The Making of the Modern Corporation

by Morton Keller

The large business corporation has a firm place in the American imagination as the dark repository of private power. There are no more reliable villains on TV or in movieland than these shadowy, soulless, omnipresent institutions and the faceless, greedy men and women who serve them. And yet today as much as ever before, corporations are accepted as the driving engines of our economy, as the places where most of us work. It sometimes seems that corporations in America are what lying was to the English schoolgirl: an abomination unto the Lord, but an ever-reliable friend in time of trouble.

The corporate charter was invented in medieval Europe. For centuries, incorporation legitimated a variety of public institutions and semiprivate enterprises, rather than private businesses. It found receptive soil in the American colonies, and during the early years of the Republic became a widely accessible instrument of economic growth. Yet from early on there was a tension between the public character and private purposes of corporations.

As the term *corporation* became a synonym for big business after the late 19th century, corporations increasingly became the subject of political debate and the target of legislation and regulation. But to an extent that is not generally appreciated, many of the challenges posed by the corporate form have been handled in the nation's courtrooms rather than in the political arena. In part, this is simply because corporations are creatures of the law. But turning the corporation to public purposes without impinging on its proven ability to create wealth (which is, in fact, another public purpose) has proved also to be a very delicate task—one of many such tasks that Americans have relied heavily upon the courts to carry out.

To understand what corporations are, it is necessary first to have some idea of where they came from. The idea that certain kinds of institutions—towns, guilds, schools, hospitals—should have a charter from some higher authority that grants them defined privileges dates from at least the Middle Ages. Early charters were vari-

In 1721, William Hogarth memorably satirized England's South Sea Bubble, one of the world's first bouts of speculative fever in corporate shares.

ants of the basic feudal contract that linked lords and vassals in medieval society; if for individuals, then why not for institutions?

Out of this experience came the idea of chartering commercial ventures as well. During the 16th and 17th centuries, English entrepreneurs sought royal charters for all sorts of ventures, including trading outposts in the Baltic, Russia, and Ireland, and then "plantations" in the New World.

Most of these early chartered ventures were joint-stock companies, composed of investors who pooled their assets for a single enterprise. The Dutch East India Company of 1602 is often accounted the first true stock corporation, with a permanent fund of capital. The great advantage here was that in the (not unlikely) event of failure, the participants' liability was limited to the amount they had invested. This made it easier to amass the large capital pools these early overseas ventures required.

So the early modern corporation emerged to meet the financial and organizational needs of the Age of Discovery. But charters also served the power-aggrandizing monarchs of 17th century England, such as James I. By establishing the principle that corporations were legal entities created by the Crown, the king not only asserted his authority over them but was in a position to grant monopolies and other perquisites to his favorites.

But the royal stamp of approval, too freely given, encouraged rampant speculation, much as U.S. government deposit insurance in the 1980s encouraged American savings and loan societies to overextend themselves. The inevitable end came in 1720 with the ruinous collapse of

the South Sea and Mississippi "bubbles," rampages of speculation in the shares of two companies established to launch commercial ventures in the New World. Parliament's Bubble Act of that year put an end to almost all corporate chartering for commercial purposes in England for the rest of the 18th century.

That long hiatus, coming as it did during the seedtime of the Industrial Revolution, strengthened what was already a strong inclination in England to rely on partnerships rather than corporations as the preferred form of business enterprise. Partnerships made sense in a tightly knit, hierarchical society, where extensive and complicated bonds of personal relationship defined the social structure and controlled the major sources of investment capital.

The Bubble Act applied also to the American colonies, which faced the added difficulty of trying to launch commercial ventures in the face of a British imperial policy that reserved the profits of more sophisticated forms of enterprise to the mother country. The Philadelphia Contributionship for Insuring Houses from Loss by Fire (1768) was the only chartered business corporation in colonial America, acceptable because of the socially useful nature of its business.

Nevertheless, incorporation turned out to be as American as apple pie. Every colony had a royal charter by the eve of the Revolution. Colleges, charities, New England towns and villages, churches, and quasi-public enterprises such as wharves and mills eagerly sought charters of incorporation from colonial assemblies.

Independence opened the floodgates to innovation in many realms of American society, not least the launching of commercial ventures. No longer did a hostile king or parliament threaten their legitimacy. And a new structure of state and national government now existed that could create, define, and limit incorporation.

An important early statement on the place of the charter in the American system of government was John Marshall's decision in the *Dartmouth College* case (1819). Could New Hampshire unilaterally alter the terms of Dartmouth's pre-Revolution royal charter? Marshall (and a dutifully unanimous Supreme Court) said no: Dartmouth's charter was a contract, and hence came under the protective wing of the Constitution's clause barring the impairment of contract.

This ruling seemed to suggest that incorporated bodies would enjoy a high level of immunity from state interference. New York judge James Kent said soon after the *Dartmouth College* decision that it "did more than any other single act . . . to throw an impregnable barrier around all rights and franchises derived from the grant of government; and to give solidity and inviolability to the literary, charitable, religious and commercial institutions of our country."

But to say that a charter was the same as a contract challenged the

> Morton Keller *is Spector Professor of History at Brandeis University. He is the editor of* The Encyclopedia of the United States Congress *(1995) and the author of several books, including* Regulating a New Economy: Public Policy and Economic Change in America, 1900–1933 *(1990).* *Copyright © 1997 by Morton Keller.*

assumption in English common law that a corporation was free to do everything that it was not explicitly forbidden to do. Instead, American courts took the view that a corporation could do only what its charter—granted by the state legislature, that republican tribune of the people—explicitly said it could do. In other words, a charter was not an open-ended grant of authority but a specific and limited authorization to take on a particular task: an approach well suited to a republic dedicated to the principles of limited and representative government.

There was more. By saying that corporate charters were contracts, not grants, the Supreme Court stripped away any implication that corporations enjoyed the special favor of the chartering authority. It thus enabled the charter of incorporation to become a widely accessible instrument in the contract-dominated market economy of the 19th century.

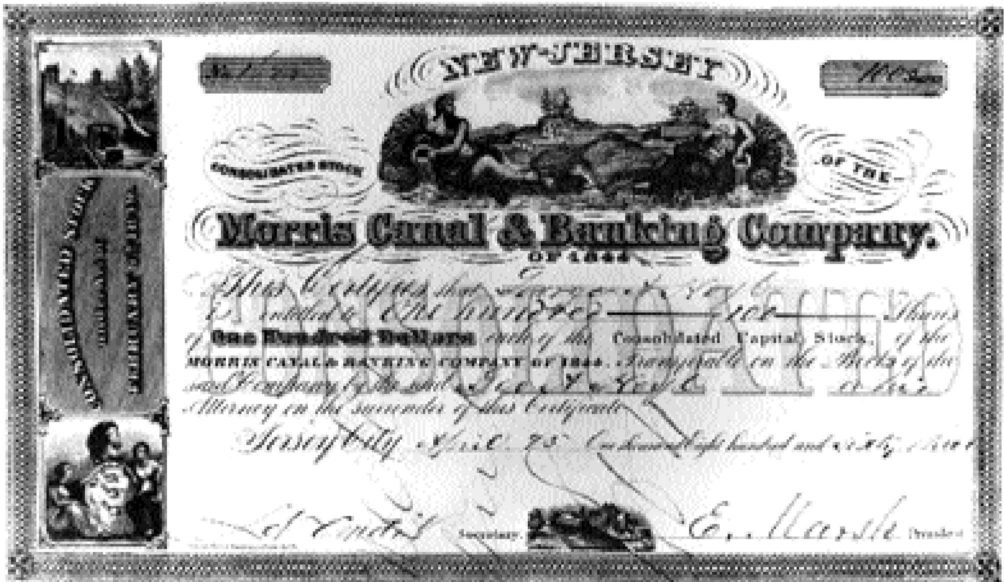
The benefits of the corporate device quickly became evident. Incorporation's limited liability reduced investor risk, thus making it easier to attract the relatively large and unaffiliated American investing public. And a corporate structure made it easier to bring in professional management. These were important advantages in a scattered, diverse society, so unlike the tightly interconnected world of business and capital in England.

The spread of corporations also democratized—or, more accurately, republicanized—commercial enterprise by bringing it within the framework of American government. Charters came not from an unaccountable sovereign but from popularly elected state legislatures. At the same time, the semiofficial status of corporate charters eased the access of companies—and their competitors—to the new nation's legislatures and courts.

In the heady days of the early and mid-19th century, American corporate chartering expanded as never before. Schools and colleges, medical and agricultural and charitable societies, churches, towns, and cities barraged state legislatures with charter requests. The number of business corporations soared. By 1817 some 2,000 had been chartered, and this was just the beginning. Turnpikes, canals, bridges, banks, ferries, steamboat and insurance companies, and railroads were the most conspicuous recipients. New York alone granted about 500 turnpike charters between 1797 and 1847.

The prevailing view was that there was no important difference between purely commercial and quasi-public enterprises. Each in its own way benefited the young republic. It was not difficult to believe that banks, bridges, canals, turnpikes, railroads, and insurance companies played a public role, and to accept the fact that they often got special privileges, such as monopoly rights for a period of years, when they were chartered.

But as the economy grew, these privileges came under fire. Some critics were rising entrepreneurs who sought to compete with existing enterprises, while others voiced a more general resentment that these "artificial creatures" should be so favored by the state. "Corporations have neither bodies to be kicked, nor souls to be damned," went a common complaint of the time.


NEW-JERSEY

CONSOLIDATED STOCK OF THE

Morris Canal & Banking Company.

OF 1844

One Hundred Dollars ... Consolidated Capital Stock ... MORRIS CANAL & BANKING COMPANY OF 1844

Secretary. President.

Widespread sales of corporate shares like those above to the general public was a uniquely American practice, speeding the rise of corporations.

The depression of the late 1830s and early '40s, which led to massive failures of canal and railroad companies, cleared the way for new ideas about the scope and meaning of incorporation. One result was easier access. By the mid-19th century, legislatures were passing general laws designed to make incorporation as cheap and easy as possible. No longer was it necessary to secure a legislative act. Now one filled out a simple form and paid a small fee. Incorporation became almost a perquisite of American citizenship, like voting or going to school. This democratization of what had once been an instrument of privilege made the corporation a form of economic organization more widely used in the United States than anywhere else in the Western world. In New York, for instance, more than 4,700 manufacturing firms were chartered between 1848 and 1866.

At the same time, the ability of the state (if it so chose) to regulate corporations was reinforced. The Supreme Court's *Charles River Bridge* decision (1837) set the tone. Writing for the majority, Chief Justice Roger B. Taney refused to let the privileges granted to an 18th-century Massachusetts bridge company block the construction of a second bridge nearby, even if the effect of the new enterprise was to destroy the economic advantage of the old one. The promise of economic growth lay not in the guarantee of old privileges (as Marshall had suggested in the *Dartmouth College* case) but in a process of "creative destruction" in which existing charter rights were narrowly interpreted in their duration and impact, and legislatures were empowered to foster economic change at the expense of vested corporate interests.

States that freely granted the gift of incorporation were ready to regulate or limit what they created. A number of them (including New York in its 1846 constitution) forbade subsidies or favors of any form to railroads and other corporations. While the courts remained sensitive to

the sanctity of property and contract, they tended to interpret corporate charters narrowly; in effect, to say to a company that wanted to go beyond its prescribed powers, "Have you got it in writing?" It was common for corporate charters to include a reserve clause allowing the legislature to amend them at any time. And by the 1850s, the "police power" to regulate the safety, health, morals, and welfare of the people had come to be accepted in American law as a broad justification for economic regulation.

This, then, was the ambiguous status of the business corporation in the mid-19th century, on the eve of the rise of big business. The corporate charter had evolved into a readily accessible instrument for a vibrant entrepreneurial society. Simply and cheaply attained, stripped of its traditional exclusionary or monopoly character, it was an essential handmaiden of economic growth. But at the same time, the corporation had an aura of threatening economic power to which government was expected to respond.

The first corporate body to evoke such fears was the Second Bank of the United States. But it died in 1832, when President Andrew Jackson vetoed the bill rechartering it. Next came the railroads. By the mid-19th century they had become the nation's first big business, a new and frightening source of unchecked power. In the early 1870s E. L. Godkin of the *Nation* observed, in his usual portentous way: "The locomotive is coming in contact with the framework of our institutions. In this country of simple government, the most powerful centralizing force which civilization has yet produced must, within the next score years, assume its relations to that political machinery which is to control and regulate it."

Popular anxiety over corporate power peaked at the turn of the century with the movement against "the trusts." In the late 1870s, John D. Rockefeller's attorney Samuel C. T. Dodd figured out a way for Standard Oil to absorb competitors without running afoul of its Ohio charter, which forbade it from holding the stock of other companies. The stock of Standard Oil and the companies it absorbed was turned over to a Rockefeller-dominated board of trustees, which issued trust certificates in return. A trust was not a corporation, and thus no state laws were broken.

Only about 10 trusts were launched during the 1880s. But the potential for more such mergers, and the fearsome business practices of the Standard Oil combine, made the trust a lightning rod for public concern over corporations and big business. The author of an 1883 law journal article wondered, "The Standard Oil has grown to be a more powerful—corporation, shall we call it? or what? for this is one of our questions—than any other below the national government itself." A number of states passed antitrust laws, and in 1890 the Sherman Antitrust Act, which outlawed "every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce," swept through Congress.

But this legislation hardly eased the growing national concern over big business. In its early years, the Sherman Act proved to be difficult to administer. The Supreme Court, in the *Sugar Trust* case (1893), severely limited the impact of the law by ruling that although the American

Sugar Refining Company controlled more than 90 percent of the nation's output, it could not be attacked under the Sherman Act. Why? Because sugar refining was part of the manufacturing process, a concern of the chartering state; the federal government's authority applied only after the company's product began moving in interstate commerce.

At the same time James B. Dill, another creative corporation lawyer—it was soon after this that Finley Peter Dunne's Mr. Dooley observed that what looked like a stone wall to the ordinary man was a triumphal arch to the lawyer—came up with a new legal device that nicely removed the remaining constraints on corporate consolidation. Dill's invention was the holding company: a corporation whose sole reason for being was to possess the stock of other corporations.

What to do about state laws that forbade corporations from doing this? That was easy: get a state or two to ease that restriction, and then interstate competititiveness would do the rest. Delaware and New Jersey soon obliged in response to intensive corporate lobbying and became the legal homes of many of America's largest corporations. The result, said one observer, was that "the conduct and condition of [a corporation's] business are treated as private and not public affairs."

This legal-legislative transformation went hand in hand with a new judicial perception of the corporation. In its *Santa Clara* decision of 1886 the Supreme Court held, en passant, that a corporation was a person under the Fourteenth Amendment and thus was entitled to the guarantees of due process and equal protection that the amendment afforded to the nation's citizens. This quiet change sculpted a constitutional safeguard of the rights of newly freed slaves into a potent instrument for use against state taxation and regulation.

It is not surprising that large American corporations felt free to go on a consolidation binge around the turn of the century. From 1898 to 1902 there were 2,653 mergers, with a combined capitalization of $6.3 billion. Within a few years an economy dominated by large, consolidated railroad, coal, steel, tobacco, oil, and dozens of other giant firms—the world of the 20th century American economy—had come into being.

Europe was creating its own economic megaliths at the same time: Great Britain saw 198 mergers during 1898–1900. But very different political, economic, and strategic realities prevailed there. Partnerships continued to be the rule in Britain (though they enjoyed limited liability and other corporate goodies). And English courts saw nothing wrong with—indeed, encouraged—firms entering into cartel agreements on prices and production. As an observer of the time put it, "Combination has been accepted without regulation in England because the entire English social system is a series of closed groups." Nothing of this sort was legal in the United States.

The popular American response to the rise of big business was colored by very different social realities. American historical memory did not include sentimentalized feudal-aristocratic traditions of patriarchal oversight, or guilds that were part of a traditional social order, or a tradition of class conflict. Rather, the most powerful economic creeds were

A century ago, the growing economic and political power of big business alarmed many Americans. An 1886 cartoon targets corporate influence in Congress.

individualism and self-reliance; enterprise was not to be cosseted but was to be left alone by the state. The growing diversity of early-20th-century American life—with manufacturers, merchants, farmers, railroads, shippers, retailers, consumers, unions, lawyers, judges, economists, journalists, and politicians pushing their interests and jockeying for position—served only to strengthen this fluid social environment.

In theory, Americans could draw on several different policy responses to the rise of big business. One was public ownership of public utilities. Another was federal incorporation (and therefore oversight)—sometimes sought by industry leaders themselves, who saw in it protection from burdensome state supervision. Yet a third was general federal regulation of

industrial prices and services: the creation of an interstate trade commission to parallel the railroads' Interstate Commerce Commission.

But these alternatives failed to suit the national temperament—or to fit the prevailing realities in American politics and government. Public ownership of utilities was tried in a few places, but the opposition of private interests and public suspicion of politician-run enterprises kept it marginal. Presidents Theodore Roosevelt and William Howard Taft proposed federal chartering, without success. And while the Federal Trade Commission was created in 1914, it did little more than try to block false and deceptive advertising.

What developed instead was a heavily judicial and highly nonideological system of mixed state and federal oversight, dominated by the federal courts. The number of antitrust suits varied from presidential administration to administration. But in the last analysis, antitrust policy was not set by elected officials or the government bureaucracy. It was set by the Supreme Court.

What was the character of that judicial policy? At first, reluctance to use the Sherman Act to strike down large combinations. Then, influenced in part by political and public opinion, a growing readiness to order the dissolution of combines that clearly violated the letter and spirit of the Sherman Act, culminating in the *Standard Oil* and *American Tobacco* decisions of 1911. In these cases, the Court set down a "rule of reason" for judging when combinations and bigness passed over the invisible line from efficiency to monopoly—and it ruled that both companies had done so. But the decisions made it plain that it would be the *Court*, and not an administrative or political agency, that would decide when that line had been crossed.

There were other forms of corporate regulation besides court-driven antitrust policy, but none were very satisfactory. Insurance companies, banks, and securities markets were subject to state regulatory systems—all notable for their inadequacy. Railroads, regulated by the Interstate Commerce Commission since 1887, were involved for decades in an intricate, politically charged, and terribly costly regulatory drama.

The newer public utilities—gas and electric, bus and streetcar and telephone companies—operated in yet another distinct regulatory environment. They were expected to provide a constant flow of a necessary service, and by their very nature they were monopolies, or nearly so. To deal with them, the states resurrected the old regulatory device of licensing. Public service or utility commissions issued "certificates of public convenience and necessity" to the companies under their supervision: a new form of corporate oversight. But often these commissions were "captured" by the utilities they regulated.

None of these problems reduced the ubiquity of the corporate form of business organization. Big business was only the tip of the American corporate iceberg. The vast majority of corporations were small enterprises, remote from the regulatory world of antitrust or utilities regula-

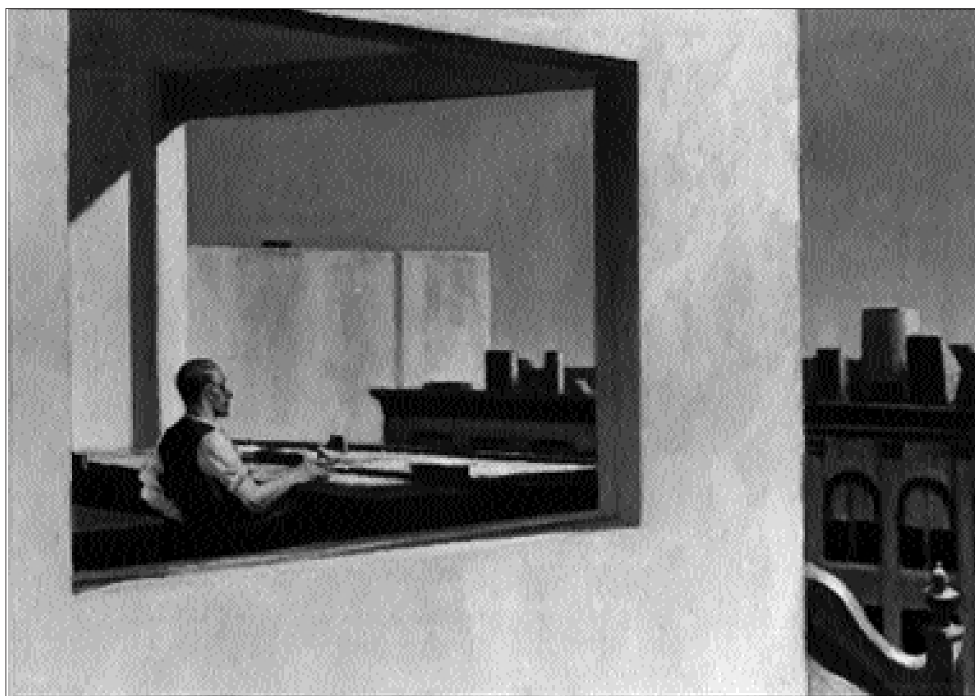
tion. Easy access to the corporate form was now a century old, and taken for granted. There were more than 340,000 corporations in 1916 and 516,000 in 1931, when they controlled some 30 percent of the nation's wealth and accounted for four-fifths of business income. No one worried that hundreds of thousands of farmers, shopkeepers, and small manufacturers availed themselves of the liability and, increasingly in the 20th century, the tax advantages of incorporation.

What did continue to concern courts, legislatures, and (intermittently) the public was how to restrict the corporation's potential for economic and political power while not crippling its potential for economic growth. This involved, first of all, an assault on the late-19th-century legal doctrine that a corporation was the equivalent of a person. That doctrine was the source of some of the more controversial judicial decisions of the early 20th century. It allowed corporations to claim Fourteenth Amendment immunity from much state taxation, and to beat back some attempts to regulate wages and working conditions. Companies argued with some success that the states had no right to interfere with the contracts that they as "persons" entered into with their workers.

Not until the 1930s did the Supreme Court finally come to accept that both the federal government and the states should have considerable regulatory authority over corporations. Congress then passed laws severely limiting the ability of employers to secure court injunctions against strikers and guaranteeing collective bargaining. Corporate taxation increased significantly during the New Deal and World War II. Big business came once again, as in the Progressive era, to be treated as what in fact it was: not a collection of legal "persons" more or less free to do what they would, but a potent American institution.

The decades since the 1930s have not fundamentally altered the place of the corporation in American life. Antitrust now, as throughout the 20th century, ebbs and flows with the forces of politics and the economy. Comparing the breakup of Standard Oil in 1911 and of AT&T a decade ago gives one an overpowering sense of *déjà vu*. The anticorporate strictures of Ralph Nader and other latter-day critics stand in a tradition that has its roots in the early 19th century. True, there is far more regulation of corporations today, including rules on environmental and occupational safety and health. And modern liability law makes companies much more subject to consumer and bystander damage suits than in the past. Yet big business today has as secure a place in American society as at any time during the past century.

One feature of large corporations has been a continuing source of trouble: the separation of ownership and control. Until the 20th century, ownership rested in relatively few hands—though rarely in the hands of only one proprietor, such as Henry Ford—and owners were able for the most part to exercise effective control. But as companies grew bigger, and stockholders more numerous (4.4 million in 1900, an estimated 18 million in 1928), the separation of control from ownership loomed ever larger. In 1927 and 1929 leading New York corporation lawyers revised Delaware's statutes, already hospitable enough to make that state the home of 70,000 firms, further



The move from farm and factory to white-collar work in corporate offices brought a major cultural shift, suggested by Edward Hopper's midcentury painting.

strengthening the hand of management against stockholders.

The Modern Corporation and Private Property (1932), by lawyer (and later New Deal brain truster) Adolf Berle and economist Gardiner Means, addressed the ownership-control problem in much the same way as, a generation before, Louis D. Brandeis's *Other People's Money* (1914) focused on corporate consolidation and size. Could stockholder-owners who were not actually responsible for the operation of a firm justly claim all of its profits? And given the impossibility of oversight by masses of stockholders, how could non-owner managers be counted on to maximize profits and secure the health of the company, rather than seek perquisites and power for themselves?

Berle and Means's larger point was that corporations were social as well as economic institutions and thus subject to public accountability. It took the Great Depression and the New Deal to bring about significant reform, though nowhere near as comprehensive as many corporate critics wanted. The Securities Act of 1933 and the Securities Exchange Act of 1934 imposed strict new rules on stock issues and securities trading, and required full disclosure of executive compensation. State securities laws were also tightened.

But the gap between stockholders and management persisted. Stockholders continued to be regarded more as investors than as owners—and, indeed, it is hard to see how any other assumption could work. "Faith in publicity," the sovereign Progressive remedy (along with antitrust) for corporate ills, has remained the guiding spirit of corporation law reform. In times of corporate profitability (that is, pretty much since the Great Depression), criticism of the management-stockholder

relationship—like criticism of corporate size—tends to be muted. Even today's excessive stock options, golden parachutes, and other arrangements that avaricious managers secure with the help of complaisant directors elicit more indignation than action. Of course, an economic catastrophe could very well change that.

Two very different impressions emerge from the long history of the corporation in the United States. One is that the corporate form has been extraordinarily useful as a way of giving legal (and public) standing to economic or social ventures. Whether in regard to a covenanted New England town in the 17th century, a colonial college in the 18th century, a bank or a railroad company in the 19th century, or the biggest of big businesses in the 20th century, some form of incorporation has been a sine qua non. It guarantees public standing or limited liability, helps attract capital, or gives managers relatively free scope to operate.

No less striking is the halting and uncertain, slow and limited record of the state and of public opinion when it comes to subjecting corporations to significant government control. The usual explanation is that big business wields enormous political power. No one would deny the existence of that power, but it seems an insufficient explanation. Corporations seldom form a united political front, and big business is often vulnerable to adverse public opinion. The antitrust movement of the early 20th century, the New Deal, and the continuing strain of populist hostility to big business are all evidence of that. In American politics, an aroused public that knows what it wants usually can get its way.

It is revealing that the area in which modern corporations have been most vulnerable to public control is liability law. Customers or bystanders who suffer harm from a company's products, even if the harm was impossible to anticipate, now routinely win multimillion-dollar judgments against corporate giants. It is no accident that this is an area, like antitrust, that is the particular responsibility of the courts. Corporations to a considerable degree are legal creatures, and it is the law, more than politics or government, that seems best able to trace the bounds between their private rights and public responsibilities.

Much of the corporation's relative immunity from broad political assault exists because it has been able to lay claim to the status—and the legitimacy—that comes from being an old, massive, generally successful American institution. The corporate device is used by middling farmers and entrepreneurs as well as gargantuan businesses. And despite highly publicized episodes of downsizing, many big companies still command the loyalty of their managers and workers. Corporations, as has so often been observed, are social as well as economic institutions, and the attractive power of the corporate culture should not be underestimated. Most of all, corporations, especially large ones, have been able to deliver the economic goods. For all their very evident faults and inadequacies, as long as they continue to do that, their place in American society seems assured.