Companies and Corporations: Their Transition from Status to Contract and Its Political Economy

Palladam M Vasudev, York University

Available at: https://works.bepress.com/palladam_vasudev/1/
Companies and Corporations: 
Their Transition from Status to Contract, 
And Its Political Economy

© P.M. Vasudev 2007 
Ph.D. Candidate 
Osgoode Hall Law School of York University
Email: p_m_vasudev2001@yahoo.com
Companies and Corporations: Their Transition from Status to Contract, and Its Political Economy

Abstract

This article traces the state of corporate law in the English-speaking world since 1720, identifies the political economy of the changes that occurred since mid-nineteenth century, and the consequences for corporate law. During this period, there was a transition from the position that incorporation was a status to be conferred by the law to the position that they were the products of private contracts. In addition, they came to be treated as the property of their shareholders. These conceptual changes have had far-reaching consequences for the growth of corporations and were used to largely abandon the public regulation of corporations. This has had far-reaching consequences for corporate governance. This article explores the political and economic factors which led to the transition of corporations from status to contract, and the entry of the proprietary notion in corporate law.

Keywords: Corporate law, corporate law history, corporate governance, regulation of corporations

* * * * *
Companies and Corporations: Their Transition from Status to Contract, and Its Political Economy

*The path of the law was a progress from status to contract; the development of the law was a progressive unfolding of the idea of freedom.*

~ Roscoe Pound (1930)

Roscoe Pound spoke the above words in 1930 to describe the popular notions about the spirit of the legal changes that occurred in the nineteenth century. Pound’s utterances were more in an ironical sense, but there is substantial truth in them as this essay shows. This article traces the state of corporate law in the English-speaking world since 1720, identifies the political economy of the changes that occurred since mid-nineteenth century, and the consequences for corporate law. During this period, there was a transition from the position that incorporation was a status to be conferred by the law to the position that they were the products of private contracts. In addition, they came to be treated as the property of their shareholders.

These conceptual changes have had far-reaching consequences for the growth of corporations, and were used to virtually abandon the public regulation of business corporations. This has had far-reaching consequences for corporate governance. The article explores the political and economic factors which led to the transition of corporations from status to contract, and the entry of the proprietary notion in corporate law.

Two pronouncements of the United States Supreme Court, the earlier one in 1819 and the latter one in 1886, quite strikingly capture the transition that occurred in corporate law during the intervening period. In *Trustees of Dartmouth College v. Woodward* (1819),

---


2 17 US 518 (1819).
Justice Marshall of the United States Supreme Court famously described a corporation in the following words.

> A corporation is an artificial being, invisible, intangible, and existing only in the contemplation of law. Being a mere creature of law, it possesses only those properties, which the charter of its creation confers upon it, either expressly or incidental to its very existence.

According to this description, corporations were no more than creatures of statutes, and had no qualities other than those conferred by their constituent charter. The clarity in the words of Marshall is unmistakable. Here, the law was everything, and nothing existed beyond or outside the law. Corporations would exist and operate strictly within the four corners of the law. Less than 70 years later, in *Santa Clara County v. Southern Pacific Railroad* (1886), Chief Justice Waite considered a plea that corporations were on par with natural persons, and were entitled to the same level of constitutional protection. While doing so, he made the following, equally famous observations:

> The court does not wish to hear argument on the question whether the provision in the Fourteenth Amendment to the Constitution, which forbids a State to deny to any person within its jurisdiction the equal protection of the laws, applies to these corporations. We are all of opinion that it does.

The decision in *Santa Clara* (1886) was a radical departure from the principle of the *Dartmouth College* (1819). In deciding *Santa Clara* (1886), the Supreme Court made no serious efforts to understand the characteristics of business corporations, but instead accepted a sweeping proposition that they were on par with natural persons. It did so in a rather casual manner, and without serious discussion. What had happened in the interval that could explain such a far-reaching change in the perception of corporations and the law of corporations?

---

3 118 US 394 (1886).
The short answer is that since about mid-nineteenth century, the spirit of the age or the *Zeitgeist*, started turning in favour of corporations. This engendered radically new habits of thought with respect to corporations. The introduction of the general incorporation statutes since the mid-nineteenth century both reflected and strengthened the views of the New Age, so to speak. The New Age of economic liberalism transformed companies from their status as creatures of statutes, to a position that they were the products of private contracts. The earlier requirement that separate legislative charters were required for the formation of companies was abandoned. Instead, the incorporators were permitted to write their own contracts, subject to the formal requirement of registration with a public official. The English *Joint Stock Companies Registration and Regulation Act, 1844* was the first statute to permit this variety of incorporation. Equally important, business corporations also came to be considered the “property” of their shareholders.4

Contract and property, the twin pillars of the common law, became the foundation of corporate law, and the common law principles of sanctity of property rights and freedom of contract began to shape the law of corporations. The earlier tendencies to treat corporations as undermining individual liberty and to regulate corporate activity were abandoned. In result, corporate law as it took shape in the nineteenth century had a minimalist approach. These developments occurred both in the United States and Britain, and were soon adopted in other jurisdictions in the English-speaking world.5

This paper explains the aforesaid transition in corporate law by placing it in the context of the *laissez-faire* political economy that gained ascendancy in the nineteenth century. The

---


5 This trend, as explained later in the paper, was halted in Britain commencing from 1900, and the law reverted to a more regulatory mode. But in the United States, the trend towards laxity only gained greater momentum in the twentieth century. These divergent developments were products of their respective political economies, which is also briefly referred to in the discussion.
doctrines of *laissez-faire* led to a significant change in the public perception of business and the entire question of wealth creation. It engendered attitudes that favoured business enterprises, and the role of corporations as business vehicles acquired greater emphasis. The agglomerative character of corporations and consequent need to regulate them were increasingly sidelined. The public policy towards corporations, finding its expression in the corporate statutes enacted during the period and judicial decisions, gradually abandoned its attitude of circumspection and caution. The new approach was to provide freedom and encouragement to corporations.

The essay is divided into two parts of which the first part describes the position in the post-Bubble Act era from 1720 when the Bubble Act was enacted until early nineteenth century. This discussion is important for understanding how the political economy of that period was inimical to the growth of business corporations. The second part of the essay explains the changes which occurred in the political economy in the nineteenth century, conducive to the transition in corporate law. The process of transition can be said to have started in 1811 when New York enacted the first general incorporation statute.

1. **Companies and Corporations until the early Nineteenth Century**

To understand the transition that occurred in the nineteenth century, it is first necessary to look at the situation that prevailed earlier. The year 1720 was decisive in the history of business corporations in the English-speaking world. It was in that year that the British Parliament enacted a statute, commonly referred to as the Bubble Act, at the height of the stock market frenzy in England. The Bubble Act (1720) prohibited the formation of companies without charters from the parliament or crown, and marked the beginning of

---

6 Geo. c. 18 (U.K.).
legislative intervention in business corporations. It crystallized the position that incorporation was a status to be granted by the state.

The Bubble Act was a product of developments in the stock market – namely, boom in the formation of companies as arrangements in the common law, and large-scale speculation in their shares. It was hardly the object of the Bubble Act to check speculation in the stock market. It was meant to favour the South Sea Company, and to sustain increases in the price of its shares by preventing the flow of funds to the shares of the other companies that had been floated.7

Before the enactment of the Bubble Act, there was ambiguity about the mode of formation of companies. The question whether incorporation could be attained by arrangements in the common law, or it required affirmative action of the government by way of a charter was quite open, as evident from the following discussion. The origin of modern companies has been traced to the guilds that existed in England even before the Norman Conquest of 1066 A.D.8 The early guilds were social institutions, rather than business organizations. But after the Conquest, they steadily acquired a business character, and this marked the beginning of commercial associations in the form of Guild Merchants, or gilda mercatoria.

The practice of granting royal charters to such institutions also commenced after the Conquest, and the charter granted to Ipswich in 1200 A.D. is a good example.9 These charters came with special privileges, which were mostly in the nature of exclusive trading rights in designated localities and the right to bar other persons from engaging in trade in such localities. Soon, the tendency to seek charters of this variety gained momentum.

---

By the sixteenth century, trading companies which pooled the capital of many individuals had emerged, and charters were issued to companies like The Merchant Adventurers (1554), and the East India Company (1600). The charters granted to such companies conferred trade privileges, like the exclusive right of the East India Company for trade with the Indies. The charters were, therefore, meant for conferring valuable trade rights, rather than attaining incorporation. The incorporators had to make payments to the crown for the grant of such charters.

Alongside the larger chartered companies, there also existed a number of smaller companies which had no charters. These companies were usually formed by the execution of documents known as “deeds of settlement,” and were quite numerous in the decades before the enactment of the Bubble Act. These companies had transferable shares, and W.R. Scott pointed out that even in the sixteenth century, their “shares were sold outside personal acquaintances and without limiting conditions.”

Early in the seventeenth century, Lord Coke asserted that the creation of corporations required affirmative action of the sovereign. Similarly, William Blackstone (1765-69) suggested that government licensing for corporations was a requirement under the common law. But such opinions are contradicted by the fact that companies were formed without any charters, and this state of affairs continued at least until 1720 when the Bubble Act was introduced, largely for extraneous reasons.

---

11 Ibid.
12 W.R. Scott, supra note 8 at 327.
13 Ibid at 443.
In this early period, a relationship between companies and the state was a fact, both for companies that had charters and for companies without charters. The trade privileges which the chartered companies derived from their charters were valuable, and they helped these companies to raise capital from the public by issuing their shares. Many companies that had no charters also relied on patents that were granted to them by the government for a variety of inventions, and used them for marketing their public issues.16

The government was thus understood as playing a role in the promotion of companies and the public issue of shares by them, whether such companies had charters or not.17 A stream of criticism of companies appeared quite as soon as the formation of companies and the issue of shares by them gathered pace in the 1690s. The Board of Trade published a report in 1696, which stressed the relationship between the stock market and the companies, and this laid the foundation of a regulatory regime that was primarily concerned with the stock market implications of the corporate form of organization. The remarks of the Board of Trade appear to be the earliest policy statement on the issue:

The pernicious Art of Stock Jobbing hath of late so wholly perverted the End and Design of Companies and Corporations erected for the introducing or carrying on of manufactures to the private profit of the first projectors, that the privileges granted to them have, commonly, been made no other use of, by the first Procurers and Subscribers, but to sell again, with advantage, to ignorant men, drawn in by the Reputation, falsely raised, and artfully spread, concerning the thriving state of their Stock.18

There is sufficient evidence of a strand of public opinion critical of companies and their ways during this period. Even before the report of the Board of Trade referred to above,


17 This history of relationship between companies and the government played an important part in engendering a sense of hostility towards business corporations in the early years of the American republic, as we will see a little later.

Thomas Shadwell’s play *The Volunteers, or the Stock-Jobbers*,\(^\text{19}\) (1693) had satirized the ways of companies and the stock market. Daniel Defoe, who was a keen observer of companies and the stock market in this period, wrote extensively on these subjects and he was quite critical.\(^\text{20}\)

These facts point to the presence of a negative attitude towards companies and the stock market, but they hardly affected the formation of companies, or the enthusiasm of the public for speculation in their shares. Despite the prominent presence of disapproval, there was a boom in company formation between 1690 and 1720, which indicates the predominantly utilitarian tendencies of the society. These gave primacy to the practical value of an idea or a practice, and largely ignored the theoretical or philosophical considerations.\(^\text{21}\)

Matters reached a head in 1720, when there was feverish activity in the stock market in the shares of the South Sea Company, in the midst of parliamentary approval of its plans to acquire the entire government debt from the public in exchange for its shares. For reasons that are not clear, the market was electrified by this development, and its enthusiasm soon spread to other shares also. The whole market went into frenzy. This, in turn, gave a further fillip to company formations, and numerous companies without charters made their appearance. It was in this background that the Bubble Act, which prohibited the formation of companies without charters from the parliament or the crown, was enacted in June 1720. This statute established the position that incorporation was a status to be conferred by the sovereign, and not a matter of private arrangement in the common law. A.B. Dubois described the Bubble Act:


\(^{20}\) See *e.g.* Daniel Defoe, *An Essay Upon Projects* (1697), cited in Stuart Banner, *ibid.*

\(^{21}\) This concept would be given greater sophistication in the twentieth century in the discipline of economics, which argued for “efficiency” as the ultimate test.
The product of an emergency situation, it was ambiguous in the extreme. Nevertheless, it was destined to be for one hundred and five years the statutory framework by which (in legal theory at least) the business organizations of the time were restricted.22

As pointed out earlier, the Bubble Act (1720) was not inspired by a desire for reform. It was meant to prevent the diversion of public funds in the stock market towards the shares of other companies, and thereby sustain increases in the price of the shares of South Sea Company. The king and a sizable section of the ruling classes were involved in the South Sea scheme, and they had a vested interest in the price of the shares of the South Sea Company. Despite all the efforts, however, the price of South Sea shares sank after August 1720, and this triggered a general collapse of the stock market. It caused widespread economic disorder and shrinking of liquidity.

The stories of political corruption in the South Sea episode affirmed the prevailing notion about the relationship between companies and the government. The downslide in the stock market and the fortunes of the fraudulent companies, and the general recession in the economy resulting from the disturbance in the stock market strengthened the element of suspicion towards companies. This was a decisive moment in the history of business corporations, which were the targets of significant public hostility. The Bubble Act (1720) had a strong impact on company formations, and Dubois described the consequences:

> Whether in fear of the statute or because money was tight, new schemes for “raising stock of transferable shares” without incorporation of the enterprise were relatively infrequent in the years immediately after 1720. . . . There is every indication that in the first decades that followed its passage, the Bubble Act was a latent menace present in every board room and lawyer’s chambers when problems of business organization were deliberated. At this time men were convinced that governmental authority was necessary if stocks of transferable shares were to be raised.23

22 A.B. Dubois, supra note 16 at 2.
23 Ibid. at 11.
In the post-Bubble Act era, the grant of charters to companies was discretionary, and not a public right. Persons desiring a charter were not assured of getting it; quite often, the government declined to grant charters. For instance, the application for a charter for a company to manufacture pig iron under a patented process was refused, and the communication by which the refusal was conveyed made a specific reference to the widespread abuse of patents for the purpose of issuing shares to the public.

In the closing decades of the eighteenth century, the canal companies made their appearance, and this led to a change. The canal companies were generally granted charters, and there was a rationale for the liberal attitude towards them. Construction of canals required large amounts of capital which could only be raised by pooling the resources of many people, and companies were best suited for this purpose. The canals were also in the nature of public utilities, rather than pure business enterprises, and the grant of charters was understood as advancing public welfare.

The spirit of the age was, however, unambiguously regulatory, and it was a common practice to impose stringent conditions in the charters. The charter of Chelsea Water Works is a good example. Its charter prohibited trade in its shares until “the water be brought into the Grand Reservatory . . . near Oliver Mount.” This was intended to check speculation in the shares until the company was at least in a position to actually carry on the activity for which it was granted a charter.

A more interventionist approach is seen in the case of Stroudwater Navigation Company, chartered in 1776. Its charter sought to check concentration of corporate power, and

---

24 Ibid. at 15.
25 Ibid. at 23.
27 A.B. Dubois, supra note 16 at 16.
prohibited any individual from owning more than fifteen shares in the company. It also provided a system of regressive voting rights in which the number of votes declined with increase in the number of shares held by a person within the prescribed ceiling of fifteen shares.28

The position that incorporation in the post-Bubble Act era was a status to be conferred by the sovereign was, therefore, no empty posturing. It was neither possible to obtain charters for the asking, nor could the incorporators have complete freedom in managing their companies. They were subject to a number of conditions perceived to be in the public interest. The prominent notion was that corporations were public institutions, and the law of corporations, as it was beginning to take shape, clearly subordinated private interests to considerations of public policy.

The circumspection in law was a product of the sense of suspicion and hostility towards companies, which was prominent both before the South Sea Bubble (1720), as we noted earlier, and became more so in the post-Bubble era. Dubois has referred to the literature in circulation in England between 1683 and 1781, which were critical of the style of functioning of joint-stock companies, and regularly complained about the trade privileges enjoyed by them. Among other things, companies were charged with lacking a soul.29

An important theme in the anti-corporation platform of the era was the emphasis on the virtue of individualist economic arrangements vis-à-vis collective ones represented by business corporations. In 1810, Joseph Marryatt argued in the House of Commons that companies would destroy individual enterprise.30 In 1825, an editorial in The Times questioned how a “body of capitalists” was in a better position to “supply [ ] European market with either

29 A.B. Dubois, supra note 16 at 70-71.
30 B.C. Hunt, supra note 26 at 24.
grain or flour from Odessa” than “a single merchant.” 31 But the times were a-changing, and the wind now turned in favour of companies. It was in the same year (1825) that the Bubble Act was repealed.

American Colonies and the United States

When we cross the Atlantic and arrive in the New World, we are greeted by a similar sense of hostility to corporations, which was prominent both before and after the American Revolution (1776). The Bubble Act (1720), which prohibited companies without charters, was extended to the American colonies in 1741, 32 and for this reason, America never had companies without charters, or common law companies. From the beginning, legislative charters were mandatory for incorporation in America.

Joseph Stancliffe Davis (1917) noted that there were very few corporations in early America, and the individualist tendencies of the American pioneers discouraged the corporate form of organization:

Small-scale enterprise was still the order of the day, particularly in America, where difficulties hindered cooperative action, both by preventing initial intercourse of men of affairs and by hampering the continuance of all but local relationships. Political conditions operated rather to check than to promote such intercourse, especially between men in different colonies. The independence of temper characteristic of the American colonists was an adverse factor. 33

These attitudes substantially continued after the American Revolution, and the sense of individualism became more emphasized in the nascent republic. The background of the American Revolution and the notion inherited from Britain that companies were the products of government patronage led to a strong sense of opposition to corporations. These sentiments were emphasized in the writings of John Taylor (1794), who termed the

31 Ibid. at 13.
32 14 Geo. II, c. 37 (U.K.).
shares of corporations “artificial property.” Referring to the ability of corporations created by legislative charters to issue shares and raise money, Taylor stated:

No form of civil government can be more fraudulent, expensive, and complicated, than one which distributes wealth and consequently power, by the act of the government itself.34

John Taylor was no less harsh in his *A Definition of Parties*, where he commented:

A constitutional expulsion of stock-jobbing paper interest, in every shape, out of the national legislature, can alone recover the lost principles of a representative government, and would save the nation from being owned – bought and sold.35

The American Constitution, which can be viewed as the first effort in human history for a society to attempt to organize itself into a defined framework and to live by a more or less agreed set of ideals, was silent on the question of corporations. It did not vest jurisdiction over them either in the federal government or in the states. At the time of framing of the Constitution, James Madison proposed that the federal government would have jurisdiction over corporations, but the states opposed the move. They expressed the apprehension “that granting such powers to a central government created the risk that an American version of the East India Company might come into being.”36

Despite the attitude of suspicion and hostility towards corporations, quite a few were chartered in the initial years. They were meant for specific activities like banking, insurance, and construction of canals and turnpikes, which were more in the nature of public utilities than private businesses. These corporations were chartered by the state legislatures. There was no bar on Congressional chartering either, and the Congress chartered the Bank of the United States in 1792. The bank was meant to be a public institution that would improve

the financial condition of the United States.\footnote{Richard Sylla, “Origin of the New York Stock Exchange” Paper presented at the Conference on the History of Financial Innovation, International Center for Finance, Yale School of Management, New Haven, Connecticut, March 6-7, 2003, available online: \url{http://icf.yale.edu/pdf/hist_conference/Richard_Sylla.pdf}, April 2006.} George Washington was in favour of the states building the turnpikes and canals as public works, but was realistic about their inability to raise the tax revenues required for the purpose.\footnote{See generally Joseph Stancliffe Davis, \textit{supra} note 33 at 111-112.}

William Gouge (1833),\footnote{Cited in J.W. Hurst, \textit{The Legitimacy of the Business Corporation in the Law of the United States 1780-1970} (Charlottesville, VA.: The University Press at Virginia, 1970) at 30-32.} Gideon Wells (1835)\footnote{Cited in Ted Nace, \textit{ibid.} at 63.} and Theodore Sedgwick (1835)\footnote{Theodore Sedgwick, \textit{What is a Monopoly? or Some Considerations upon the Subject of Corporations and Currency} (1835), cited in Ted Nace, \textit{ibid.}} were among the prominent critics of corporations in the America of early nineteenth century. Ted Nace also cites the case of a group of carriage makers who opposed the grant of a charter to the Amherst Carriage Company (1838).\footnote{Ted Nace, \textit{ibid.} at 64.} The carriage makers explained that aggregation of wealth in corporations undermined individual enterprise, which was relatively in a weaker position.

As was the case in England, the public attitude of suspicion towards corporations meant that their rights were subject to serious limitations, and the charters granted to the corporations were interventionist. This was the practical dimension of the prevailing notions of disapproval. The major restrictions were with respect to the activities that corporations could engage in, the properties which they could own, geographical limits on their operations, and equal voting rights for the shares.\footnote{For a list of the general restrictions placed on corporations, see Ted Nace, \textit{supra} note 36 at 68-69.} J.W. Hurst pointed out:

\begin{quote}
[t]hese limitations imply a concern for balance of power arising out of the potentials of the corporate device itself, and not simply out of possession of special privileges of substantive economic action, such as toll rights or capacity to issue bank notes. The breadth of their adoption indicates concession to some substantial opinion distrustful of the corporation as such.\footnote{J.W. Hurst (1970), \textit{supra} note 39 at 45.}
\end{quote}
The criticisms leveled at corporations in this period can be broadly grouped into the following:

1. The ability of corporations to raise money from the public issue of their shares and the culture of stock market speculation that was a part of the process.\(^{46}\)
2. The difficulties in procuring legislative charters for incorporation, which were perceived as government patronage to select groups.\(^{47}\)
3. The grant of franchises by the government under corporate charters, which was seen as yet another form of governmental patronage.\(^{48}\)
4. A bias in favour of individualism that also extended to the economic sphere, and the apprehension that individual businessmen would not be able to effectively compete with the organized strength of corporations.\(^{49}\)

The restrictive attitude towards corporations was also echoed in the judiciary, and the decision in *Dartmouth College*,\(^{50}\) referred to earlier, is a good example. We find another instance of this conservative sentiment in *Bank of Augusta v. Earle* (1839),\(^{51}\) where the Supreme Court ruled that corporations chartered in one jurisdiction had, unlike citizens, no automatic right to operate in other jurisdictions.

Speaking for Canada, we find an instance of the hostility towards corporations in William Mackenzie, who led a rebellion against British rule in 1837. The views of Mackenzie were aligned with the traditional suspicion that corporations were an instrument of the governing classes and products of government patronage. Mackenzie referred to the “monopolistic

\(^{46}\) For a detailed discussion on the prevailing attitudes towards the stock market, see Stuart Banner (1998), *supra* note 19.

\(^{47}\) Morton J. Horwitz, *supra* note 4 at 181.

\(^{48}\) J.W. Hurst (1970), *supra* note 39 at 33-34.

\(^{49}\) *Ibid.* at 32.

\(^{50}\) *Supra* note 2.

\(^{51}\) *Supra* note 43.
practices inherent in the use of the corporate form by politically powerful men,” and made a proposal to simply outlaw corporations in the republic for which he fought. Section 56 of Mackenzie’s Draft Constitution read:

There shall never be created within this State any incorporated trading companies, or incorporated companies with banking powers. Labour is the only means of creating wealth.52

These are some samples of the hostile public attitude towards corporations, which continued to be dominant until mid-nineteenth century. We now move on to a discussion of the developments since early nineteenth century that led to radical changes in the regulation of corporations commencing from the middle of that century.

2. Developments in the Nineteenth Century

Adam Smith’s acclaimed work, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), emphasized economic freedom, and this is generally understood as advocating the principle that giving freedom to individuals to act according to their choice and form relationships is the ideal means for attaining the best economic results.53 The traditional instrument in the common law for governing relationships among individuals is contract. The society was understood as a contractual arrangement freely arrived at by the citizens, and freedom of contract became the bedrock of the *laissez-faire* regime that gained ascendancy in the nineteenth century.

This idea soon traveled into corporate law, and the notion that corporations were nothing but products of contracts among their shareholders became prominent. This idea was further developed, and corporations came to be treated *both* as aggregations of their

---


shareholders, and as their “property.” This variety of thinking had important consequences for corporate law.

- The contractarian idea of corporations encouraged the notion that they were “private” in character, and this resulted in the gradual abandonment of public regulation of corporations through the law. Corporate administration was treated as a purely internal matter to be regulated through contracts.

- The view that corporations are nothing but aggregations of their shareholders was canvassed and accepted, and this idea led to the formulation of a legal principle that they were on par with natural persons. This, in turn, enabled the removal of the fetters that were earlier applied to corporations, such as the prohibition on ownership of the stock of other corporations and carrying on activities other than those specified in their constituent documents.

- A theory was developed that corporations were the property of the shareholders who had contributed its capital, and consequently “owned” them. This was further refined to include the notion that the property of corporations was, in effect, the property of their shareholders, and was entitled to the same standard of protection as private property. Shareholders were also free to deal with “their” property as they pleased. These principles found ready acceptance given the emphasis on protection of property rights in the Anglo-American tradition.

---

54 Santa Clara County v. Southern Pacific Railroad, supra note 3.
55 See generally Morton Horwitz, supra note 4 at 186-188.
56 The importance given to property rights can be traced to the writings of John Locke (1632-1704). Locke, however, hardly referred to property rights in the abstract issue, nor did he treat it as a matter of ideology or doctrine. The emphasis given by Locke to private property rights and their protection was in the context of arbitrary interference by the ruler, and his writings were essentially from the perspective of promoting and ensuring economic security of individuals against sovereign action. But the idea has since been applied in a variety of contexts, and often, its application has resulted in the undermining of individual liberty.
The “contractarian revolution” in corporate law during the nineteenth century did away with the need for individual charters for incorporation. Incorporators could now write their own contracts of incorporation, and file them with a public official who would formally grant incorporation. Incorporation thus became a matter of contract, and a public right. These developments can be attributed to a number of factors.

There was the Industrial Revolution, which gathered pace in the nineteenth century and opened up demand for large fixed capital for setting up factories. The rising affluence meant that capital was available and looking for profitable investment. Companies were found to be the ideal vehicles for pooling capital and for carrying on industrial activity on a large scale. Yet other factors were corruption and favourtism, particularly in the United States, in the matter of grant of legislative charters to corporations.57 Widespread corruption in the grant of legislative charters for incorporation was an important argument advanced for making incorporation available to everyone as a matter of right, and it was accepted.

The trends that led to the contractarian revolution in corporate law in Britain and the United States are examined below. Authentic accounts of the events in Britain are available, and it is possible to detect a clear pattern in the events there. But there is relative paucity of material for the United States, where the changes in corporate law occurred in the states. It is, therefore, helpful to first trace the events in Britain, as this makes it easier to comprehend the developments in the United States during the same period.

In early nineteenth century Britain, a number of companies were promoted without charters despite the Bubble Act (1720) being in force, and the general reluctance to grant charters.58 Between 1803 and 1811, the number of securities quoted in the stock market doubled.59

---

57 Morton Horwitz, supra note 4 at 181.
58 B.C. Hunt, supra note 26 at 21.
59 Ibid. at 14.
R v. Dodd\textsuperscript{60} (1808), the court refused to apply the Bubble Act as there was no evidence that the statute had ever been invoked in the last eighty-seven years. Nonetheless, the existence of the Bubble Act on the statute book cast a shadow on the legality of joint-stock companies.

In this murky environment which prevailed in early nineteenth century, a school of opinion in favour of the corporate form of organization began to form, and there is sufficient evidence of the trend from both anecdotal and official sources. Referring to the Bubble Act, a pseudonymous writer asked in 1807:

\begin{quote}
Are we now, in this age of civil liberty, to be deprived of commercial freedom? Are the people of small capitals to be restrained from making them productive by uniting to trade as a body?\textsuperscript{61}
\end{quote}

This argument viewed the Bubble Act as opposed to the principle of economic liberty, which had by then been accepted as an article of faith, largely due to the influence of the work of Adam Smith.\textsuperscript{62} During the parliamentary examination of the charter for the Gas Light and Coke Company (1810), Lord Sheffield spoke in glowing terms about the ability of companies “to carry on great undertakings requiring large capital and a steady perseverance not dependent on the exertions or life of an individual.”\textsuperscript{63}

The trend of thinking in favour of companies continued, and a letter written to the \textit{Morning Star} in 1825 was significant. It addressed “anyone with a spoonful of the milk of human kindness,” and pointed out that the rate of interest on government bonds was quite low at three percent, and mortgage loans which paid three and a half percent interest were little

\textsuperscript{60} 9 East 516
\textsuperscript{61} Cited in B.C. Hunt, \textit{supra} note 26 at 18.
\textsuperscript{62} Here, we cannot overlook the fact that “liberty” was not something invented by Adam Smith. It has been a consistent theme in the Anglo-American political and legal tradition since at least 1200 A.D. when King John granted a charter to Ipswich, see \textit{supra} note 8. The contribution of Adam Smith and his disciples was formal extension of the principle of liberty to the economic field. Their works also provided a handy and timely theoretical basis to arguments such as those made by Robert Lowe, President of the Board of Trade, in the 1850s. See \textit{infra} notes 78 and 79.
\textsuperscript{63} B.C. Hunt, \textit{supra} note 26 at 26.
better. With this preface, the writer referred to the general desire for investment in company shares, and expressed optimism that the eponymous individual “with a spoonful of milk of human kindness:”

[w]ill surely find some milder term than “a spirit of gambling” by which to characterize the wish of individuals unused to business, of limited income and small capital, to embark their slender means in something that without trouble to themselves will pay a living interest and yield some hope of an increase to the principal.64

This letter was written in 1825, and around this time, Britain whose empire was expanding had plenty of capital looking for profitable investment. Two months earlier, in February 1825, the King had proclaimed that “there was never a period in the history of this country when all the great interests of the nation were at the same time in so thriving a condition.”65

It was estimated that in the boom of 1824 and 1825, 624 companies were promoted, although by 1827, only 127 of them had survived.66 This was despite the Bubble Act still being in force. In the House of Commons, when questions were raised about joint stock companies, parliamentarians like William Huskisson leaped to their defence, and asserted:

If there was any one circumstance, to which more than any other, this country owed its wealth and commercial advantages, it was the existence of joint stock companies. There was no greater error than to cry down companies as public evils.67

Another factor which contributed to the growing acceptance and popularity of companies around this time was the improvement in the methods followed by company promoters for raising capital through public issues. The public issues had become more transparent and responsible. By early nineteenth century, it was a regular practice for many promoters to distribute “prospectuses” about their projects, and hold meetings at which they would make

64 Ibid. at 31.
65 Ibid. at 37.
66 Ibid. at 46.
67 Cited in B.C. Hunt, ibid. at 49. Hunt has pointed out that at the time of making these statements, Huskisson was the president of a recently-chartered company.
presentations about the projects. A committee would then be formed to examine the viability of the project, and only if the committee recommended, a second general meeting would be held for the purpose of making a decision on applying for a charter and taking further action.\textsuperscript{68}

It was in this milieu that the Bubble Act was repealed in June 1825. But even after the repeal of the Bubble Act, the position that charters were required for incorporation continued and charters were only handed out selectively.\textsuperscript{69} By 1834, the Board of Trade had drawn up a policy on grant of incorporation, and the policy considerations included (a) requirement of a large amount of capital which had to be raised from a number of persons, the nature of the proposed activities, and their suitability for being effectively pursued by individuals.\textsuperscript{70} The policy statement developed the Board of Trade largely took care of the longstanding criticism that the charter regime was “a source of patronage” and that charters could be obtained only “by endless begging and intrigue.”\textsuperscript{71}

The law was thus clearly moving towards general incorporation, which finally happened by the \textit{Joint Stock Companies Registration and Regulation Act, 1844.}\textsuperscript{72} This statute was the product of the report of a Committee established by the Board of Trade for examining the issues related to joint-stock companies. The Committee was headed by Gladstone, who was also the President of the Board of Trade. It examined the question of joint-stock companies at some depth, and submitted its report in 1844.

The statute of 1844 was the pioneer in the concept of general incorporation, and it provided for two-stage incorporation. Initially, provisional registration would be granted, and this

\textsuperscript{68} George Herberton Evans Jr., supra note 28 at 14-15.
\textsuperscript{69} B.C. Hunt, supra note 26 at 58-60.
\textsuperscript{70} Ibid. at 57-58.
\textsuperscript{71} Cited in B.C. Hunt, supra note 26 at 58.
\textsuperscript{72} 7 & 8 Vict., c. 110 & 111) (U.K.).
would be followed by full registration after the specified capital amount was received by a company and the traditional “deed of settlement” was filed. The statute of 1844 did not radically alter the principle that incorporation was a status to be conferred by statute, but put in place a general mechanism by which anyone could attain the status. It also recognized a degree of contractarianism by accepting the “deed of settlement,” which would be prepared by the incorporators.73

In 1855, the principle of limited liability, by which the liability of shareholders was limited to the amount of capital either contributed or agreed to be contributed by them, was accepted by the Limited Liability Act, 185574 introduced in that year. Although an argument that parties could contract their way out of unlimited liability had been raised,75 it was a longstanding position in the common law that limitation of liability could only be conferred by statute.76 The statute of 1855 affirmed the position that limited liability of the shareholders, which is among the important privileges of corporations, was also a matter of status that had to be conferred only by statute.

But alongside, contractarianism in corporate law was making rapid strides, and could not be halted. The Joint Stock Companies Act, 1856,77 which replaced the Joint Stock Companies Act, 1844, completely contractualized the terms of incorporation. It marked the beginning of a period of laxity in English corporate law, which would last until the end of the century. The statute of 1856 introduced the Memorandum of Association and Articles of Association as the two constituent documents of corporations, and they continue to the present.

74 18 & 19 Vict., c. 133 (U.K.).
75 B.C. Hunt, supra note 26 at 28.
76 Ibid. at 41.
77 19 & 20 Vict., c. 47 (U.K.).
The Memorandum of Association dealt with aspects of interest to the external constituencies of corporations, such as lenders and suppliers. These were the capital of a company, its business objects and the liability of its shareholders. Articles of Association, on the other hand, covered internal matters like the procedure for transfer of shares and calls on shares. The incorporators were free to decide on the contents of the documents, and this emphasized the contractarian approach of the law. Robert Lowe, who was then the President of the Board of Trade, can be considered the father of this contractarian revolution in corporate law, and he proclaimed:

> The principle of freedom of contract and the right of unlimited association [were at stake]. I am arguing in favour of human liberty – that people may be permitted to deal how and with whom they choose, without the officious interference of the State . . . not to throw the slightest obstacle in the way of limited companies, the effect of which would be to arrest ninety-nine good schemes in order that the bad hundredth might be prevented. *We should profit by the lessons of the science of political economy; to interfere with and abridge men’s liberty,* to undertake to do for them what they can do for themselves . . . is helping the fraudulent to mislead them.”

(Italics mine.)

With respect to the internal administration of companies, or what is now known as “corporate governance,” Lowe was equally unambiguous when he declared in the parliament:

> Having given them a pattern, the State leaves them to manage their own affairs and has no desire to force on these little republics any particular constitution.

This emphatic rejection of any kind of paternalism, communitarianism or even their politically more acceptable Anglo-American equivalent, “public interest,” in corporate law emerged as the philosophy of corporate law. The emphasis on liberty and individualism

---

78 Cited in B.C. Hunt, *supra* note 26 at 134.
80 But this rugged, individualistic approach did not last very long in Britain, and by early twentieth century, there was a directional change in English company law. In the early decades of the twentieth century, a more professional approach came to be adopted and expert committees were regularly constituted to examine the state of corporate law, and to make recommendations for reform. In result, the *Companies*
would, in theory, abhor any patronizing or paternalism in law and public policy. The dominant idea is that people can and ought to take care of themselves, and it was reflected in the principle of non-interventionism in company law. In this setup, there can be hardly any question of corporate law taking the initiative for things like identifying different corporate constituencies in corporations and making efforts to protect the weaker ones, or conversely, checking the powerful among the constituencies.

The contractarian theme of English company law, of course, dates back to the companies that emerged as common law arrangements under “deeds of settlement” in pre-Bubble Act era. The deeds of settlement were, indeed, contracts. The idea that companies were contractual arrangements received formal recognition in the statute of 1844. Subsequent statutes expressly affirmed the position that the Memorandum of Association and Articles of Association of a company are contracts among the members of companies, and this has since continued in English company law.

United States

The march towards general incorporation was actually born in the United States, when New York enacted a statute in 1811 for the incorporation of manufacturing businesses. This statute dispensed with the need for individual legislative charters for attaining incorporation, and sowed the seeds of general incorporation. The corporations formed under it would have a limited life of twenty years, and could only engage in manufacturing activities. In

_Act, 1948_, enacted about a hundred years after the libertarian statute of 1856, was considerably regulatory, and struck a balance between regulatory concerns and the dictates of business freedom.

---

81 L.C.B. Gower, _supra_ note 73.
82 See _e.g._ _Companies Act, 1948_, 11 & 12 Geo. 6, c. 38, s. 20(1) (U.K.).
83 Ted Nace, _supra_ note 36 at 89-90.
1848, New York once again played a pioneering role by introducing a statute for the incorporation of general business corporations that could do any business. \(^{84}\)

We have earlier referred to the hostility in the United States to the idea of corporate organizations, and a prominent school of thought that preferred individualism in the economic sphere also. But this did not deter the increasing adoption of the corporate form by a large number of industrial businesses from early nineteenth century, as evident from the data presented by J.W. Hurst\(^{85}\) and Stuart Banner. \(^{86}\)

Unlike with Britain, we do not have detailed evidence of either the shift of public opinion in the United States in favour of corporations or the factors that led to the enactment of general incorporation statutes by the states. There is considerable merit in the reasoning of J.W. Hurst that simple, utilitarian considerations – namely, the effectiveness of the corporate organization in pooling capital, centralizing control and facilitating large-scale business operations, proved to be decisive. \(^{87}\) These considerations led to the increasing adoption of the corporation in the United States without serious debate or fanfare.

The developments in Britain from around mid-nineteenth century, discussed earlier, were favourable to the emergence of the corporate form of organization, and it is not improbable that they influenced events in the United States. The two countries with their common heritage were also well-connected; in particular, British investment in the American stock market, centered in New York, was substantial. \(^{88}\) Given this background, the fact that New York adopted a general incorporations statute in 1848, four years after Britain did so, appears to be hardly a coincidence.

\(^{84}\) N.Y. Laws, ch. 40. (U.S.).
\(^{85}\) J.W. Hurst, \textit{supra} note 39 at 18.
\(^{86}\) Stuart Banner, \textit{supra} note 19 at 191-192.
\(^{87}\) J.W. Hurst, \textit{supra} note 39 at 25 and 47.
Despite the shift in emphasis in favour of the corporate form for business, corporate law in the United States retained a substantially regulatory character at least for another thirty-five years. Hurst observed:

When all the incorporation was put under general statutes at the end of the nineteenth century, the general acts included regulations of corporate structures and procedures. Thus as of the 1880s the standard incorporation acts as well as the rudimentary law of public utilities asserted that organized private power as well as public power must be legitimate.\(^89\)

It was in the late 1880s that the “race to laxity” in corporate law began in the United States.\(^90\) Progressively, the states competed with one another to remove the restrictions that were generally applied to corporations, a process which culminated in the present, predominantly open, and loose structure of American corporate law.\(^91\) The first step was taken when the corporate statute of New Jersey permitted corporations to hold the stock of other corporations, and this was followed by measures like issue of shares without voting rights, without par value and even substantial monetary consideration. In an echo of the “little republics” theme propounded by Robert Lowe in England, internal matters were left entirely to the corporate will, which was mainly controlled by management.

Thus was born the contractarian corporation in the United States, and henceforth, statutes authorized corporations to mostly define their own terms without any legislative interference. This theme of statutory law found a ready echo in the other important branch of lawmaking – the judiciary. The doctrine of *ultra vires*, which recognized limitations on the powers of corporations to engage in businesses other than those specified in the constituent


\(^90\) This memorable phrase was used by Justice Brandeis in his dissenting opinion in *Louis K. Liggett Co. et al. v. Comptroller et al.*, 288 U.S. 517 at 548 (1933).

documents was gradually whittled down,\textsuperscript{92} and the earlier restriction that corporations formed in one jurisdiction had no inherent right to operate in other jurisdictions was dropped.\textsuperscript{93}

The decision of the US Supreme Court in \textit{Santa Clara Country v. Southern Pacific Railroad} (1886)\textsuperscript{94} exemplified the change that had occurred. We have earlier referred to the decision in \textit{Dartmouth College} (1819),\textsuperscript{95} which emphasized that the character of corporations was limited to what they derived from their constituent statutes. But in \textit{Santa Clara} (1886),\textsuperscript{96} decided by the same US Supreme Court less than seventy years later, the sweeping proposition that corporations were on par with natural persons was accepted readily, in fact, rather casually.

This trend of statutory law and judicial thinking at once reflected and strengthened the view that corporations were the products of private contracts, and the role of corporate law was only formal. They indicate the dominance which the utilitarian conception of corporations had attained. The utilitarian principle was carried to its extreme, if logical conclusion in the almost total empowerment of corporate managements to design and manage the corporations as they pleased. In the words of Hurst:

\begin{quote}
[i]f the law of corporate organization was legitimated by its utility to business enterprise, legitimacy would be most fully achieved if the law empowered businessmen to create whatever arrangements they found most serviceable.\textsuperscript{97}
\end{quote}

The new reality and the open structure of contemporary corporate law were quite accurately captured by the New York Supreme Court in \textit{Farmers’ Loan & Trust Co. v. Pierson} (1927).\textsuperscript{98} It observed:

\begin{footnotesize}
\begin{itemize}
\item[92] Morton Horwitz, \textit{supra} note 4 at 186-187.
\item[93] David Millon, \textit{supra} note 89 at 212-213.
\item[94] \textit{Supra} note 3.
\item[95] \textit{Supra} note 2.
\item[96] \textit{Supra} note 3.
\item[97] J.W. Hurst, \textit{supra} note 39 at 70.
\end{itemize}
\end{footnotesize}
A corporation is more nearly a method than a thing, and . . . the law in dealing with a corporation has no need of defining it as a person or an entity, or even as an embodiment of functions, rights, and duties, but may treat as a useful name and a usual collection of jural relations, each of which must in every instance be ascertained, analyzed and assigned to its appropriate place according to the circumstances of the particular case, having regard to the purposes to be achieved. (Italics mine).

The latter part of the passage emphasized that each corporation was virtually free to design its own framework, a far cry from the rigidity with which corporations were perceived in earlier decisions in cases like *Dartmouth College* (1819), and *Bank of Augusta* (1839).

The process of change was undoubtedly the result of historical developments and change in values, a product of the Hegelian Zeitgeist, inevitable given the values of the age. But it would be an oversimplification if we were to leave the matter at that. Efforts to identify specific actors and their influence on the development of legislation are hampered by the shortage of material on the background of the legislative changes made in the various states. J.W. Hurst observed:

> Unlike the comparative riches supplied by the published records of congressional hearings, committee work, and debates, state legislative records are typically a bare-bones collection. The press usually finds little that is newsworthy in what goes on at state capitols, in contrast to the range of attention it focuses on the Hill and the White House. Where important values are enmeshed in technical detail, there is little likelihood that the moving forces will be reflected in unofficial published papers.99

We must, therefore, put together as best a picture as we can from the anecdotal evidence that is available.

- The influence of investment bankers has been pointed out by J.W. Hurst in the move for the dilution of corporate statutes.100

---

98 130 Misc. 110, 222 NYS 532 (1927).
100 *Ibid.* at 72.
Specifically, the influence of the railroad barons has been identified as a factor in the decision of New Jersey to enable the holding company mechanism by which a corporation could own the stocks of other corporations.\textsuperscript{101}

Morton Horwitz has described the effectiveness of a campaign by corporate lawyers in persuading the move in New Jersey for the relaxation of its corporate statute.\textsuperscript{102}

The incorporation fees paid by the corporations were a major consideration, and competition among the states to attract incorporation to their jurisdictions also played an important part.\textsuperscript{103}

Verily, terms like “inevitable” and “organic development” have been used to describe the growth of business power embodied in the corporate form,\textsuperscript{104} and these arguments were used to justify the \textit{status quo}. The remarkable success of America as an industrial power in early twentieth century and the relative industrial peace left little room for a political climate that could seriously question corporate power. In result, the corporate law in America has continued in its lax form for a considerable length of time. Even now, with more than three decades of active corporate governance debate behind us,\textsuperscript{105} there is little evidence of the emergence of a political climate that can consider serious reform of corporate law.

The position in the United States in the early decades of the twentieth century makes an interesting comparison with Britain. After flirting with near-complete laxity between 1856 and 1900, English company law embarked on a serious reformist path at the turn of the century. A touch of professionalism was brought to the subject, and successive committees of experts were established to examine the issue. These were, respectively, the Loreburn

\textsuperscript{101} Ted Nace, \textit{supra} note 36 at 81-83.
\textsuperscript{102} Morton Horwitz, \textit{supra} note 4 at 194.
\textsuperscript{103} \textit{Ibid}. 195-196.
\textsuperscript{104} \textit{Ibid}. at 196.
Committee (1906), the Wrenbury Committee (1918), the Greene Committee (1926), and the Cohen Committee (1945). In result, efforts were made to achieve a reasonable balance between the elements of public interest and regulatory imperatives on the one hand, and business freedom on the other. Quite obviously, the rise of the welfare state and the Labour Party in British politics helped the process. Despite the growing volume of literature on the subject of corporate governance in the United States, and increasing complaints about corporate abuses, there is hardly any sign of efforts of this variety being undertaken in any of the United States.106

**Conclusion**

There is a tendency, particularly among economics scholars and those from the branch of law-and-economics to reify corporations and corporate law in their present state.107 The works of these scholars either stress that corporate law has no role other than “enabling” corporate existence and corporations have no object other than to increase shareholder value, or alternatively, treat them as established facts. These are considered “state of nature” concepts, which brook no question or debate. This narrow standpoint of corporate law has been influential in the recent decades, and economic freedom and efficiency are advanced as the theoretical justifications when many grievances against corporate conduct are expressed. The influence of this school is, to a significant extent, responsible for the paralysis of corporate law.

---

106 The inclusion of stakeholder concerns in the American corporate statutes during the 1980s has been attributed to lobbying by corporate managements, which wanted greater freedom in their decision-making powers. See e.g. Douglas M. Branson, *ibid.* at 636.

107 Jensen and Meckling, (e.g. “Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure” (1976) 3 J. Fin. Eco. 305), Frank Easterbrook and Daniel Fischel (e.g. *The Economic Structure of Corporate Law* (Cambridge, Massachusetts: Harvard University Press, 1991), and Stephen M. Bainbridge (e.g. “In Defence of the Shareholder Wealth Maximization Norm: A Reply to Professor Green” (1993) 50 Wash. & Lee L. Rev. 1423), are among the leading proponents of this theory of corporations and their law.
The idea that corporate law is no more than enabling and corporations are nothing but profit-maximizing entities overlooks the process of development of corporate law, and the forces that have shaped the law. The modest objects of this paper are to demonstrate that corporate law has not always been as minimalist as it is now, and earlier it had a broader and well-reasoned theory or philosophy. The earlier theory has been mostly discarded, and the following is a pithy explanation of the process of development of corporate law, and its present state:

In the last sixty years of business law in the United States, point by point, topic by topic, issue by issue, the commercial image of the business organization has emerged to overshadow the concept of the “corporation.”

*****

One result of this break-through is that corporation law, as field of intellectual effort, is dead in the United States. When American law ceased to take the “corporation” seriously, the entire body of law that had been built upon that intellectual construct slowly perforated and rotted away. We have nothing left but our great empty corporation statutes – towering skyscrapers of rusted girders, internally welded together and containing nothing but wind.

In the present round of globalization, American corporate law in this state is aggressively promoted as the role-model, and many of its principles have been accepted in jurisdictions like India. Recently, the end of history of corporate law has been proclaimed and the American model is presented as the ideal for the world. Therefore, the problems with

---

109 Ibid. Footnote 37.
American corporate law are no longer merely American in their scope; they are now international.

The reform of corporate law is essentially a political question, and it is a task for the political leadership to counter the strength of business interests and initiate reform. There is, at present, no sign of a political climate that can lead to meaningful reform of corporate law.\(^{113}\)

All that the corporate scandals at the turn of the century could evoke was the *Sarbanes-Oxley Act of 2002*, and already, there are calls for its dilution.\(^ {114}\) The apparent inertia in corporate law makes the ongoing debate on corporate governance all the more important. The debate pays scant attention to the history of corporate law, and the consequence of this neglect is to weaken the arguments advanced by the proponents of change. Corporate law history has the important role of recalling the earlier philosophy of corporations and the approach of the law in regulating them. They must be examined for their relevance in the present times.

\* * * * * *\n
\(^{113}\) The word “reform” is used here to refer to the adoption of a broader philosophy of corporations. It is quite likely that the very choice of the word would be challenged by the status quoists, who do not see any need for reform. See *e.g.* Stephen M. Bainbridge, note 107, above.  