

## Historicizing Corporations and Democracy

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[Corporations and American Democracy](#) (Naomi R. Lamoreaux & William J. Novak eds., 2017).

Americans' interest in the impact of corporations on society, always high, reached fever pitch with the Supreme Court decisions in *Hobby Lobby* and *Citizens United*, as reflected in the ongoing political and media dialogue about reforms necessary to protect or restore democracy. Believing that the historical assertions informing this debate are largely "claims about the history of corporations in the United States that are at best outdated, if not entirely lacking in historical foundation", the Tobin Project supported new research on this topic, the results of which are now available in Naomi R. Lamoreaux & William J. Novak, **Corporations and American Democracy** (2017) (hereinafter "Lamoreaux & Novak").

Lamoreaux & Novak contains the work of 16 scholars, organized as an introductory essay and ten chapters, which together provide a coherent and enlightening look at the nature of the corporation and corporate law from the founding of America to the present. At the same time, Lamoreaux & Novak also provides a provocative look at the nature of democracy, viewed in the context of the nation's ongoing struggle over the proper relationship between corporations and government. Whether your interest lies in better understanding the corporation at the turn of the 19<sup>th</sup> century, in the early stages of the industrial revolution, during the pre-first-World-War reform era, in the early days of the New Deal, or as the corporation later evolved, Lamoreaux & Novak has something for you. For me, the highlight was Chapters 2 and 3, which provide a much needed clarification of the standard account of our understanding of the corporation as it evolved in the nineteenth century.

The standard account, which describes the history of corporations and corporate law as a race to the bottom, goes something like the following. At the onset of the 19<sup>th</sup> century, business activity was conducted primarily by artisans and craftsmen. Corporations were mostly engaged in quasi-public activities, and charters were granted only via legislative act and only with charter provision designed to ensure that the corporation served a public interest. With the onset of the industrial revolution, the demand for corporate charters by railroaders and manufacturers could not be filled by special chartering, leading to general incorporation laws. In an effort to retain at least some of the public-interestedness of these new creatures—business corporations—the first generation of general incorporation laws contained many public-interest-oriented immutable laws. But, by the coming of the 20<sup>th</sup> century, states (led by New Jersey) were adopting lenient general incorporation laws which enabled corporations to operate with near total disregard of the public interest.

In Chapter 2, Eric Hilt explores the corporation from 1791 through the first half of the 19<sup>th</sup> century with a primary focus on New York, which during that period was both the center of American economic life and a corporation law trend setter. What we see is the interconnectedness between politics and the corporation.

At the starting point, 1791, New York politics is dominated by aristocratic landowners and wealthy merchants and only two businesses had been permitted to incorporate, one of them the Bank of New York. A survey of New York City wealth in 1791 reveals that stockholders in these corporations were disproportionately wealthier than the population as a whole, that the stock was also distributed disproportionately amongst different categories of the population, with public officials benefitting the most disproportionately. In other words, at our starting point the evidence suggests that governmental control of corporate chartering fostered corruption, as public officials skimmed off a substantial portion of the economic rents flowing from stock ownership.

In the period from 1791 to 1830, the number of business corporations in the United States steadily increased, reaching 250 by 1800, 1,138 by 1810, and at least 4,492 by 1830, with 23% of these chartered by New York State. While turnpikes, canals and other quasi-public businesses accounted for approximately half of New York's business corporations, the other half included 70 banks, 73 insurance companies, and 293 firms in the manufacturing and mining sector.

New York also led the way in the move to general incorporation. However, its first statute, enacted in 1811, limited "free" incorporation to manufacturers of textiles, glass, iron, steel or lead, and placed a \$100,000 limit on capitalization. The statute seemed clearly a response to New York falling behind neighboring states in the number of small manufacturing enterprises, and can be seen as an effort to spur entrepreneurial activity in New York.

Thus, beginning in 1811 and continuing until mid-century, New York had both a limited form of general incorporation and the continued importance of special chartering. Larger firms and those with greater influence could still use special chartering to obtain more desirable rights and privileges than would be provided by operating with a general incorporation charter.

As we move from 1791 to mid-century, Hilt shows that the nature of public corruption changed. By 1826, public officials are no longer the most disproportionate beneficiaries of stock ownership. Instead, Hilt persuasively argues, special chartering had become a mechanism by which "to perpetuate and extend the power of a political party and the interest groups associated with it." Dominant-party legislators used special charter provisions not to protect the public interest, but to grant monopoly protection and other special economic privileges to the favored corporations owned by supporters.

In Chapter 3, Jessica Hennessey and John Wallis take us from the world of 1840 to the 20<sup>th</sup> century, and provide a very different understanding of the universal move from special chartering to widely available and fairly liberal general incorporation statutes which occurred during this period. Rather than being a phenomenon unique to corporations and a governmental failure to protect the public interest, the move to general incorporation is but a part of a general effort to curb the unique corrupt use of special chartering by dominant political factions.

In the first part of the 19<sup>th</sup> century, citizens could and did approach the legislature for special laws granting benefits only to them in a wide range of matters. For example, permission for divorce could be obtained by a special legislative act, a path famously used by Andrew Jackson's wife Rachel to divorce her first husband. In another area of great concern, municipalities were subject to legislative mercy in pleading for charter provisions to allow local governance.

Hennessey and Wallis show that beginning in 1851, state after state began adopting "general law provisions . . . mandating that laws for a wide variety of purposes be 'general' laws that applied equally to everyone." A strong correlation can be shown between a state's adoption of general law provisions and its adoption of a general incorporation statute. During the same period, states began adopting home rule provisions that provided municipalities with blanket governance rules rather than a patchwork of special charters.

Initially general incorporation statutes and municipal home rule laws contained substantial immutable provisions, but by century's end had given way to more liberal statutes granting substantial discretion in how a particular corporation or municipality could choose to structure its internal and external affairs. With respect to corporations, this move to more liberal general incorporation statutes has been commonly described as a race to the bottom.

Hennessey and Wallis caution that this standard view is misleading at best. People at the time thought general incorporation statutes, and broader general law provisions, "limited the ability of politicians and legislatures to create special privileges [and thus were designed] to improve how democracy works." Was the move to less restrictive general incorporation statutes inconsistent with that goal and a function of state legislatures being captured by business interests? We may come to a different answer than has commonly been given if we see this 19<sup>th</sup> century history as part of an ongoing struggle to create democracy itself. Hennessey and Wallis remind that a near unique aspect of American society is the richness of public and private organizations and the ease with which individual can organize as they choose. As they note, citing China and Russia as leading examples, "[m]ost political systems manipulate organizations, limiting their number and allocating special privileges among them to coordinate and enrich ruling political coalitions."

The move to more liberal general incorporation statutes occurred as the modern corporation of Berle and Means fame was first stirring. But rather than see this move as the product of legislative self-interest or corruption, might we see it as two steps forward and one step back in the creation of our democracy? The remaining steps taken, and those yet needed, are the subject of the remainder of this fine book.

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