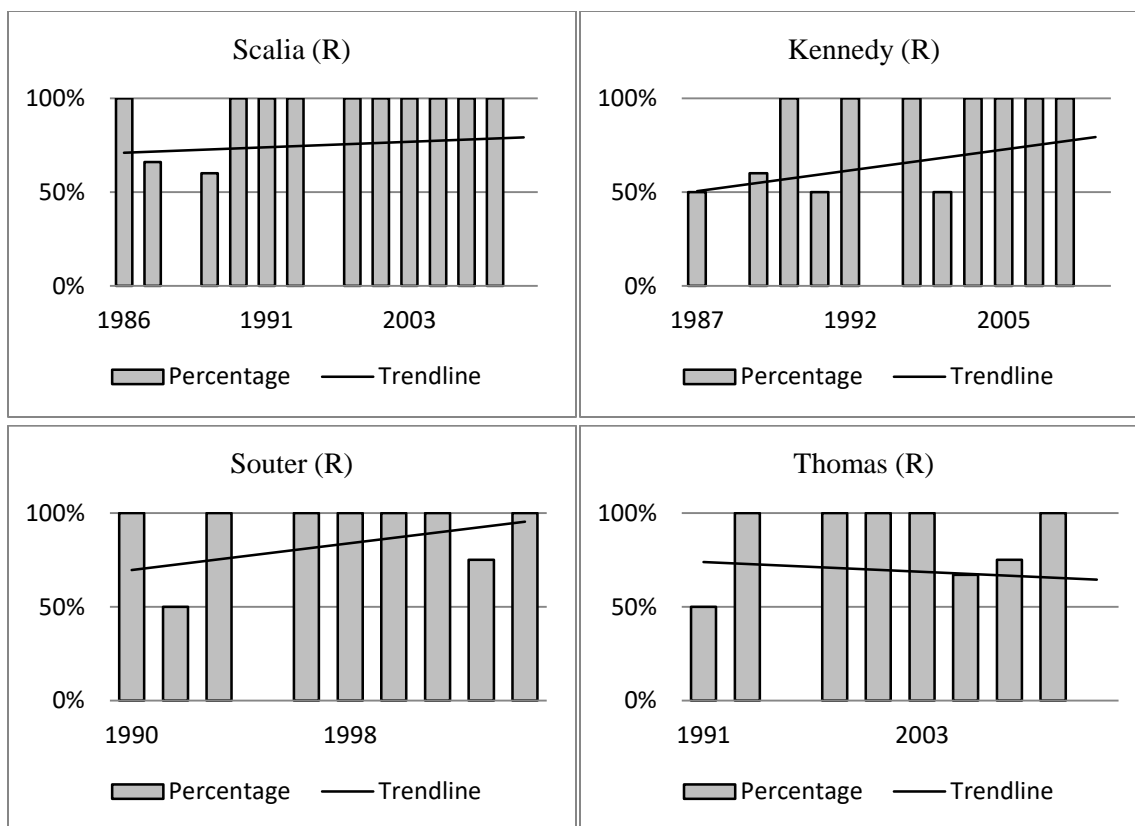
⁵⁴ Figure 8 includes each Justice who served for at least 10 terms between 1950 and 2010 in which at least one antitrust case was decided by the Court. This excludes Justices Reed, Jackson, Burton, Minton, Vinson, Whittaker, Goldberg, Fortas, Ginsburg, Breyer, Roberts, and Alito, who each served for less than 10 terms between 1950 and 2010 in which at least one antitrust case was decided. The timescales for each chart in Figure 8 are different, given that each Justice served for different periods of time. Voting information for terms before 1950 and after 2010 is not included in my database and therefore not shown in Figure 8. For a list of the full names and tenures of all Justices in the database, see the Appendix.

⁵⁵ Cases in which the particular Justice did not participate are excluded from analysis.

Figure 8. Annual Percentage of Market-Based Votes of Individual Justices Over Time







A few Justices' voting records did become increasingly market-oriented. For two reasons, the voting record of Justice William Brennan offers the most interesting example. His was the record that changed the most, as his decisions moved from very interventionist in the 1950s to relatively market-oriented by the 1980s. Moreover, Brennan was also one of the twentieth-century Court's most important liberals, and while his antitrust voting moved in an increasingly market-based direction, his *overall* voting record became even more liberal.⁵⁶ The divergence between Brennan's antitrust record and his record in other types of cases suggests his antitrust views were not simply a function of his broader ideology. As his tenure overlapped with the most important changes in antitrust practice, Brennan's evolution may also imply his growing acceptance of parties' and amici's economic arguments.

⁵⁶ As measured by the commonly-used Martin-Quinn score, Brennan's overall judicial ideology became increasingly liberal over his tenure. See "Martin-Quinn Scores: Measures," accessed May 10, 2017, <http://mqscores.berkeley.edu/measures.php>.

As intriguing as such developments may be, any changes in the voting behavior of individual Justices are far outweighed by the greater effect of turnover in the composition of the Court. Each and every Justice appointed after Thurgood Marshall cast a higher percentage of market-based votes than the departing Justice they replaced. Over the course of successive appointments, this led to a stable majority of market-based votes in most Supreme Court antitrust cases. Significantly, this phenomenon is not merely a function of party identity. When the analysis includes every Justice in the database, it becomes clear that *all* recent appointees, both Democratic and Republican, cast greater percentages of market-based votes than nearly every Justice predating the Nixon administration.⁵⁷ This can be seen in Table 1, which provides the total percentage of market-based votes cast by each Justice serving between 1950 and 2009:

Table 1. Percentage of Market-Based Votes of Individual Justices

Black (D)	22.31%	Fortas (D)	23.08%
Reed (D)	50%	Marshall (D)	47.37%
Frankfurter (D)	66.07%	Burger (R)	70.67%
Douglas (D)	22.3%	Blackmun (R)	63.22%
Jackson (D)	60%	Powell (R)	76.67%
Burton (R)	65%	Rehnquist (R)	68.13%
Vinson (D)	55.56%	Stevens (R)	62.65%
Minton (D)	50%	O'Connor (R)	74.47%
Clark (D)	30.86%	Scalia (R)	80.56%
Warren (R)	18.56%	Kennedy (R)	71.88%
Harlan (R)	64.71%	Souter (R)	86.96%
Brennan (D)	34.91%	Thomas (R)	77.27%
Whittaker (R)	71.43%	Ginsburg (D)	68.75%
Stewart (R)	60.16%	Breyer (D)	75%
Goldberg (D)	52.63%	Roberts (R)	88.89%
White (D)	38.3%	Alito (R)	83.33%

As Table 1 shows, recent conservative appointees have been more likely to cast market-based votes than prior conservative appointees, while recent liberal appointees have been more likely to cast market-based votes than prior liberal appointees—as well as many prior conservative appointees! Justice Ruth Bader Ginsburg and Justice Stephen Breyer, current members of the Court's liberal wing, have more market-

⁵⁷ The single exception being Justice Whittaker, who had an unusually brief tenure on the Court and cast an unusually high percentage of market-based votes.

oriented voting records than both Justice John Marshall Harlan and Justice Potter Stewart, historically considered antitrust conservatives. If measured strictly in terms of antitrust decisions, the median Supreme Court Justice has shifted significantly rightward since the early 1970s. This phenomenon of later Court appointees—both Democrats and Republicans—casting higher percentages of market-based votes than their immediate predecessors has been the single most important factor in the Court’s changing antitrust jurisprudence.

ii. Economic Arguments and Individual Justices’ Votes

But changes in Justices’ voting over time are only a crude measure of the influence of economics. In effect, time is serving as a proxy for the economization of antitrust arguments, hardly a precise metric of the economic content of specific cases. Fortunately, there is a more direct means of assessing the relationship between economic arguments and individual Justices’ votes. Using 2x2 contingency tables, I compare, for each Justice, the percentage of cases in which the Justice cast a market-based vote in (1) cases in which either party made at least one economic argument and (2) cases in which neither party made an economic argument. This comparison allows direct assessment of the statistical relationship between economic arguments and individual Justices’ votes.

The results are fascinating. In a nutshell, the effect of the presence of economic arguments on individual Justices depends on the particular Justice’s overall antitrust record: Justices who were more likely to cast market-based votes in all cases were even *more* likely to cast market-based votes in cases featuring economic arguments. Justices who were more likely to cast interventionist votes in all cases, however, were even *less* likely to cast market-based votes in cases featuring economic arguments. In other words, the presence of economic arguments in antitrust cases seems to have an amplifying effect on Justices’ preexisting policy views. These results hold for nearly every Justice in the dataset.⁵⁸

⁵⁸ The exceptions being Justice Souter and (significantly) Justice Brennan. Three early Justices, Burton, Minton, and Reed, cast market-based votes in approximately 50% of total cases, but were significantly less likely to cast market-based votes in cases featuring economic arguments. This may be due to the fact that economic arguments (while rare) tended to support interventionist outcomes in the early 1950s.

Table 2 presents 2x2 contingency tables for the same Justices included in Figure 8,⁵⁹ reporting the Justice-specific relationships between (1) the presence or absence of at least one economic argument in the parties' briefs (whether made by the defendant, plaintiff, or both)⁶⁰ and (2) whether the Justice cast a market-based or interventionist vote:⁶¹

Table 2. Individual Justices' Votes by Presence or Absence of Economic Arguments

Black (D)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	73.27%	26.73%	100%
Economic Argument(s)	100%	0%	100%
Total	77.69%	22.31%	100%

Frankfurter (D)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	36.17%	63.83%	100%
Economic Argument(s)	22.22%	77.78%	100%
Total	33.93%	66.07%	100%

Douglas (D)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	73.50%	26.50%	100%
Economic Argument(s)	95.83%	4.17%	100%
Total	77.30%	22.70%	100%

⁵⁹ That is, Justices who served at least 10 terms between 1950 and 2010 in which at least one antitrust case was decided by the Court.

⁶⁰ Including the initial merits briefs, as well as reply briefs and supplemental briefs, if any.

⁶¹ In social science research, contingency tables are often used to assess relationships between categorical variables. When used with sample data, they are typically accompanied by tests of statistical significance (most often the chi-square test). For this analysis, I have not included significance tests because the data are not a sample—they encompass the entire population of individual votes within my period of interest. Significance testing is inapplicable because there is no statistical inference to be made. Whether *substantively* significant or not (a question for the reader to decide), the data speak for themselves. That said, if one *were* to perform two-tailed chi-square tests on the data in Table 2, the results for Justice Black would be statistically significant at $p \leq 0.01$; the results for Justices Douglas, Burger, and O'Connor would be statistically significant at $p \leq 0.05$; and the results for Justices Harlan, Powell, Rehnquist, and Scalia would be statistically significant at $p \leq 0.1$.

Clark (D)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	64.62%	35.38%	100%
Economic Argument(s)	87.50%	12.50%	100%
Total	69.14%	30.86%	100%

Warren (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	78.21%	21.79%	100%
Economic Argument(s)	94.74%	5.26%	100%
Total	81.44%	18.56%	100%

Harlan (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	41.18%	58.82%	100%
Economic Argument(s)	17.65%	82.35%	100%
Total	36.47%	63.53%	100%

Brennan (D)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	67.46%	32.54%	100%
Economic Argument(s)	58.14%	41.86%	100%
Total	65.09%	34.91%	100%

Stewart (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	43.75%	56.25%	100%
Economic Argument(s)	25.93%	74.07%	100%
Total	39.84%	60.16%	100%

White (D)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	60.19%	39.81%	100%
Economic Argument(s)	66.67%	33.33%	100%
Total	61.7%	38.3%	100%

Marshall (D)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	52.86%	47.14%	100%
Economic Argument(s)	52%	48%	100%
Total	52.63%	47.37%	100%

Burger (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	36.54%	63.46%	100%
Economic Argument(s)	13.04%	86.96%	100%
Total	29.33%	70.67%	100%

Blackmun (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	43.33%	56.67%	100%
Economic Argument(s)	22.22%	77.78%	100%
Total	36.78%	63.22%	100%

Rehnquist (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	39.06%	60.94%	100%
Economic Argument(s)	14.81%	85.19%	100%
Total	31.87%	68.13%	100%

Powell (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	32.5%	67.5%	100%
Economic Argument(s)	5%	95%	100%
Total	23.33%	76.67%	100%

Stevens (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	40%	60%	100%
Economic Argument(s)	32.14%	67.86%	100%
Total	37.35%	62.65%	100%

O'Connor (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	40%	60%	100%
Economic Argument(s)	0%	100%	100%
Total	25.53%	74.47%	100%

Scalia (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	28.00%	72.00%	100%
Economic Argument(s)	0.00%	100.00%	100%
Total	19.44%	80.56%	100%

Kennedy (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	34.78%	65.22%	100%
Economic Argument(s)	11.11%	88.89%	100%
Total	28.13%	71.88%	100%

Souter (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	6.67%	93.33%	100%
Economic Argument(s)	25.00%	75.00%	100%
Total	13.04%	86.96%	100%

Thomas (R)			
	Interventionist Vote	Market-Based Vote	Grand Total
No Economic Argument	35.71%	64.29%	100%
Economic Argument(s)	0.00%	100.00%	100%
Total	22.73%	77.27%	100%

As these tables show, the direction of the effect of economic arguments on a particular Justice's voting decisions has been dependent on the Justice's overall antitrust record.⁶² Justice Lewis Powell, for example, one of the most conservative Justices in economic cases, cast a market-based vote in 67.5% of cases that did not feature economic arguments, but in 95% of cases that did feature economic arguments. For Justices with interventionist voting records, economic arguments had the opposite effect. Justice Earl Warren, for example, cast a market-based vote in 21.79% of cases that did not feature economic arguments, but in only 5.26% of cases that did feature economic arguments. This phenomenon is also seen in the lack of effect on Justices in the center: Justice Thurgood Marshall, with the most centrist record in Table 2, appears to have been unaffected by economic arguments either way. Marshall cast a market-based vote in 47.37% of all cases, and cast almost the same percentage of market-based votes in

⁶² There is also an alternative interpretation of the data in Table 2. Not all antitrust cases are equal in terms of the relevance of economic analysis to their decision, as some antitrust cases turn on technical legal issues with minimal economic implications. It is therefore possible that the presence of economic arguments in the parties' briefs is a proxy for the economic nature of the underlying case. Under this interpretation, the Justices' voting patterns in Table 2 were influenced by the nature of the cases themselves, rather than by the manner in which they were argued by the parties. While the nature of the cases may be a lurking variable in Table 2, I doubt it is the primary explanation. Since the distribution of antitrust cases with highly economic implications has assumedly remained stable over time, but the frequency of economic arguments has significantly increased, it seems unlikely that economic arguments are a close proxy for underlying case content.

cases that did and did not feature economic arguments. With Marshall, there seem to have been no preexisting convictions for economic arguments to challenge or reinforce.⁶³

Brennan is among the very few Justices whose record is inconsistent with this pattern. While Brennan cast a market-based vote in 35.91% of all antitrust cases in which he voted, he cast a market-based vote in 41.86% of cases featuring economic arguments and only 32.54% of cases that did not feature economic arguments. As discussed above, Brennan is also the Justice whose antitrust record changed the most over time, becoming increasingly market-oriented even as his overall record became increasingly liberal. If many Justices have joined the Court with relatively fixed antitrust views, Brennan may be the exception that proves the rule: a Justice whose perspective on antitrust was reshaped, post-appointment, by developments in academic scholarship.

D. Summary and Interpretation

Examining both case-level patterns and the voting records of individual Justices reveals that the market-based shift in antitrust jurisprudence was the result of multiple, complementary factors. Turnover on the Court was the most immediate and most important. The Nixon appointments, in particular, had a clear effect on the Court's decision making. Once established on the Court, the Nixon appointees constituted a stable pro-defendant voting bloc and were able to secure many pivotal antitrust decisions by garnering the support of their moderate colleagues. While these Republican Justices tended to be highly receptive to economic arguments,⁶⁴ their receptiveness appears to have been due to political attitudes formed earlier in their careers, rather than to any post-appointment economic enlightenment. With the possible exception of Justice Warren Burger (whose market-based voting increased somewhat), each of

⁶³ This is consistent with perceptions of Marshall as an antitrust moderate who made voting decisions on a non-ideological, case-by-case basis. Given Marshall's background, interest, and expertise in constitutional law, some commentators have portrayed him as comparatively disinterested in antitrust law, and thus particularly open to the influence of his law clerks and fellow Justices. See, e.g., William E. Kovacic, "Antitrust Decision Making and the Supreme Court: Perspectives from the Thurgood Marshall Papers," *Antitrust Bulletin* 42 (1997).

⁶⁴ See Table 2.

these Justices' antitrust voting records remained stable over time,⁶⁵ even as the content of party and amicus briefs became increasingly economic.⁶⁶ At the same time, incumbent Justices holding interventionist views were generally unmoved by economic appeals.⁶⁷ In terms of individual votes, it appears that preexisting political attitudes have been more important than economic arguments.

The Court's embrace of market-based economics cannot be explained purely in political terms, however. As discussed above, certain liberal Justices of the older generation—most notably Justice Brennan—became more likely to support market-based decisions over the span of their tenures. This did not correspond with any rightward shift in their overall voting records. In the case of Brennan, for example, an increasingly market-based record in antitrust cases was accompanied by an increasingly liberal record in non-antitrust cases. Even more significant were the market-based antitrust views of newly-appointed Justices: By the 1990s, the market-based approach to antitrust law had transcended partisan divisions, characterizing the Court's liberal wing as well as its conservatives. Indeed, nearly every member of the current Court—Democrats as well as Republicans—would be considered an antitrust conservative by the standards of the prior era.⁶⁸ This development, more than any other, accounts for the current direction of antitrust law.

This fundamental shift in judicial attitudes is difficult to explain. Fully answering the question of why recent Justices, both liberal and conservative, have accepted the market-based approach to antitrust law would require an examination the broader influence of economic thought on American legal culture.

⁶⁵ See Figure 8.

⁶⁶ See Figures 2–7.

⁶⁷ See Table 2.

⁶⁸ See Table 1. The only potential exception being Justice Kagan, the most recent Democratic appointee, who has been involved in too few antitrust cases for an accurate assessment of her views. Even Justice Sotomayor has established a record as a moderate in business cases (based largely on her tenure on the Second Circuit), comfortable with the use of economic theory, particularly in antitrust cases. David Baumer et al., “Justice Sotomayor on the Supreme Court: A Boon for Business?,” *Virginia Law and Business Review* 4, no. 2 (fall 2009): 187–230. Justice Gorsuch is likely to be a reliable market-based vote, though he may prove less consistently conservative than the late Justice Scalia. See Jeffrey Rosen, “A Supreme Court Nominee Alert to the Dangers of Big Business,” *Atlantic*, March 20, 2017.

Such an ambitious inquiry is—unfortunately—beyond the scope of this study. A qualitative analysis of major antitrust cases can demonstrate how this transformation progressed, however. The following Chapter 12 presents such an analysis in view of the statistical trends discussed above, examining three major cases from three distinct phases in postwar antitrust law.

CHAPTER 12: CASE STUDIES

As the years have passed, the number of law and economics citations by the Court, litigants, and amici curiae has significantly increased; arguments are more frequently cast in specifically economic terms; and the Court has become increasingly accepting of the policy conclusions of law and economics. Statistical data yield insights into this transformation, but only reading individual cases can convey the full flavor of the change. Such an examination reveals the gradual yet inexorable shift in the assumptions, rhetoric, and argumentative strategies of nearly all legal actors involved. In order to convey these qualitative changes, this chapter presents a closer analysis of three landmark antitrust cases, each drawn from a distinct period in postwar antitrust law: *Brown Shoe* (1962), decided during the height of the Supreme Court's interventionism; *Sylvania* (1977), signaling the transition to market-based antitrust jurisprudence; and *Brooke Group* (1993), representing the current economic paradigm.

Each of these cases is famous (or infamous, depending on one's perspective) for establishing legal precedents and policy assumptions that would influence antitrust law for years to follow. Rather than focusing on their doctrinal significance—ground well covered by prior scholars—the analysis below provides a more descriptive, “externalistic” account of these cases' decisions, including the legal strategies of the various parties, the decision-making process of the Court, and broader changes in the historical context that may have influenced their respective outcomes. Treating these cases as representative of the trends identified in Chapter 11 can give substance to otherwise abstract statistics.

A. *Brown Shoe Co. v. U.S.* – Equalitarianism Versus Efficiency

Of the three cases selected for review, *Brown Shoe* represents the “inhospitality” era of traditional, interventionist antitrust.⁶⁹ As such, it also has the least remaining legal force. A long-standing target of criticism by legal and economic scholars,⁷⁰ its central holding has been largely

⁶⁹ According to this tradition, “judges view each business practice with suspicion, always wondering how firms are using it to harm consumers.” Easterbrook, “The Limits of Antitrust,” 4.

⁷⁰ See, e.g., Dominick T. Armentano, *Antitrust and Monopoly: Anatomy of a Policy Failure* (Oakland: Wiley, 1982), 245–46; Harlan Blake and Kenneth Jones, “Toward a Three-Dimensional Antitrust Policy,” *Columbia Law Review* 65 (1965): 456–57; Bork, *The Antitrust Paradox*, 198–216; Thomas E. Kauper, “The ‘Warren Court’ and the

abandoned, though never formally overruled.⁷¹ *Brown Shoe* endured as controlling precedent for decades following its decision, however, and remains controversial today.⁷² In the words of Robert Bork (writing in 1978): “It is not merely a bad case, it is also a trend setter—as if the poems of E. A. Guest had determined the course of modern literature.”⁷³

Brown Shoe involved a merger challenged by the U.S. government under amended Section 7 of the Clayton Act, the primary federal anti-merger statute.⁷⁴ In 1955, Brown Shoe Company, Inc., a large, integrated shoe manufacturer, had acquired by merger G. R. Kinney Company, Inc., a nationwide shoe retailer. Five years prior, under the Celler-Kefauver Antimerger Act of 1950, Congress had expanded the Clayton Act to cover asset acquisitions as well as stock acquisitions, an amendment intended to bring mergers under the act’s purview.⁷⁵ The government challenged the Brown-Kinney merger pursuant to this amendment, claiming that its effect “may be substantially to lessen competition, or to tend to create a monopoly” in the shoe industry, the relevant legal standard under the Clayton Act.⁷⁶ On appeal, the Supreme Court ruled for the government, despite the fact that the combined, nationwide market share of

Antitrust Laws: Of Economics, Populism, and Cynicism,” *Michigan Law Review* 67 (1986): 325–42; Richard A. Posner, “Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger, and Potential Competition Decisions,” *Columbia Law Review* 75 (1975): 302–12.

⁷¹ *Brown Shoe*’s legal significance was weakened by a series of pro-defendant Clayton Act decisions in the 1970s, and by the Department of Justice’s hands-off merger enforcement policies in the 1980s. With little likelihood of strong government enforcement, the anti-merger provisions of Clayton Act Section 7 (the specific statute under which the *Brown Shoe* case was brought) have faded in significance. For a discussion of *Brown Shoe*’s legacy, see Robert Skitol and Kenneth Vorrasi, “The Remarkable 50-Year Legacy of *Brown Shoe Co. v. United States*,” *Antitrust* 26, no. 2 (spring 2012): 47–53. For a discussion of merger enforcement policy under the Reagan administration, see Eisner, *Antitrust and the Triumph of Economics*, 195–210.

⁷² Skitol and Vorrasi, “The Remarkable 50-Year Legacy of *Brown Shoe Co. v. United States*.”

⁷³ Bork, *The Antitrust Paradox*, 210.

⁷⁴ *Celler-Kefauver Antimerger Act of 1950, U.S. Statutes at Large* 64 (1950): 1125.

⁷⁵ *Ibid.* Although the Clayton Act’s original reference to acquisitions of “stock or other share capital” arguably included mergers even before 1950, it was not generally interpreted as regulating mergers until after the Celler-Kefauver amendments.

⁷⁶ *Ibid.*

Brown and Kinney was only 4.4% of national shoe manufacturing⁷⁷ and only 2.3% of national retail sales⁷⁸—hardly monopoly levels. Legal scholars have since pilloried the decision as an excessive restraint on mergers and acquisitions that explicitly protected less competitive firms from larger, more cost-efficient rivals.⁷⁹ What many of these criticisms fail to acknowledge is that *Brown Shoe* was consistent with the antitrust thinking of its time and that it faithfully implemented Congress’s agenda in passing the Celler-Kefauver amendments.

i. The Court’s Opinion

The social and political concerns animating the *Brown Shoe* decision are far removed from the narrow economic criteria that dominate antitrust today. The logic of the Court’s opinion, authored by Chief Justice Warren,⁸⁰ focused on preserving the decentralized structure of the American shoe industry—characterized by a large number of small, independent manufacturers and retailers—from the incipient threat of powerful manufactures dominating the retail market.⁸¹ The issue of economic efficiency, obliquely raised in the Court’s opinion, was subordinated to the political goal of halting a “rising tide of economic concentration.”⁸²

⁷⁷ Brief for Appellant, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962), 128.

⁷⁸ *Ibid.*, 174.

⁷⁹ Armentano, *Antitrust and Monopoly*, 245–46; Blake and Jones, “Toward a Three-Dimensional Antitrust Policy,” 456–57; Bork, *The Antitrust Paradox*, 196–216; Kauper, “The ‘Warren Court’ and the Antitrust Laws: Of Economics, Populism, and Cynicism”; Posner, “Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger, and Potential Competition Decisions,” 302–12.

⁸⁰ The decision was unanimous except for a partial dissent by Justice Harlan, who believed the Court lacked proper jurisdiction. *Brown Shoe Co.*, 370 U.S. at 357 (Harlan, J., dissenting).

⁸¹ The *Brown Shoe* decision is noted (and criticized) for establishing the legal standard that “tendencies toward concentration in industry are to be curbed in their incipiency” under Section 7. *Brown Shoe Co.*, 370 U.S. at 346.

⁸² *Brown Shoe Co.*, 370 U.S. at 317.

Assessing the potential consequences of the merger, the Court found that, in a context of increasing industry consolidation,⁸³ Brown's acquisition of Kinney and its vertical integration into retailing would "foreclose" part of the retail market to competing manufacturers, who would no longer be able to sell to Kinney. It would similarly "foreclose" part of the manufactured shoe market to competing retailers, who would no longer be able to buy from Brown.⁸⁴ Drawing on the legislative history of the Celler-Kefauver amendments, the Court held that by "foreclosing the competitors of either party from a segment of the market otherwise open to them," the Brown-Kinney merger would deprive competing rivals of "a fair opportunity to compete."⁸⁵ The Court predicted that Brown would "force" its product upon Kinney, thus eliminating Kinney as a competitive factor in the marketplace. Its condemnation of this outcome was not based in economic theory, however. In particular, the Court cited no theory explaining why Brown, presumably a profit-maximizing enterprise, would pursue such a policy *unless* it created efficiencies that allowed Brown to undersell its competitors.⁸⁶ This style of opinion—marked by ad hoc economic reasoning from the bench and suspicion of aggressive business practices—was typical of the Warren Court. Although the *Brown Shoe* opinion included six citations to legal-economic scholarship, each of these citations supported interventionist conclusions, and none spoke directly to efficiency or consumer prices. At the time *Brown Shoe* was decided, economic harm to competitors—in and of itself—tended to establish antitrust liability, even in the absence of reduced output and/or increased prices.

Indeed, despite the Court's concern over market foreclosure, evidence had been introduced at trial that following the acquisition Brown continued to sell shoes to competing retailers and Kinney continued

⁸³ Whether or not concentration in the shoe industry was actually increasing was disputed by the parties. See Brief for the United States, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962); Brief for Appellant, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962). The Court accepted the government's argument that the Brown-Kinney merger represented incipient industry consolidation.

⁸⁴ *Brown Shoe Co.*, 370 U.S. at 328–334.

⁸⁵ *Ibid.*, 324.

⁸⁶ *Ibid.*, 370 U.S. at 330–332.

to buy shoes from competing manufacturers⁸⁷—but that small, independent firms had difficulty competing with the combined Brown-Kinney’s lower prices.⁸⁸ Acknowledging the possibility that large, integrated firms such as Brown-Kinney might provide lower prices to consumers, the Court explicitly rejected consumer prices as a controlling factor in Section 7 cases. Turning again to the legislative history, the Court concluded that Congress’s objectives in passing the Celler-Kefauver amendments had been to protect small businesses, preserve economic autonomy, and maintain the existing “economic way of life” by halting trends toward industrial consolidation at their earliest incipency.⁸⁹ To the extent that these goals conflicted with minimizing consumer prices, the Court determined that preventing concentration was Congress’s priority:

It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress’s desire to promote competition through the protection of viable, small, locally owned business. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.⁹⁰

In this famous passage, the Court at once recognized and deprecated the value of economic efficiency under the antitrust laws .

Whatever the economic merits of this ruling, and despite impassioned arguments to the contrary,⁹¹ the Court’s interpretation of Congressional intent was undoubtedly correct. The legislative history of the Celler-Kefauver amendments (and of the original Clayton Act itself) is replete with unambiguous statements of Congress’s anti-bigness, anti-concentration agenda and of its goal of halting

⁸⁷ Following the merger, Brown and Kinney continued to operate as separate business units.

⁸⁸ See Brief for the United States, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962), 120–137.

⁸⁹ *Brown Shoe Co.*, 370 U.S. at 328–335.

⁹⁰ *Ibid.*, 344.

⁹¹ Bork, *The Antitrust Paradox*, 200. Throughout his academic career, Bork argued that Congress’s primary objective in passing the antitrust laws was to maximize “consumer welfare,” rather than to protect small businesses and prevent economic concentration. In the Section 7 context (among others), this argument strains credulity. For a more measured critique of the Supreme Court’s use of legislative history in the *Brown Shoe* case, see Donald R. Turner, “Conglomerate Mergers and Section 7 of the Clayton Act,” *Harvard Law Review* 78 (1965): 1313–95.

even the earliest trends toward economic centralization.⁹² The Court's interpretation was also consistent with the mainstream academic views of the era. Antitrust was seen by many legal academics as an important check on economic power, an equalitarian perspective complemented by the industrial organization economics of the period. When *Brown Shoe* was decided, Harvard-style structuralism was the dominant approach in antitrust economics, while the revisionist arguments of the Chicago School remained underdeveloped and obscure. The immaturity of the Chicago School in 1962 is evidenced by the fact that the Court cited Chicago economist George Stigler in support of its interventionist, anti-concentration holding.⁹³ As discussed in the next section, the lack of alternatives to traditional, interventionist antitrust was also reflected in the parties' briefs, in which the market-based arguments that would come to characterize later antitrust cases were conspicuously absent.

ii. Plaintiff's Arguments

The Court's opinion generally followed the arguments of the government, which were even more explicit in prioritizing equalitarianism over efficiency. Most of the government's arguments focused on Congress's anti-bigness agenda and on the attendant importance of halting monopoly in its earliest incipency.⁹⁴ While the government's brief included a total of five legal-economic citations (generally supporting its interventionist theory of the case), efficiency and consumer prices were peripheral to its core arguments.

⁹² Thomas J. Horton, "Fixing Merger Litigation 'Fixes': Reforming the Litigation of Proposed Merger Remedies Under Section 7 of the Clayton Act," *South Dakota Law Review* 55 (2010): 191–94; Herbert Hovenkamp, "Distributive Justice and the Antitrust Laws," *George Washington Law Review* 51 (November 1982): 24–26; Robert Pitofsky, "The Political Content of Antitrust," *University of Pennsylvania Law Review* 127 (April 1979): 1060–66.

⁹³ Two of the Court's six legal-economic citations were to a 1955 Stigler article on the preventative role of merger policy. *Brown Shoe Co.*, 370 U.S., n. 56, n.61. The government also cited Stigler in its merits brief. Brief for the United States, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962), n. 35. Stigler would emerge in the 1960s as one of the leading economists of the Chicago School, but his early work emphasized the economic danger of industrial concentration. Although ironic in light of his later scholarship, Stigler's (fleeting) anti-bigness views were consistent with an early Chicago intellectual tradition most fully expressed in the writing of Henry Simons. It was not until the work of Aaron Director in the 1950s (and its propagation by Bork, Stigler, and others in the 1960s) that Chicago became known for its free-market antitrust perspective.

⁹⁴ See *Ibid.*, 45.

The contradictions between the government’s arguments and the “consumer welfare” model are striking. Employing a legal strategy that would seem perverse by the standards of current antitrust thinking, the government repeatedly cited Brown-Kinney’s price advantages as reasons to invalidate the merger. For example, according to the government, the merger was unfair to Brown-Kinney’s competitors because the combined business could “sell its own product at a significantly lower price than the nonintegrated independent retailer.”⁹⁵ The government also cited Brown’s own justifications for the merger,⁹⁶ including a smoother manufacturing-retail cycle, more effective advertising and promotion, and greater flexibility to adjust styles, quality, and prices, as additional evidence that the merger violated the Clayton Act.⁹⁷ A general theme of the government’s brief was that any competitive advantage resulting from the merger was legally suspect.

During oral argument, Solicitor General Archibald Cox tied the government’s case to a larger goal of preserving the “economist’s classical free market.”⁹⁸ He expressed that goal without any reference to any actual economics scholarship, however—classical or otherwise.⁹⁹ Within the logic of the government’s case, the economic consequences of the “classical free market” seemed secondary to Congress’s “social philosophy” of protecting small businesses.¹⁰⁰ Citing the language of the Ninth Circuit opinion in *Crown Zellerbach Corp. v. F.T.C.*,¹⁰¹ the government argued that “[as amended Section 7] was under consideration by Congress, it was duly appreciated that decentralized and deconcentrated markets are often uneconomic and provide higher costs and prices,” but that Congress choose to accept these costs

⁹⁵ Ibid., 48.

⁹⁶ Brown’s president, Clark Gamble, testified as a witness at trial.

⁹⁷ Ibid., 120–22.

⁹⁸ Arguments of Archibald Cox, Oral Argument, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962) (available at http://www.oyez.org/cases/1960-1969/1961/1961_4).

⁹⁹ Ibid.

¹⁰⁰ Ibid.

¹⁰¹ *Crown Zellerbach Corp. v. F.T.C.*, 296 F.2d 800 (9th Cir. 1961).

to combat “concentration of power.”¹⁰² Although this argument was an accurate characterization of Congress’s legislative intent, it is far removed from modern antitrust theory, which has come to focus exclusively on “consumer welfare,” rather than concentration per se. As discussed in the context of the *Sylvania* and *Brooke Group* cases below, it is inconceivable that a plaintiff would make such an argument today.

iii. Defendant’s Arguments

Unlike the government’s arguments, the defendant’s arguments in support of the merger gained little traction with the Court. This may have been partly the result of a misguided legal strategy: Defendant’s counsel¹⁰³ spent the majority of a more than 200 page brief arguing that Brown and Kinney were not competitors—and therefore their merger did not threaten competition—because the two firms sold different types of shoes in different price ranges.¹⁰⁴ Although this argument was certainly relevant to the horizontal aspects of the case, it failed to impress the Court, which rejected it almost out of hand.¹⁰⁵ At a deeper level, defense counsel seemed unable to effectively convey why *any* merger should be viewed by courts with anything besides hostility. This broader theoretical failure may have stemmed from an absence—at the time—of market-based antitrust scholarship for defendant’s counsel to draw on.

At certain points in its briefs¹⁰⁶ the defense broached arguments similar to those that would eventually become hallmarks of the Chicago School, but without the aura of economic sophistication that academic citations might have afforded. As an example, the defense argued that the government’s case

¹⁰² Arguments of Archibald Cox, Oral Argument, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962) (available at http://www.oyez.org/cases/1960-1969/1961/1961_4).

¹⁰³ Brown’s lead attorney was Arthur Dean, of Sullivan & Cromwell—hardly incompetent antitrust counsel.

¹⁰⁴ Brief for Appellant, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962).

¹⁰⁵ Defendant’s counsel argued that the shoe market was actually comprised of a large number of distinct and separate submarkets (corresponding with different varieties of shoes and different price ranges). The Court held that, for purposes of the case, there were only three identifiable markets: men’s shoes, women’s shoes, and children’s shoes. Both Justice Clark (concurring) and Justice Harlan (dissenting) would have taken an even stricter approach, holding that the shoe industry was comprised of a single market. *Brown Shoe Co.*, 370 U.S. at 355–56 (Clark, J., concurring); *Brown Shoe Co.*, 370 U.S. at 366–69 (Harlan, J., dissenting).

¹⁰⁶ The defendant submitted an initial brief and a reply brief.

conflated injury to *competitors* with injury to *competition* and that evidence of Brown's competitive success was irrelevant to establishing antitrust liability (themes common to later Chicago scholarship).¹⁰⁷ Despite the economic implications of this argument, however, defendant's briefs included no citations to law and economics scholarship. Without the benefit of a theoretical model of how mergers could promote economic efficiency, the defense was incapable of rebutting the assumption that all mergers were competitively suspect. Ironically, the defense went so far as to argue the merger would *not* achieve economic benefits—even for Brown itself!—in an attempt to counter the government's claims as to Brown's competitive advantages.¹⁰⁸ Given the inability of the defendant to coherently justify its own transaction, it is hardly surprising it fared so poorly before the Court.

iv. Summary

The *Brown Shoe* case is representative of its era in at least three key respects: (1) the Court's opinion focused on protecting competitors rather than maximizing "consumer welfare"; (2) the logic of the parties' arguments did not rely on formal economic theory; and (3) neither the Court's opinion nor the parties' briefs contained extensive citations to law and economics scholarship.¹⁰⁹ Although modern critics have denounced *Brown Shoe* as economically unsophisticated, it is important to remember that the decision reflected the mainstream antitrust views of the era. The moderate, consensus nature of the *Brown Shoe* decision is underscored by the facts that the government's case was originally brought under a Republican administration,¹¹⁰ that the Court's opinion was authored by a Republican Chief Justice,¹¹¹

¹⁰⁷ Brief for Appellant, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962), 109, 114–118, 136, 155–160, 184, 198. Reply Brief for Appellant, *Brown Shoe Co. v. U.S.*, 370 U.S. 294 (1962), 2, 38–47. Interestingly, the Court's statement that the Clayton Act was meant to protect "competition, not competitors"—a phrase which would later become a touchstone of modern antitrust—appears to have been drawn from the initial brief of the defendant. It appears nowhere in the legislative history of the Celler-Kefauver amendments.

¹⁰⁸ *Ibid.*, 33–37.

¹⁰⁹ At six and five citations respectively, the Court's opinion and the plaintiff's merits brief were each above average for the era, but well below average for all cases in the database. The defendant's merits briefs included no law and economic citations.

¹¹⁰ The case was originally brought in 1955, under the Eisenhower administration.

¹¹¹ Albeit the single most interventionist Justice of the postwar era. See Table 1.

and that the decision on the merits was essentially unanimous.¹¹² Claims by critics that the decision constituted a dramatic, activist overreach are both inaccurate and ahistorical.

Brown Shoe is also representative for another important reason: like most antitrust cases of its era, it featured no involvement of amici curiae. Amicus briefs were rarely submitted in antitrust cases before the 1970s. Although the historical phenomenon of increasing amicus briefs has affected nearly every area of law, it may have been particularly influential in the antitrust context. As law and economics scholarship began to criticize traditional antitrust jurisprudence, amicus briefs were often the medium by which these critiques were communicated to the Court.¹¹³

Significantly, it was not until after *Brown Shoe* that market-based antitrust scholarship became widely published. The decision itself may have even played a role in spurring the publication of market-based critiques: Robert Bork and Ward Bowman's 1963 *Fortune* article "The Crisis in Antitrust"—the opening salvo of both professors' career-spanning assaults on interventionist antitrust—was written partly in response to the *Brown Shoe* decision, which they saw as symptomatic of incoherent antitrust jurisprudence.¹¹⁴ The critique outlined in "The Crisis in Antitrust" would grow increasingly influential over the years, and antitrust law and enforcement policy would eventually gravitate toward the Chicago perspective. *Brown Shoe* therefore stands as a high-water mark of interventionist antitrust, largely disconnected from the economic concerns of the current intellectual paradigm.

B. Continental T.V., Inc. v. GTE Sylvania Inc. – The Economic Turn in Antitrust

The *Sylvania* case of 1977 is widely considered a turning point in antitrust. Its economics-based, pro-defendant holding and its explicit break from established Court precedent signaled a new perspective on the part of the Court toward the appropriate role of antitrust law. Although *Sylvania* was not the first

¹¹² Although Justice Harlan dissented on a procedural jurisdictional issue, he concurred with the Court's decision on the merits. Justice Frankfurter and Justice White took no part in the decision of the case. For discussion of the Court's internal decision-making process in *Brown Shoe*, see Freyer, "What Was Warren Court Antitrust?"

¹¹³ See, for example, the discussion of *Sylvania* below.

¹¹⁴ Robert H. Bork and Ward S. Bowman, "The Crisis in Antitrust," *Fortune*, December 1963, 138.

decision to apply economic analysis to antitrust law, its clear endorsement of market-based economic theory heralded the future direction of the field. Andrew Gavil speaks for most when he writes that after *Sylvania*, “a revolution unfolded in the content of the law of antitrust.”¹¹⁵

Sylvania concerned the legality of non-price vertical sales restraints imposed by manufacturers on retailers—in other words, the ability of manufacturers to impose specific resale conditions (other than price) on the retailers that purchase and resell their goods. Although this was a different legal subject than addressed in *Brown Shoe*, it implicated similar social, political, and economic concerns. In 1967, 10 years prior to *Sylvania*, the Court had held in *U S. v. Arnold, Schwinn & Co.* that a manufacturer’s practice of restricting the sales activities of wholesalers and retailers, such as by limiting the sale of the manufacturer’s products to specific authorized locations, was a per se violation of the Sherman Act.¹¹⁶ GTE Sylvania, Inc., a television manufacturer, engaged in distribution practices similar to those held illegal in *Schwinn*: It established exclusive sales territories by restricting the locations from which dealers were allowed sell its products. One of these dealers sued Sylvania after attempting to sell Sylvania products from an unauthorized location, in competition with the authorized Sylvania dealer for the area. Applying *Schwinn*, the district court ruled in favor of the plaintiff. On appeal, the Ninth Circuit (sitting en banc) reversed the decision of the district court, distinguishing the facts of Sylvania’s distribution practices from the practices held unlawful in *Schwinn*. Granting certiorari, the Supreme Court went even further, holding that non-price vertical sales restraints were subject to the rule of reason (rather than the per se rule), expressly overruling *Schwinn*. According to the Court’s opinion, although vertical restraints such as those employed by Sylvania reduced competition among dealers of the same brand (so-called

¹¹⁵ Gavil, “A First Look at the Powell Papers: *Sylvania* and the Process of Change in the Supreme Court,” 8.

¹¹⁶ *U S. v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). Schwinn, a bicycle manufacturer, had secured agreements from its wholesalers not to sell outside of their assigned geographic areas, as well as agreements from its retailers to sell only to retail customers (and not to sell to other unauthorized resellers). These practices were intended to reduce competition among wholesalers and retailers, increasing the price of Schwinn products and encouraging retailers to invest in promotional and service efforts.

“intra-brand” competition), this was more than offset by fostering competition among manufacturers of competing brands (“inter-brand” competition).

Like *Brown Shoe*, *Sylvania* is a representative example of many antitrust decisions of its era—in this case, the transitional period of the late 1970s and 1980s. As shown below, *Sylvania* demonstrates the following characteristics common to many cases of the period: (1) the decisive role of conservative Justices (particularly Justice Powell, the author of the *Sylvania* opinion); (2) extensive citation to law and economics scholarship on the part of the Court; (3) extensive citation to law and economics scholarship on the part of the defendant; (4) a relative *lack* of law and economics citations on the part of the plaintiff; and (5) the submission of multiple economically-sophisticated amicus briefs. Together, these characteristics clearly distinguish *Sylvania* from earlier cases such as *Brown Shoe* and *Schwinn*. Although a full analysis of the *Sylvania* decision—one of the most important in recent antitrust history—is beyond the scope of this study, the discussion below highlights the ways in which *Sylvania* illustrates these overarching trends.¹¹⁷

i. The Court’s Opinion

The *Sylvania* opinion provides a clear example of the impact of Nixon’s judicial appointees, particularly Justice Powell, on U.S. antitrust jurisprudence. Powell—the opinion’s author—purposefully crafted a far-reaching decision that extended well beyond the facts of the case, overturning established Court precedent and reshaping the law of vertical restraints. Much of Powell’s discussion in *Sylvania* actually focused on criticizing *Schwinn*, clearly telegraphing his desire to overrule it. Unlike the Ninth Circuit, Powell found *Sylvania*’s distribution practices indistinguishable from those in *Schwinn*. Powell justified expressly overruling *Schwinn* on grounds of its fundamental doctrinal weakness; its confused, inconsistent application by the lower courts; and its overwhelmingly negative reception by academic

¹¹⁷ For broader analyses of *Sylvania*, see Warren S. Grimes, “The Life Cycle of a Venerable Precedent: GTE *Sylvania* and the Future of Vertical Restraints Law,” *Antitrust* 17 (2002): 27–31; Robert Pitofsky, “The *Sylvania* Case: Antitrust Analysis of Non-Price Vertical Restrictions,” *Columbia Law Review* 78, no. 1 (1978): 1–38; Robert L. Steiner, “*Sylvania* Economics—A Critique,” *Antitrust Law Journal* 60, no. 1 (1991): 41–59.

commentators.¹¹⁸ This last factor appears to have been particularly significant, as the opinion cites the academic literature extensively—in total, Powell’s opinion includes 24 citations to law and economics scholarship, compared to only 6 in *Brown Shoe* and 0 in *Schwinn*.

These citations provided the basis of the opinion’s economic analysis of vertical restraints, which posited that manufacturers imposed such restraints *not* to reduce retail competition and uphold prices, but rather to ensure effective product distribution and more effectively compete with rival manufactures. Although vertical restraints reduced *intra*brand competition by limiting competition among dealers of the same brand, they enhanced *inter*brand competition by encouraging dealers of competing brands to invest in promotion, merchandising, and point-of-sale services.¹¹⁹ The logic of this argument was strongly influenced by recent developments in antitrust scholarship, particularly the work of scholars associated with the Chicago School. Citing Richard Posner, Robert Bork, and other prominent antitrust scholars, the opinion argued that manufacturers have an economic interest in ensuring the maximum level of dealer competition consistent with the efficient distribution of their products. Thus, vertical restrictions imposed by manufacturers are unlikely to have net anti-competitive effects—particularly not to an extent justifying inflexible *per se* treatment.¹²⁰

Although the logic of the Court’s opinion relied heavily on economic theory, it is difficult to say whether law and economics scholarship actually influenced *Sylvania’s* outcome. There is abundant evidence that Justice Powell needed little convincing to overrule *Schwinn*. Powell had arrived on the Court in 1972 with considerable pro-business sympathies, as suggested by his prior experience as a

¹¹⁸ *Schwinn* is among the most criticized opinions in the history of antitrust law. Its *per se* result was not advocated by the plaintiff, but was rather a confusing consequence of Justice Fortas’ widely panned opinion. Even a noted critic of the Chicago treatment of vertical restraints has identified *Schwinn* as an example of “bad workmanship, sloppy use of terms, and a persistent failure to examine the reasons why the decision might be criticized.” Peter Carstensen, “Annual Survey of Antitrust Developments: 1976–1977,” *Washington and Lee Law Review* 35, no. 1 (January 1, 1978): 16.

¹¹⁹ *Continental T.V., Inc.*, 433 U.S. at 54–57.

¹²⁰ *Ibid.*, 56–59. This is a necessarily simplified description of the economic arguments of *Sylvania*. For more detailed treatments of the Court’s arguments, see Grimes, “The Life Cycle of a Venerable Precedent: GTE *Sylvania* and the Future of Vertical Restraints Law”; Pitofsky, “The *Sylvania* Case: Antitrust Analysis of Non-Price Vertical Restrictions”; Steiner, “*Sylvania* Economics—A Critique.”

successful corporate attorney and his service on several corporate boards of directors. Indeed, his voting record was consistently pro-business following his appointment¹²¹ In addition, only two months prior to his nomination, Powell had authored the infamous “Powell memorandum” to the U.S. Chamber of Commerce. An impassioned for the defense of free enterprise, this confidential memorandum, which became public after Powell’s confirmation, warned of growing hostility in American culture to the capitalist economic system and advocated concerted efforts to spread pro-capitalist ideas among universities, the media, and—most significantly—the courts.¹²² Whether or not the Powell memorandum is proof of judicial bias, as some critics of Powell have claimed, it is safe to say that his connections to the business world likely influenced his antitrust views.

Thus, Powell’s dissatisfaction with *Schwinn* (and the broader inhospitality tradition it represented) influenced nearly all aspects of the *Sylvania* case. Indeed, without Powell’s intervention in the certiorari process, the Court might never have heard *Sylvania* at all. As documented by Andrew Gavil, Powell’s personal papers reveal that the Court’s initial vote on granting certiorari attracted only three of the four Justices necessary to accept the case. However, Powell requested reconsideration and lobbied fellow Justices to change their votes, successfully persuading Justice Stewart.¹²³ As the Ninth Circuit had already ruled for the defendant *Sylvania*, Powell’s motivation to hear the case was clearly to revisit *Schwinn*. Once the case had been heard by the Court, Powell worked behind the scenes during the opinion-drafting process to ensure that *Schwinn* would be expressly overruled, strategically tailoring the

¹²¹ Powell’s pro-business voting record was not limited to antitrust cases. For example, he was also one of the most pro-defendant Justices in securities cases, spearheading a rollback of many Warren Court decisions during the 1970s and 1980s. See A. C. Pritchard, “Justice Lewis F. Powell, Jr. and the Counterrevolution in the Federal Securities Laws,” *Duke Law Journal* 52, no. 5 (March 2003): 841–949.

¹²² Lewis F. Powell, “Attack on American Free Enterprise System,” August 23, 1971. For discussion of the historical context and influence of the Powell memorandum, see Kimberly Phillips-Fein, *Invisible Hands: The Businessmen’s Crusade Against the New Deal* (New York: W. W. Norton, 2010), 150–65. The memorandum is “infamous” primarily among left-leaning advocacy groups, which see it as an inspiration for the conservative intellectual mobilization of the 1970s and 1980s.

¹²³ Gavil, “A First Look at the Powell Papers: *Sylvania* and the Process of Change in the Supreme Court,” 9. Pursuant to the informal “rule of four,” the Supreme Court grants certiorari upon the affirmative vote of at least four Justices.

language of his opinion to ensure the support of fellow Justices.¹²⁴ Powell was highly conscious of the jurisprudential and economic significance of reversing the per se treatment of vertical restraints, instructing his clerks to articulate clearly why *Schwinn* was both doctrinally and economically unsound.¹²⁵

Ultimately, Powell’s decision to overrule *Schwinn* was likely made independent of economic theory. Nevertheless, economic theory was the intellectual framework within which his decision was articulated and justified. As discussed below, the economic content of the *Sylvania* opinion was drawn from multiple sources—partly from the contributions of Powell’s clerks, partly from the defendant’s merits brief, and partly from amicus briefs (particularly that of the Motor Vehicle Manufacturers Association).¹²⁶ The *plaintiff’s* briefs,¹²⁷ on the other hand, were largely disregarded by the Court’s opinion, despite their firmer grounding in established Court precedent.

ii. Plaintiff’s Arguments

The various *Sylvania* briefs and their different approaches to the case highlight the vigorous intellectual debates occurring in antitrust scholarship in the late 1970s. On the interventionist side, the plaintiff was represented by Lawrence Sullivan and Jesse Choper, law professors at Berkeley and proponents of strict, per se treatment of vertical restraints. Sullivan, in particular, was an outspoken defender of traditional antitrust and one of the Chicago School’s most prominent and respected critics. Despite Sullivan’s intellectual engagement with the economic debates of the day, he failed to connect his legal arguments in *Sylvania* to the growing economic literature, relying instead on a more traditional, precedent-based legal strategy.

¹²⁴ Ibid., 9–10. In the final tally, Blackmun, Burger, Stevens, and Stewart joined Powell’s opinion, with White concurring. Brennan filed a dissenting opinion, which Marshall joined. Rehnquist took no part in the case.

¹²⁵ Ibid., 10.

¹²⁶ The Court’s reasoning was *not* drawn from any expression of Congressional intent, statutory or otherwise. The remarkable activism of Justice Powell (and the Court more generally) in shaping and reshaping antitrust doctrine may be an example of what Harry First and Spencer Weber Waller have referred to as “antitrust’s democracy deficit”—that is, the displacement of Congressional policymaking by that of unelected institutions. Harry First and Spencer Waller, “Antitrust’s Democracy Deficit,” *Fordham Law Review* 81, no. 5 (April 2013): 2543–74.

¹²⁷ The plaintiff submitted an initial brief and a reply brief.

The plaintiff's briefs included a total of nine citations to law and economics scholarship; the defendant's single merits brief had thirty-one. Moreover, most of the plaintiff's law and economics citations were actually refutations of the cited scholar.¹²⁸ Rather than drawing on economic principles, the plaintiff's arguments against Sylvania's distribution practices were primarily grounded in Court precedent—namely *Schwinn*.¹²⁹ This may have been a reasonable strategy, given *Schwinn*'s clear application to the facts, but it left the plaintiff with little to stand on if *Schwinn* were overruled.¹³⁰ Instead of focusing on economic efficiency, the plaintiff emphasized the broader concerns that had animated earlier antitrust cases, arguing that per se prohibition of vertical restraints ensured “fair and rational income distribution,” “an economic climate in which any person can aspire to independence and growth,” and “the dispersion of political, social and economic power.”¹³¹ These non-efficiency arguments made little impression on the Court's majority; Powell disposed of them in a footnote: “Competitive economies have social and political as well as economic advantages,” he wrote, “but an antitrust policy divorced from market considerations would lack any objective benchmarks.”¹³²

Sullivan and Choper's legal strategy was typical of many antitrust plaintiffs during this period. The emphasis on legal precedent rather than economic efficiency, the appeal to traditional notions of economic equality, and the relative dearth of law and economics citations were traits seen again and again in plaintiff's briefs up to the 1980s.¹³³ For many years, this had been a successful approach. Following the Nixon appointments, however, this strategy became much less viable, as market-based defendants' arguments began to win a greater number of cases.

¹²⁸ Citing Bork in the context of arguing Bork is wrong, for example.

¹²⁹ Brief for Petitioners, *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), 29–43.

¹³⁰ See Carstensen, “Annual Survey Of Antitrust Developments,” 23–24.

¹³¹ *Ibid.*, 55.

¹³² *Continental T.V., Inc.*, 433 U.S., n. 21.

¹³³ See, e.g., Brief for the Respondant, *U.S. Steel Corp. v. Fortner Enter.*, 429 U.S. 610 (1977).

iii. Defendant's Arguments

The defendant's brief in *Sylvania* was characteristic of emerging trends in antitrust practice, in that it reached beyond traditional legal analysis to provide an economic justification for Sylvania's practices. Defendant's counsel supported its arguments with a total of 31 law and economics citations (compared to the plaintiff's nine), the vast majority of which were consistent with the Chicago position on vertical restraints. The defendant's brief also incorporated testimony of Lee Preston, Jr., an economics professor at Berkeley, to the effect that Sylvania's use of vertical restraints was more likely to promote competition than to harm it.¹³⁴ Preston's testimony was grounded in a decidedly market-oriented economic perspective, according to which the self-interested distribution decisions of independent manufacturers such as Sylvania would—almost by definition—benefit consumers as well.¹³⁵ A majority of the Court apparently agreed, as Powell's final opinion reflected many of the defendant's economic arguments. Sylvania's brief was therefore representative of many defendants' briefs of the period: grounded in economics, supported by academic citations, and addressed toward an increasingly receptive Court.

iv. Amicus Curiae Briefs

Sylvania provides an early example of another important trend in antitrust practice—the increasing number of economically sophisticated amicus curiae briefs. In *Sylvania*, three amici submitted legal briefs (compared to zero in *Brown Shoe* and one in *Schwinn*), each in support of the defendant. All three briefs included economic arguments, but one in particular—submitted by the Motor Vehicle Manufacturers Association (MVMA)—made a particularly strong impression on the Court, perhaps even more so than the defendant's brief itself.¹³⁶

¹³⁴ See, e.g., Brief for Respondent, *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), 12.

¹³⁵ See Carstensen, "Annual Survey Of Antitrust Developments," 29–30.

¹³⁶ Motion for Leave to File Brief and Brief for Motor Vehicle Manufacturers Association as Amicus Curiae, *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). The two other amicus briefs were submitted by the Associated Equipment Distributors and the International Franchise Association.

The MVMA brief was authored by Donald Turner, who served as counsel to MVMA, together with the law firm of Wilmer, Cutler & Pickering.¹³⁷ In 1977, Turner was among the most prominent and respected antitrust scholars in America. Holding a law degree and a Ph.D. in economics, both from Harvard, Turner had served as Assistant Attorney General for antitrust under President Johnson. His multivolume antitrust treatise, co-authored with Phillip Areeda, was (and remains) the single most cited publication in the field.¹³⁸ Although trained at Harvard, Turner’s views on antitrust policy—always informed by economic analysis—became increasingly aligned with the Chicago perspective over the course of his career. His MVMA brief was for all intents and purposes an economic essay on vertical restraints that cited many scholars in the Chicago School and arrived at substantially similar conclusions.¹³⁹

The MVMA brief was particularly well received by Powell and his clerks. During the opinion drafting process, Powell advised his clerks to use the MVMA brief as inspiration: “My recollection is that the brief filed by Wilmer Cutler is the single most helpful brief in this case,” he wrote to them. “No doubt you have drawn on it heavily. If not, I commend it to you.”¹⁴⁰ Tyler Baker, one of Powell’s clerks, was as impressed by the MVMA brief as his boss. Discussing the case with Andrew Gavil, Baker

¹³⁷ The precise division of labor between Turner and Wilmer Cutler is unclear, though given the brief’s high level of economic sophistication, it is reasonable to assume that Turner’s contribution was significant. Turner subsequently joined Wilmer Cutler as counsel, suggesting their working relationship was very close.

¹³⁸ The original version of the treatise was published as Phillip E. Areeda and Donald F. Turner, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (New York: Aspen Law & Business, 1978). The current iteration of the Areeda-Turner treatise, now edited by Herbert Hovenkamp, is Phillip E. Areeda and Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (New York: Wolters Kluwer Law and Business, 2015).

¹³⁹ One important difference between the position of the MVMA brief and that of the Chicago School was whether vertical *price* restraints (i.e., retail price maintenance) serve the same economic function as vertical *non-price* restraints (such as the policies at issue in both *Sylvania* and *Schwinn*). Although many Chicago scholars believed that vertical price restraints and vertical non-price restraints are equivalent from an economic perspective, and thus equally deserving of rule-of-reason analysis, the MVMA brief explicitly disclaimed any support for vertical price restraints, stating they tend to uphold prices and “plainly disserve the interests of many if not most consumers.” Motion for Leave to File Brief and Brief for Motor Vehicle Manufacturers Association as Amicus Curiae, *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), 45.

¹⁴⁰ Gavil, “A First Look at the Powell Papers: *Sylvania* and the Process of Change in the Supreme Court,” 11.

recalled that “the Wilmer Cutler brief was head and shoulders above anything else we had. It really was a masterful brief that was clearly written and yet had all the policy arguments included.”¹⁴¹ This is not to say that the MVMA brief *persuaded* Powell to decide one way or another—it seems likely that Powell’s mind had been made up even before the certiorari process—but it does suggest that the brief helped shape the analysis used to justify the decision. This analysis, in turn, has had far-reaching jurisprudential implications. Indeed, the MVMA brief is probably unusual in the degree of influence it had on the law.¹⁴² It nonetheless serves to illustrate a more general trend in antitrust cases—the rise of economics-based amicus briefs authored by prominent antitrust scholars. In the decades following the *Sylvania* decision, this trend has only intensified.

v. *Summary*

Sylvania represents a transition period between two eras of antitrust: the mid-century inhospitality era, marked by aggressive interventionism, and the modern era of market-based antitrust, marked by faith in the efficiency of private ordering. *Sylvania* heralded the modern era with its detailed economic arguments and extensive law and economics citations. These characteristics distinguished *Sylvania* from earlier cases such as *Brown Shoe* and *Schwinn*, in which economics played a minor role. *Sylvania* remains connected to the earlier era as well, however, particularly in terms of the legal strategy employed by plaintiff’s counsel. Although the decision to focus on legal precedent rather than abstract economic theory was clearly the wrong one, it was not until the 1980s that plaintiffs began to use economic arguments. The absence of any amicus curiae supporting the plaintiff reflected a similar lag—later cases would feature economics-based amicus briefs on both sides.

¹⁴¹ Ibid., n. 31. Baker himself was almost certainly an important factor in shaping the *Sylvania* opinion. Baker came to his clerkship after having studied under William F. Baxter at Stanford Law School, and went on to work for Baxter at the Department of Justice in the early 1980s. Baxter was a committed adherent of the Chicago approach to antitrust, a perspective shared by his student Baker. See Ibid.

¹⁴² In the words of Stephen Calkins, most amicus briefs in antitrust cases “sparkle briefly and then expire, forgotten if not unnoticed.” Stephen Calkins, “The Antitrust Conversation,” *Antitrust Law Journal* 68 (2001): 625.

Perhaps the most notable feature of *Sylvania* is the activism of Justice Powell. This aspect of the case raises difficult questions regarding the influence of law and economics scholarship, highlighting the historical ambiguity at the very heart of this study. It is clear that Powell—together with his clerks—accepted the economic arguments of *Sylvania* and MVMA, given that he incorporated them directly into the Court’s opinion. However, it appears equally clear that Powell’s decision to overrule *Schwinn* (and to hear the case at all) was dictated primarily by his political attitudes. Ultimately, the true significance of law and economics scholarship as employed in the *Sylvania* case may have been in persuading marginal Justices (Stevens and Stewart, for example) to join Powell’s opinion, as well as in enshrining Chicago vertical restraint analysis as authoritative Supreme Court precedent. Through its citations to the Chicago School and its explicit endorsement of market-based economics, the *Sylvania* opinion put litigants on notice that the foundations of antitrust were beginning to change.

C. Brooke Group Ltd. v. Brown & Williamson Tobacco Corp. – A New Era

Brooke Group, my third and final case study, demonstrates the triumph of economic analysis in U.S. antitrust law. In this 1993 case, *Brooke Group Ltd.*,¹⁴³ a cigarette manufacturer, brought a predatory pricing claim under the Robinson-Patman Act¹⁴⁴ against *Brown & Williamson Tobacco Corp.*, a competing manufacturer. *Brooke Group* claimed that *Brown & Williamson* had priced its generic cigarettes below cost in an attempt to undermine *Brooke Group*’s competitive efforts and to maintain oligopolistic pricing in the cigarette industry. The Court ruled in favor of *Brown & Williamson*, relying on a market-based theory of predatory pricing. What is most notable about *Brooke Group* is not the

¹⁴³ Formerly known as Liggett Group Inc.

¹⁴⁴ The case was brought under § 2(a) of the Clayton Act, as amended by the Robinson-Patman Act. Like the Court and most commentators, I refer to this provision simply as the “Robinson-Patman Act.” *Act of June 19, 1936, U.S. Statutes at Large* 49 (1936): 1,526. The Robinson-Patman Act forbids price discrimination “where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.” *Ibid.* *Brooke Group* claimed that *Brown & Williamson* had used price discrimination as a means of implementing predatory pricing. In the legal context, the term “predatory pricing” generally refers to pricing intended to drive a competitor from the marketplace. The vagueness of this concept (and its potential for encompassing otherwise legitimate competition) is one of the reasons for cases such as *Brooke Group*.

outcome of the case (market-based decisions had become the norm by the early 1990s), but rather the similarity of the analytical perspective of both plaintiff's and defendant's counsel. Both sides agreed that "consumer welfare" was the decisive analytical issue and even agreed on the specific economic test to be used in predatory pricing cases. In an antitrust "clash of the titans," plaintiff and defendant were represented by two of the most famous scholars in the field, Phillip Areeda and Robert Bork, respectively.¹⁴⁵ Areeda's association with the Harvard tradition and Bork's association with Chicago underscores the significance of their intellectual agreement and illustrates the convergence of antitrust scholarship on a fundamentally economic perspective. Plaintiff and defendant's mutual acceptance of the "consumer welfare" standard and their concomitant rejection of any broader, non-economic policy goals represented the culmination of a paradigm shift in antitrust law.

i. The Court's Opinion

The *Brooke Group* opinion bears many of the hallmarks of contemporary antitrust decisions. Its ruling for the defendant was firmly grounded in market-based economics and reflected the skepticism of many economists as to the prevalence and feasibility of predatory pricing. Among its many law and economics citations—31 in total—the opinion relied especially on a 1975 article by Phillip Areeda and Donald Turner, in which the authors criticized the traditional understanding of predatory pricing.¹⁴⁶ Areeda and Turner argued that true predatory pricing was rarely attempted and even more rarely successful. A legal claim of predatory pricing should therefore require two factors: (1) evidence that the alleged predator had priced below average variable cost and (2) a likelihood of subsequent recoupment of the predator's losses through supracompetitive pricing.¹⁴⁷ Without these two elements, Areeda and

¹⁴⁵ Stephen Calkins, "The October 1992 Supreme Court Term and Antitrust: More Objectivity Than Ever," *Antitrust Law Journal* 62 (1994): 377.

¹⁴⁶ Phillip Areeda and Donald Turner, "Predatory Pricing and Related Practices Under Section 2 of the Sherman Act," *Harvard Law Review* 88, no. 4 (February 1975): 697–733.

¹⁴⁷ "Supracompetitive pricing" refers to the higher prices a monopolist can charge in the absence of competition. Although Areeda and Turner's 1975 article is most commonly associated with the average variable cost test, it also set forth the recoupment requirement. Herbert J. Hovenkamp, "Predatory Pricing under the Areeda-Turner Test," March 15, 2015, 1.

Turner argued, so-called “predatory pricing” was more likely to be vigorous price competition, which benefited consumers.¹⁴⁸ The Areeda-Turner analysis was highly influential even before *Brooke Group*, having already been adopted (in various forms) by most of the circuit courts of appeal.¹⁴⁹ Although the Court’s *Brooke Group* opinion did not explicitly endorse the Areeda-Turner test, it established a similar burden, holding that a plaintiff alleging predatory pricing must show that the defendant (1) priced below “an appropriate measure” of its costs and (2) had a reasonable prospect of recoupment.¹⁵⁰

This holding imposed substantial obstacles to predatory pricing claims, reinforcing decisions from the 1980s such as *Cargill, Inc. v. Monfort of Colorado, Inc.*¹⁵¹ and *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*,¹⁵² which had also relied on law and economics scholarship in denying predatory pricing allegations.¹⁵³ In addition, *Brooke Group* distinguished (and effectively emasculated) the 1967 case of *Utah Pie Co. v. Continental Baking Co.*, the leading case in which the Court had ruled in favor of a plaintiff claiming predatory pricing.¹⁵⁴ Although *Utah Pie* was not expressly overruled, it was clearly a relic from another era. Emphasizing that the antitrust laws were for “the protection of competition, not competitors” (citing, ironically, *Brown Shoe*), *Brooke Group* affirmed the Court’s modern hostility to predatory pricing claims.¹⁵⁵

¹⁴⁸ Areeda and Turner, “Predatory Pricing and Related Practices Under Section 2 of the Sherman Act.”

¹⁴⁹ Hovenkamp, “Predatory Pricing under the Areeda-Turner Test,” 1.

¹⁵⁰ *Brooke Group Ltd.*, 509 U.S. at 222–226. The Court did not explicitly endorse Areeda and Turner’s below-average-variable-cost test, instead requiring the less specific “appropriate measure of cost” test. However, the below-average-variable-cost test was agreed to by the parties and was actually the cost test used in the case.

¹⁵¹ *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104 (1986).

¹⁵² *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

¹⁵³ Although *Cargill* and *Matsushita* were significantly different cases (*Cargill* concerned a merger while *Matsushita* concerned an alleged predatory pricing conspiracy), both cases involved claims of predatory pricing.

¹⁵⁴ *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967).

¹⁵⁵ *Brooke Group Ltd.*, 509 U.S. at 224.

ii. Plaintiff's Arguments

In many ways, the most interesting aspect of *Brooke Group* is the nature of the plaintiff's arguments. Unlike the cases of the Warren Court era, in which economic theory was largely absent, and unlike the transitional cases of the 1970s, in which plaintiffs were outflanked by defendants' economic arguments, *Brooke Group* featured substantial agreement between the parties as to the economic nature of the case. Specifically, both parties accepted the Areeda-Turner test for legally cognizable predatory pricing: pricing by the defendant below its average variable costs, with a reasonable prospect of subsequent recoupment. This adoption of an economically rigorous standard was a major departure from plaintiffs' arguments in earlier predatory pricing cases.¹⁵⁶ The fact that Brooke Group was represented by Areeda—coauthor of the test—only highlighted the extent to which antitrust had evolved.¹⁵⁷

Like the Chicago approach, the Areeda-Turner test is grounded in a consumer-welfare model of antitrust. This meant the plaintiff's arguments necessarily acknowledged that low prices were only “predatory” if they resulted in economic harm to consumers. Thus, although plaintiff's counsel claimed the defendant's arguments exalted economic theory over economic facts,¹⁵⁸ the two parties' theoretical perspectives were actually very similar. Tacitly disclaiming *Utah Pie*, which had focused on defendants' “intent” of injuring a competitor, the plaintiff accepted the more demanding burden of showing both below-cost pricing and likelihood of recoupment.¹⁵⁹ This was identical to the test proposed by defendant's counsel. The primary disagreement between the parties was *not* the appropriate economic

¹⁵⁶ See, e.g., *Utah Pie Co.*

¹⁵⁷ Areeda served as plaintiff's counsel together with his Harvard Law School colleague, Charles Fried.

¹⁵⁸ See Reply Brief for the Petitioner, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), 4.

¹⁵⁹ This acceptance could not have been more explicit: “We accept the burden of showing that prices were discriminatory, below average variable cost, and were undertaken with a reasonable prospect of recoupment.” Oral Argument, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (available at http://www.oyez.org/cases/1990-1999/1992/1992_92_466).

analysis, but whether the plaintiff had met its evidentiary burden.¹⁶⁰ Unlike plaintiffs in many earlier cases, Brooke Group's counsel engaged directly with the defendant's economic arguments, devoting substantial effort to contesting its claim that a decision for the plaintiff would chill legitimate price competition.¹⁶¹ Finally, not only did the plaintiff's arguments focus on consumer prices, they also dispensed with the equalitarian appeals that had long been a staple of antitrust cases. Plaintiff's full acceptance of the consumer-welfare model, its reliance on economic analysis, and its ability to engage the Chicago School on its own intellectual terms reveal the major changes in antitrust practice since the cases of the 1960s.

iii. Defendant's Arguments

Just as Brooke Group was represented by one of the country's most prominent antitrust scholars, so too was Brown & Williamson. Defense counsel included not only Robert Bork, a leading figure of the Chicago School, but also Bork's friend and former law partner Frederick Rowe, a noted antitrust scholar in his own right and longtime critic of the Robinson-Patman Act.¹⁶² Unsurprisingly, Bork and Rowe's defense of Brown & Williamson's pricing practices featured the consumer-welfare philosophy and market-based economic analysis typical of the Chicago School. More surprising was how much in common their arguments shared with the plaintiff's. Although their characterizations of the factual

¹⁶⁰ Brooke Group's failure to meet this burden was partly due to the testimony of its own managers. Central to plaintiff's theory of liability was its claim that the highly-concentrated cigarette industry was characterized by tacit price collusion. Brooke Group management had repeatedly testified that no such collusion existed, however, contradicting plaintiff's economic witness. Defense counsel seized on this contradictory testimony, Bork exclaiming: "I don't see how a company can come in... the client itself can walk in and deny its own case, and then the lawyers say yes, but I have an economist over here that will... contradict. That just doesn't make any sense to me." Oral Argument, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (available at http://www.oyez.org/cases/1990-1999/1992/1992_92_466).

¹⁶¹ Brief for the Petitioner, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), 28–32. Reply Brief for the Petitioner, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), 41–43.

¹⁶² Bork and Rowe had practiced antitrust law at the firm today known as Kirkland & Ellis LLP.

evidence (the true area of contention in the case) were very different, both parties endorsed the same analytical test for legally cognizable predatory pricing.¹⁶³

The arguments of defendant's counsel were actually fairly restrained, considering Bork's strong market-based views. For example, defendant's counsel stopped short of arguing that an independent oligopolist such as Brown & Williamson could *never* successfully recoup supracompetitive profits following a predatory pricing scheme, the pro-defendant rule that had been adopted by the Fourth Circuit below.¹⁶⁴ Nor did counsel argue that the likelihood of recoupment should be the sole test for predatory pricing (a rule that would imply the alleged predator's price-cost relationship is irrelevant), the "die-hard" Chicago position which had been adopted by the Seventh Circuit. The defense even acknowledged the continuing legal validity of *Utah Pie*, a case which Bork had once described as among the worst antitrust opinions ever written.¹⁶⁵ These concessions notwithstanding, the general thrust of the defendant's arguments remained in keeping with the Chicago perspective, and many of the themes of Bork's scholarly work were front and center in the defendant's brief. Although the brief never cited Bork's work directly, many of its arguments unmistakably harkened to ideas that Bork had developed over the course of his scholarly career. Among these, the most relevant was the brief's repeated insistence that claims of "predatory pricing" were often attempts to thwart price competition, the very economic activity that antitrust law was meant to protect. Thus, in most cases, imposing liability for aggressive price cutting was a perversion of antitrust law itself. Citing Frank Easterbrook, the brief also warned that courts should be suspicious of *any* antitrust suit brought by a horizontal competitor, arguing that "[t]he books are full of suits by rivals for the purpose, or with the effect, of reducing competition and increasing price."¹⁶⁶ In

¹⁶³ This was certainly the defense's view. During oral argument, when Justice Kennedy observed "[t]here's no legal difference between you and the petitioner," Bork agreed: "I don't think there is, Your Honor." Oral Argument, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (available at http://www.oyez.org/cases/1990-1999/1992/1992_92_466).

¹⁶⁴ *Liggett Group, Incorporated v. Brown & Williamson Tobacco Corporation*, 964 F.2d 335 (4th Cir. 1992).

¹⁶⁵ Bork, *The Antitrust Paradox*, 210.

¹⁶⁶ Brief for the Respondent, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), n. 37.

arguing that strict enforcement of the antitrust laws could actually *reduce* market competition, the defendant's brief echoed a central theme of decades of Chicago scholarship.

iv. Amicus Curiae Briefs

Brooke Group featured four amicus briefs, each filed in support of the defendant. Two were filed by business firms with litigation interests similar to Brown & Williamson, in that they were past, current, and/or potential defendants in predatory pricing cases; one was filed by the Grocery Manufacturers of America, a trade group whose individual members had often been subject to predatory pricing litigation; and one was filed by The Business Roundtable (the Roundtable), an advocacy group composed of CEOs of major American business corporations.¹⁶⁷ Among these four briefs, the Roundtable's is the most notable, as it represented a growing trend of amicus participation by nationwide lobbying organizations. Unlike each of the other three amici, which had more or less direct interests in the outcome of the litigation, the Roundtable's brief was intended to exert a more general influence on the direction of antitrust law. In its brief, the Roundtable claimed to be neutral as between the parties, both large corporations: "Neither party is a member," it stated, "and The Business Roundtable has no special interest in the individual fortunes of either company."¹⁶⁸ However, the association did have "a critical interest in the standards that are applied to judge the legality of aggressive competition in the marketplace."¹⁶⁹ Its efforts to promote this interest at the Supreme Court were part of a larger historical pattern. Throughout the 1980s and accelerating in the 1990s, the submission of amicus briefs by conservative business and political groups, such as the U.S. Chamber of Commerce, the American Enterprise Institute, the Pacific Legal Foundation, and the Roundtable itself, became increasingly

¹⁶⁷ For a history of the Roundtable, see Benjamin C. Waterhouse, *Lobbying America: The Politics of Business from Nixon to NAFTA* (Princeton: Princeton University Press, 2014), 76–105.

¹⁶⁸ Brief for The Business Roundtable as Amicus Curiae in Support of Respondent, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), 16.

¹⁶⁹ *Ibid.*, 1.

common. Today, these briefs have become a regular feature of Supreme Court antitrust cases, often presenting market-based arguments that parallel the holdings of the Court.

The Roundtable's brief in *Brooke Group* was thin on academic citations, though it did cite Areeda's work on predatory pricing.¹⁷⁰ The main thrust of the brief was a general warning that predatory pricing claims could chill legitimate price competition, together with an admonition that subjective "intent" (i.e., intent to take market share from a rival) was an inappropriate grounds for antitrust liability.¹⁷¹ Claiming that the Court's decision would have effects "far beyond the case at hand," the Roundtable predicted "a real risk that aggressive price competition in a large segment of the business world will be chilled" if the Court ruled in favor of the plaintiff.¹⁷² Like defense counsel, the Roundtable cast the plaintiff's case as an attempt to frustrate legitimate price competition, a familiar narrative in antitrust discourse by 1993. The Roundtable's brief is therefore significant less for the originality of its argument than for presenting it on behalf of a powerful advocacy organization that claimed to speak for the larger business community.

In at least one respect, the amicus briefs in *Brooke Group* were also *unrepresentative* of broader trends. Unusually for a case after the 1980s, *Brooke Group* featured no pro-plaintiff amici. Although pro-defendant amicus briefs outnumbered pro-plaintiff briefs in many cases, the submission of pro-plaintiff amicus briefs by businesses, advocacy groups, and legal and economic scholars had become a regular occurrence by the 1990s.¹⁷³ The high level of economic analysis that often characterized such briefs speaks to the broader economization of antitrust law, and their absence from *Brooke Group* is thus somewhat of an anomaly.

¹⁷⁰ Ibid., 5, 12 n.5.

¹⁷¹ Note that plaintiff's counsel did not argue that intent alone could establish antitrust liability, despite the Roundtable's focus on the issue.

¹⁷² Ibid., 16.

¹⁷³ Of the 25 cases in the database decided between 1990 and 2010 (i.e., the final two decades), only 3 featured no pro-plaintiff amicus briefs.

v. *Summary*

Brooke Group provides another example of historical changes in the antitrust field. From a purely doctrinal perspective, the *Brooke Group* holding was far removed from earlier, interventionist pricing cases such as *Utah Pie*. More significant for purposes of my argument, however, was the convergence of plaintiff's and defendant's counsel on a shared intellectual vision of antitrust—one in which “consumer welfare” is the dominant policy goal and economic analysis the dominant epistemological framework. Although defendants had made little use of economics during the Warren Court era, and plaintiffs had been slow to adopt economic arguments in the 1970s, modern antitrust has become defined by a universal embrace of the dismal science. The fact that in *Brooke Group* both plaintiff's and defendant's counsel were among the most eminent scholars in the field only reinforces the significance of the similarity of their approaches. Antitrust cases had once been argued in terms of fairness, opportunity, and independence. *Brooke Group* announced the ascendancy of the more limited ambitions of the modern era.

CHAPTER 13: CONCLUSION

Having explored both quantitative and qualitative features of 60 years of antitrust jurisprudence, I return now to the central question posed in Chapter 10: What explains the transition from interventionist antitrust to the market-based economic approach that dominates the field today? Did law and economics convince the Court of the importance of economic analysis? Or, as the attitudinal model would suggest, was this change determined primarily by the ideological views of conservative appointees? Given the possibility of mutual causality, are these factors necessarily distinct and separable?

Based on my study, my conclusion is that *both* factors played important roles in antitrust's transformation, though the nature and mechanisms of their respective influences were very different. First and foremost, changes in the composition of the Court (and *not* changes in individual Justices' views) were the most direct and most important cause of changes in decision outcomes. The evidence on this point is clear. The switch from interventionist to market-based decisions in the early 1970s closely corresponds with the establishment of the Burger Court's conservative voting bloc.¹⁷⁴ Although the voting records of certain incumbent Justices (most notably Justice Brennan) did move in a market-oriented direction over time, the effect of this shift was minor compared to the retirement of liberals such as Black, Douglas, and Warren and the appointment of conservatives such as Powell, Burger, and Rehnquist. In fact, when viewed in terms of retirements and appointments, the reversal in antitrust decisions of the 1970s was as much a reflection of the pronounced liberalism of the Warren Court as it was of the conservatism of the Burger Court. The evidence regarding economic arguments tells a similar story. Individual voting data show that the Justices who responded most positively to economic arguments were the Justices who were already predisposed to casting market-based antitrust votes.¹⁷⁵ Justices who were predisposed to casting interventionist votes, on the other hand (with the exception of

¹⁷⁴ See Figure 1.

¹⁷⁵ See Table 2.

Justice Brennan), generally responded negatively to economic arguments.¹⁷⁶ Together, these patterns indicate that, when it comes to individual voting, preexisting political attitudes are more important than the parties' arguments. This is further illustrated by the specific example of Justice Powell, for whom academic scholarship was a means of justifying predetermined ends. For judges such as Powell, voting decisions in antitrust cases were shaped by deep-seated political attitudes regarding the role of business in American society and the proper scope of government regulation. The evidence suggests that these attitudes "primed" conservative Justices to respond to economic arguments. It does not suggest that economic arguments determined their fundamental policy views.

If changes in antitrust law were primarily the result of changes in the membership of the Court, does it therefore follow that law and economics was irrelevant to the antitrust revolution? I would argue no—in fact, I believe academic developments have been nearly as important as judicial appointments to antitrust's transformation, though the mechanism of their influence is more difficult to specify. Essentially, by altering the intellectual perspective of the broader antitrust community, the law and economics movement changed the premises upon which the entire field is based, with profound and lasting implications for the continuing development of the law.

The evidence of this change is the increasing acceptance of market-based economic assumptions among intellectuals who had previously been guided by interventionist principles. Considering the cases discussed in this Part III, Donald Turner's role as amicus counsel in *Sylvania* is a prime example. As Assistant Attorney General for antitrust under President Johnson, Turner oversaw the case against Schwinn in 1967, which established the per se rule against vertical restraints. Only 10 years later, Turner argued essentially the opposite position in *Sylvania*, citing many of the Chicago School's economic criticisms of *Schwinn*. Even before *Sylvania*, moreover, the Harvard tradition of antitrust scholarship had begun to move in the direction of Chicago. In 1975, for example, Turner and Areeda published their economic model of predatory pricing, which shared many of the Chicago School's central analytical

¹⁷⁶

Ibid.

premises. By the time Areeda deployed this model as plaintiff's counsel in *Brooke Group*, his economic analysis of predatory pricing was little different from Robert Bork's.

Turner and Areeda's increasing affinity with the analytical approach of the Chicago School is only one of many historical examples of the growing influence of market-based antitrust.¹⁷⁷ Richard Posner, a noted proponent of the Chicago approach and a central figure in the law and economics movement, began his career as an antitrust traditionalist. Working in the Office of the Solicitor General, Posner argued several government antitrust cases during the 1960s in which he advocated (and personally agreed with) the government's interventionist legal theories—before abruptly changing his antitrust views circa 1970.¹⁷⁸ William F. Baxter, Assistant Attorney General for antitrust under Reagan and committed supporter of market-based antitrust policy, also held interventionist views earlier in his career, which he explicitly recanted in the 1970s.¹⁷⁹ Even the Chicago School's founding intellectuals, including George Stigler, Ward Bowman, and Aaron Director himself, had at one time advocated breaking up large corporations.¹⁸⁰ In the academic world, market-based antitrust theory has shown a remarkable power of persuasion, converting former skeptics and displacing the prior intellectual status quo.¹⁸¹

¹⁷⁷ Nearly 30 years ago, Richard Posner addressed the convergence of the Harvard and Chicago schools, writing that “the debate is no longer one between schools that employ consistently different and ideologically tinged premises to render predictably opposite results.” Posner, “The Chicago School of Antitrust Analysis,” 933–44. Marc Eisner suggests that this convergence has been to Harvard's disadvantage, pointing out that “it is difficult to identify any concessions on the part of the Chicago school.” Eisner, *Antitrust and the Triumph of Economics*, 111.

¹⁷⁸ “From Von's to Schwinn to the Chicago School: Interview with Judge Richard Posner, Seventh Circuit Court of Appeals,” *Antitrust* 6 (1992): 4–5.

¹⁷⁹ See William F. Baxter, “How Government Cases Get Selected--Comments from Academe,” *Antitrust Law Journal* 46 (1977): 588. Baxter “recanted” positions he had endorsed in the 1967 Report of the White House Task Force on Antitrust Policy (commonly referred to as the Neal Report), a special antitrust policy report commissioned by the Johnson administration, which had made a number of interventionist policy recommendations. “Report of the White House Task Force on Antitrust Policy,” May 27, 1969.

¹⁸⁰ A conversion narrative appears again and again in the intellectual history of the Chicago School. Robert Bork referred to his own studies under Director in religious terms: “A lot of us who took the antitrust course or the economics course underwent what can only be called a religious conversion.... We became janissaries as a result of this experience.” Edmund W. Kitch, ed., “The Fire of Truth: A Remembrance of Law and Economics at Chicago,” *Journal of Law and Economics* 26 (1983): 183.

¹⁸¹ For discussion of the broader influence of market-based economic thought in the 1970s and 1980s, see Daniel T. Rodgers, *Age of Fracture* (Cambridge: Belknap, 2012), 41–76.

By influencing the study, teaching, and practice of antitrust law, these academic developments have had long-term policy implications. Today, most antitrust scholars agree that the jurisprudence of the Warren Court was economically naïve, that “consumer welfare” is (and should be) the primary goal of antitrust policy, and that economic analysis is indispensable to the proper understanding of antitrust disputes—each principles attributable to law and economics scholarship. Even “post-Chicago” scholars, who challenge the analytical models of the Chicago School, do so from a position of fundamental agreement with its focus on economic efficiency. For example, a recent text critical of the Chicago School nevertheless acknowledges that “U.S. antitrust enforcement, as a result of conservative economic analysis, is *better* today than it was during the Warren years—more rigorous, more reasonable, more sophisticated in terms of economics.”¹⁸² Given this broad normative consensus, it is difficult to study antitrust law in law school today without being deeply exposed to orthodox economic theory, the intellectual assumptions of which have achieved nearly hegemonic status. Given these historical developments in legal education, it is hard to envision future Justices (or perhaps more importantly, their clerks) breaking from this economic paradigm to any significant degree. Although changes in antitrust originally resulted from the partisan cycle of judicial appointments, academic developments have ensured these changes are unlikely to be reversed, at least in the near term. It will require another major shift in legal thinking similar to the rise of law and economics for a fundamental reconsideration of current antitrust policy.

As a final note, it is also important to emphasize that the “legal” and “attitudinal” models are not the only explanations for changes in antitrust law. In addition to the jurisprudential developments discussed herein, changes in the cultural, political, and economic landscape have weakened the strength of antitrust as a populist force in American politics and significantly reduced public demand for vigorous antitrust enforcement.¹⁸³ The evidence presented in this study does not speak directly to those broader

¹⁸² Pitofsky, *How the Chicago School Overshot the Mark*, 5.

¹⁸³ The decline of antitrust in American politics has been a long historical process, not limited to recent decades. Richard Hofstadter’s classic 1964 essay “What Happened to the Antitrust Movement?” shows that public

changes, but speculation as to their major causes is possible. First, Americans may have simply grown accustomed to large, dominant firms in many industries. High levels of industry concentration are commonplace today (think communications, information technology, etc.), but represented unfamiliar and often frightening change early in the twentieth century. Even as late as the 1960s, amidst growing acceptance of large corporations, consolidation in major industries continued to spark public concern.¹⁸⁴ Second, the rise of international competition from nations such as Germany and Japan (and more recently China) seems to have reduced public interest in aggressive antitrust policy, in two ways: by providing new competitors in the domestic market and by rousing latent protectionist sentiment.¹⁸⁵ In the context of economic globalization and the rise of international business, the American public has become less concerned with limiting the size of domestic firms. Finally, the populism that first gave rise to the original era of antitrust policy has taken new forms in the twenty-first century, adapting to the problems of the age. While economic populism remains a powerful force in American politics, it is today expressed primarily in terms of wealth inequality, campaign finance reform, and punishing the financial industry, rather than the more traditional concerns of industrial concentration and the protection of small businesses. Americans today seem largely indifferent toward the market dominance of many large

interest in antitrust had been fading throughout the twentieth century. Hofstadter identifies antitrust as one of the “faded passions” of the populist reform movement. Hofstadter, “What Happened to the Antitrust Movement?”

¹⁸⁴ For an early postwar perspective on the advantages of big business, see David E. Lilienthal, *Big Business: A New Era* (New York: Harper & Brothers, 1952). For a mid-century assessment of Americans’ attitude toward large industrial firms, see Hofstadter, “What Happened to the Antitrust Movement?” The classic historical examination of the rise of big business is Chandler, *The Visible Hand: The Managerial Revolution in American Business*.

¹⁸⁵ The strength of this sentiment was clearly reflected in the 2016 presidential race. Several candidates—both Republican and Democrat—criticized American trade policy as overly favorable to foreign nations. Right-wing populist Donald Trump loudly decried U.S. trade policy, threatening to penalize corporations that move production overseas, impose new trade barriers against China and Mexico, and renegotiate or “break” NAFTA. Meghashyam Mali, “Trump Threatens to ‘Break’ Trade Pact with Mexico, Canada,” *The Hill*, September 26, 2015, at <http://thehill.com/blogs/ballot-box/255053-trump-vows-to-renegotiate-or-break-trade-pact-with-mexico-canada> (whether President Trump lives up to these threats remains to be seen). Similarly, left-wing populist Bernie Sanders committed his candidacy to “reversing trade policies like NAFTA, CAFTA, and PNTR with China that have driven down wages and caused the loss of millions of jobs.” *Income and Wealth Inequality*, at <https://berniesanders.com/issues/income-and-wealth-inequality> (accessed February 2, 2016). Even candidates as moderate as Hillary Clinton were compelled to criticize trade agreements such as the Trans-Pacific Partnership, suggesting global competition has become a major concern for American voters. Indeed, protectionism (and xenophobia) are on the rise in countries around the globe.

corporations, and there is little call for breaking up big businesses outside the financial sector.¹⁸⁶ Whether these changes in American politics have influenced *judicial* decisions is difficult to say, but they have certainly reduced public demand for antitrust legislation and enforcement.

Despite—or perhaps because of—this loss of public interest, few areas of law have changed as profoundly as antitrust since World War II. Although much less dramatic in human terms, the changes in Supreme Court antitrust jurisprudence are comparable in scope to changes in civil rights, criminal justice, and personal privacy over the same time period. As discussed herein, the proximate cause of these far-reaching changes were the Nixon appointments of the late 1960s and early 1970s and the resulting shift in the attitudinal balance among the individual members of the Court. At the same time, however, developments in academic scholarship have transformed antitrust’s intellectual foundations, reducing the likelihood these changes will be reversed, even in the hypothetical case of future liberal appointments. This broader intellectual shift may ultimately prove the more significant, as it has thoroughly severed antitrust policy from its populist origins. Moreover, to the extent that antitrust is the prototypical example of the policy influence of law and economics, antitrust’s embrace of economic efficiency over traditional notions of economic justice is emblematic of larger developments in recent American legal history.

¹⁸⁶ In the wake of the 2008 financial crisis, dismantling large financial companies has becoming a rallying cry for many on the left (and some on the right). The 2016 campaign proposals of Bernie Sanders, for example, included a pledge of “breaking up huge financial institutions so that they are no longer too big to fail.” *Ibid.* However, even in Sanders’s highly populist presidential campaign, this pledge did not extend to firms outside the financial sector.

APPENDIX TO PART III: SUPREME COURT JUSTICES

This table provides the full name, party affiliation, and tenure of each Justice in the database of Supreme Court antitrust decisions.

JUSTICE	PARTY AFFILIATION	TENURE
Hugo Black	Democrat	1937–1971
Stanley Reed	Democrat	1938–1957
Felix Frankfurter	Democrat	1939–1962
William Douglas	Democrat	1939–1975
Robert Jackson	Democrat	1941–1954
Harold Burton	Republican	1945–1958
Frederick Vinson	Democrat	1946–1953
Sherman Minton	Democrat	1949–1956
Thomas Clark	Democrat	1949–1967
Earl Warren	Republican	1953–1969
John Marshall Harlan	Republican	1955–1971
William Brennan	Democrat	1956–1990
Charles Whittaker	Republican	1957–1962
Potter Stewart	Republican	1958–1981
Arthur Goldberg	Democrat	1962–1965
Byron White	Democrat	1962–1993
Abraham Fortas	Democrat	1965–1969
Thurgood Marshall	Democrat	1967–1991
Warren Burger	Republican	1969–1986
Harry Blackmun	Republican	1970–1994

JUSTICE	PARTY AFFILIATION	TENURE
Lewis Powell	Republican	1972–1987
William Rehnquist	Republican	1972–2005
John Paul Stevens	Republican	1975–2010
Sandra Day O’Connor	Republican	1981–2006
Antonin Scalia	Republican	1986–2016
Anthony Kennedy	Republican	1988–present
David Souter	Republican	1990–2009
Clarence Thomas	Republican	1991–present
Ruth Bader Ginsburg	Democrat	1993–present
Stephen Breyer	Democrat	1994–present
John Roberts	Republican	2005–present
Samuel Alito	Republican	2006–present

CONCLUSION

This dissertation has traced key aspects of the legal regulation of corporations from the late nineteenth to the early twenty-first century. By way of its three studies, it has argued that major policy developments with respect to corporate taxation, internal corporate governance, and competition law have often been influenced by specific features of the political environment at the time, rather than by determinative forces of economic logic or political power. While it is tempting for the student of modern policy to assume that everything happens for a reason and to therefore search for logical explanations for the shape of the institutions around us, the reality is that the logic of these institutions is often divined in hindsight, imposed on history as a rationalization of essentially contingent processes.

The historically-dependent character of legal-economic policy is illustrated by each of my three case studies. The origins of the debt-equity distinction, often ascribed to financial lobbying, were actually the result of a disconnected series of extemporaneous political decisions. Once these decisions had been made, they became ossified in the tax system, as corporate taxpayers became increasingly reliant on the tax advantages they bestowed. The state-based system of American corporate law—often portrayed in the legal literature as an intrinsic (and economically efficient) aspect of American federalism—was in no way predetermined by American political traditions. It was rather the default outcome following the failure of Congressional legislation, despite widespread agreement on the desirability of federal law. As in the tax area, once corporate America had committed itself to the Delaware model of corporate law, comprehensive change in the form of federal law became unlikely. Finally, the transition to market-based antitrust policy was not determined by intellectual advances in the field, but was rather a function of the last major shift in the ideological alignment of the Supreme Court. Had political events unfolded differently (e.g., had Nixon not won the presidency in 1968, had Nixon not appointed Lewis Powell, etc.), the pivotal decisions of the 1970s would likely have rested on different bases, and the market-based theories of law and economics would not have gained their precedential foothold. As each of these cases show, historical context can have a decisive influence on how legal and economic institutions change over time.

Notwithstanding its emphasis on the particularity of historical events, my dissertation also traces a long-term trend in economic policy—the shift away from the economic populism of the late nineteenth and early twentieth centuries to a more elitist mode of policymaking informed by neoclassical economic theory. Comparison of the corporate law debates of the early twentieth century to the liberalization of antitrust law in the century’s latter decades suggests the rising dominance of free-market economics in both government and academics. Whether policymakers were actually influenced by developments in academic theory, or whether they simply used theory to justify preexisting political goals (the question addressed in Part III), probably depends on the specific policy context. What is certain is that by century’s end, orthodox economics had achieved a level of influence and prestige unrivaled by any other social science.¹ In the post-Cold War era, critics of “neoliberalism” bemoaned the hegemonic grip of free-market economics on policymaking across the globe.²

Despite predictions to the contrary, however, history had not yet ended.³ In the wake of the financial crisis of 2008—the worst such crisis since the Great Depression—the hegemony of free markets has been threatened in two respects: First, the nature of the crisis itself cast orthodox economic theory in doubt, particularly the claim that deregulated financial markets will safely and efficiently self-equilibrate. Given the spectacular failure of financial risk pricing in 2007-2008, free-market economic theory has lost significant political cachet. Second, and more importantly, the economic dislocation stemming from the crisis has contributed to a global resurgence in economic populism, including credible political efforts to reverse the liberal policies of the last several decades.

¹ See Rodgers, *Age of Fracture*, 41–76.

² David Harvey, *A Brief History of Neoliberalism* (Oxford: Oxford University Press, 2009); Daniel Stedman Jones, *Masters of the Universe: Hayek, Friedman, and the Birth of Neoliberal Politics* (Princeton: Princeton University Press, 2012), 329–45; Naomi Klein, *The Shock Doctrine* (New York: Picador, 2008); Philip Mirowski and Dieter Plehwe, eds., *The Road from Mont Pelerin: The Making of the Neoliberal Thought Collective* (Cambridge: Harvard University Press, 2009); George Monbiot, *How Did We Get Into This Mess? Politics, Equality, Nature* (London: Verso Books, 2016).

³ Francis Fukuyama, *The End of History and the Last Man* (New York: Avon Books, Inc., 1992).

Indeed, given the dramatic political events of the last year, including the election to the presidency of an enthusiastic capitalist who campaigned against core tenets of economic liberalism, it is worth asking whether the historical inertia of past policy decisions will continue to influence corporate regulation, or whether we may be at a historical precipice of major legal-economic policy change. That is, will the economic policies of the Trump administration break from established political precedent, or will the path-dependence of institutional structures continue to shape future policy? At the risk of making future predictions in a history dissertation, I would suggest that even a political phenomenon as disruptive as the Trump presidency will find it difficult to overcome long-established policy structures. More importantly, the new wave of populism that has swept American (and global) politics has shown little concern for the policy areas discussed in this dissertation, focusing instead on the more salient issues of trade and immigration.

Taking corporate law, for example, Trump-style economic populism has almost nothing to say regarding corporate governance. Notwithstanding campaign criticisms of economic concentration, as well as much more stringent criticisms from Bernie Sanders, the candidate of the populist left, the Trump administration has shown little interest in substantive corporate law reform.⁴ This is hardly surprising—as discussed in Part II, the primary institutional actor in American corporate law is the state of Delaware, over which the presidential administration has no direct authority. In the area of corporate regulation where the federal government *does* have authority—securities law—there have actually been recent moves toward greater involvement in corporate governance, but these have been the result of SEC rulemaking processes far removed from popular politics.⁵ Although several of these rules were promulgated under the Dodd-Frank act of 2010, a law intended to rein in Wall Street following the 2008 financial crisis, their modest changes to corporate governance have attracted little public attention. And

⁴ See Kenneth P. Vogel, “Trump Hones Attacks on Big Corporations, Donors and Media,” *Politico*, October 1, 2016, <http://politi.co/2dEbl9b>.

⁵ Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC has adopted and proposed a number of rules relating to compensation committee structure, shareholder “say on pay,” disclosure by private funds, and other corporate matters. See Part III.

while Donald Trump was highly critical of Wall Street during his campaign, he has apparently reversed course since his election, promising to roll back Dodd-Frank financial regulations.⁶ Where this leaves Dodd-Frank's corporate governance provisions is uncertain, but even if they too are reversed, we are unlikely to see any broader reforms under the Trump administration. Control of corporations, once a central issue in American politics, simply no longer commands the attention of the average American voter.

Unlike the technical details of internal corporate governance, antitrust is an area which has seemed primed for a political resurgence. Given strong and growing anti-corporate sentiment on the part of the populist left, and the surprising degree of similar feeling among at least some elements of the right, one could imagine a revival of interest in the "faded passion" of antitrust law. Despite the hopes of certain observers, however, no such revival has come to pass.⁷ Although apprehension of corporate power has expressed itself in a range of recent political proposals—some general, some targeted—none of these proposals have specifically focused on the traditional domain of antitrust policy.⁸ Reflecting the general atmosphere of anti-corporate populism, statements by Donald Trump during the 2016 campaign suggested a more rigorous approach to antitrust enforcement,⁹ but again, the reality of administration

⁶ See Peter Schroeder, "Democrats Paint Trump as Hypocrite on Wall Street," February 3, 2017, <http://thehill.com/policy/finance/317801-democrats-paint-trump-as-hypocrite-on-wall-street>.

⁷ K. Sabeel Rahman, "Challenging the New Curse of Bigness," *The American Prospect*, fall 2016.

⁸ The most salient of these proposals have focused on campaign finance reform (i.e., abrogating *Citizens United*), corporate tax avoidance, and financial sector regulation. See Oreskes, "Clinton Pledges Constitutional Amendment to Overturn Citizens United Ruling"; Naomi Jagoda, "Sanders Offers Bill Aimed at Preventing Corporate Tax Avoidance," March 9, 2017, <http://thehill.com/policy/finance/323187-sanders-offers-bill-aimed-at-preventing-corporate-tax-avoidance>; Donna Borak, "Bernie Sanders Outlines Plan to Pare Down Big Banks," *Wall Street Journal*, April 6, 2016.

⁹ During his campaign, Trump said he would oppose the proposed merger between AT&T Inc. and Time Warner Inc., stating "[a]s an example of the power structure I'm fighting, AT&T is buying Time Warner and thus CNN, a deal we will not approve in my administration because it's too much concentration of power in the hands of too few.... Deals like this destroy democracy." Ryan Knutson, "Trump Says He Would Block AT&T-Time Warner Deal," *Wall Street Journal*, October 22, 2016. Invoking the trust-busting legacy of Teddy Roosevelt, Trump also suggested he would retroactively review the Comcast Corporation-NBCUniversal acquisition of 2011, promising to "break up the new media conglomerate oligopolies that have gained enormous control over our information, intrude into our personal lives, and in this election, are attempting to unduly influence America's political process." "Trump Campaign Releases Statement Threatening That Trump Administration Will 'Break Up' Media Conglomerates That Have Criticized Trump," *Media Matters for America*, October 23, 2016,

policy seems to tell a different story. Based on appointments so far, the Trump administration does not look to depart from traditional Republican antitrust policy (which is not significantly different from recent Democratic antitrust policy).¹⁰ At the level of the Supreme Court, for example (one of the most important antitrust institutions), it is difficult to imagine that Justice Gorsuch will alter the consensus on antitrust doctrine. Thus, while President Trump has perhaps injected some uncertainty into antitrust policy, the established orthodoxy of law and economics seems likely to continue for the foreseeable future.

Finally, of my three areas of focus, corporate taxation is the area of law where there is greatest interest in substantive reform, while simultaneously the greatest obstacles in the form of political and institutional resistance. Despite bold promises by the Trump administration and Congressional Republicans to reform the corporate tax system, fundamental change (i.e., change beyond simply reducing rates) appears unlikely. The structure of the U.S. tax system is too ingrained and too consequential economically to expect major organizational reforms under even the most favorable political circumstances. Corporations and other taxpayers that benefit from the status quo—or that have relied on the status quo in forming their business and tax strategies—have strong incentives to invest significant resources in opposing unfavorable reforms. Even in the best of cases, the benefits of tax reform are often economically diffuse, undermining the incentives for any single interest to strongly support them.

Current tax reform proposals provide a relevant example, though even the diffuse economic benefits of the most recent proposals are questionable. Following the U.S. elections of 2016, which gave Republicans the presidency and both houses of Congress, party strategists began formalizing plans for an

<https://mediamatters.org/blog/2016/10/23/trump-campaign-releases-statement-threatening-trump-administration-will-break-media-conglomerates/214061>. Finally, alluding to the possibility of antitrust action against Amazon.com, Trump has commented that Jeff Bezos has a “huge antitrust problem because he’s controlling so much, Amazon is controlling so much of what they are doing.” Eric Beech, “Trump Says Amazon.Com Has ‘a Huge Antitrust Problem,’” *Reuters*, May 12, 2016.

¹⁰ Diane Bartz, “Trump Adds Antitrust Expert to Justice Transition Team,” *Reuters*, November 28, 2016; Alan Neuhauser, “On Antitrust, Trump Signals a Return to the Bush Years,” *U.S. News & World Report*, December 9, 2016; Matt Porzio, “Trump Appointments Signal Shift on Mega-Mergers, Antitrust Enforcement,” *Forbes*, January 17, 2017.

ambitious border-adjustment tax, which would significantly reduce domestic corporate tax rates while excluding revenue from sales overseas and ending the ability of corporations to deduct the cost of imported goods.¹¹ This would entail a major change to the tax system, reducing the tax burden on many corporations and changing the corporate income tax into an indirect revenue tax. One of the proposal's secondary goals is equalizing the tax treatment of different types of financing by reducing the ability of corporations to deduct interest on debt—under the proposed border-adjustment tax, corporations can deduct interest only against interest income.¹² More importantly, however, by favoring exports and disfavoring imports, the border-adjustment tax also discriminates against foreign firms, a policy consistent with rising protectionism in American politics. Tellingly, 77% of Republican voters support the plan, notwithstanding its inconsistency with the traditional Republican commitment to free trade.¹³

Despite its popularity among Republican voters and the “America first” agenda of the Trump administration, the border-adjustment tax is unlikely to become law. Many American corporations, particularly retailers, manufacturers, and refiners, would be badly hurt by new tax rules preventing them from expensing the cost of imports.¹⁴ These corporations have significant influence in national legislative politics, making enactment of the new tax doubtful.¹⁵ In addition, a number of trade groups, lobbying organizations, and free-market policy institutes also oppose the tax, intensifying pressure on Republican legislators to break ranks and oppose the measure.¹⁶ At the time of this writing, even the president

¹¹ The Republican proposal was first released in summer 2016, as “A Better Way, Our Vision for a Confident America,” June 24, 2016.

¹² *Ibid.*, 26.

¹³ Jonathan Easley, “Poll: Voters Support Controversial Border-Adjustment Tax,” *The Hill*, April 20, 2017, <http://thehill.com/homenews/administration/329607-poll-voters-support-controversial-border-adjustment-tax>.

¹⁴ On the other hand, the border-adjustment tax would benefit export-oriented corporations.

¹⁵ See, e.g., Krystina Gustafson, “With a Crippling Border Tax Looming, Retailers Head to Washington,” *CNBC*, February 1, 2017, <http://www.cnn.com/2017/01/31/with-a-crippling-border-tax-looming-retailers-head-to-washington.html>.

¹⁶ See, e.g., Naomi Jagoda, “Koch-Backed Group Unveils TV Ad Against Border Tax,” *The Hill*, April 10, 2017, <http://thehill.com/policy/finance/328038-koch-backed-group-unveils-tv-ad-against-border-tax>.

appears to have soured on the tax, preferring comprehensive rate reductions.¹⁷ Regardless of whether a border-adjustment tax would be good or bad for the American economy (and there are strong arguments that a protectionist tax would be bad), its radical break from the current tax system presents major obstacles to successful enactment. Although adjustments to the corporate tax rate may be politically feasible, fundamental changes to the structure of the tax itself—whether eliminating the interest deduction or introducing discriminatory import/export provisions—are unlikely.

With the election of Donald Trump as President of the United States, the country finds itself in a period of unprecedented policy uncertainty. Carried into power on a wave of anti-establishment anger, the Trump administration has given conflicting signals regarding its actual policy agenda. It appears possible that certain areas of major political salience, including immigration, foreign trade, and environmental regulation, may see their greatest changes in decades. More specialized policy areas, however, including antitrust, corporate law, and corporate taxation, are unlikely to see significant reform. The reality is that, once established, policy choices tend toward stability, given the economic interests that cohere around them and the access of those interests to responsible policymakers, as well as to the American political system's structural resistance to rapid change. Ironically, while *initial* policy decisions are often influenced by contingent features of their historical setting, these decisions can later become difficult to reverse, absent significant, focused political will. It would perhaps be preferable if policy choices were regularly reconsidered and remade anew, adjusting to developments in academic knowledge or changes in broader political priorities. For better or for worse, such frictionless updating is impossible—when it comes to the structure of corporate capitalism, the past remains always with us.

¹⁷ Alan Rappeport, "Parsing Trump's Promised Tax Plan, From Rates to Deficits," *New York Times*, April 25, 2017.

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