

Broadening the Concept of Public Service During Industrialization

RONALD E. SEAVOY

THE ORIGINS OF THE AMERICAN BUSINESS CORPORATION, 1784-1855

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Preface

This book examines a major factor that contributed to the rapid industrialization of the United States: the role good laws played in accelerating the transformation of one state from rural underdevelopment to the threshold of an urban industrial society within seventy years. A key legal innovation was the passage of general incorporation laws that encouraged the creation of business corporations. In the United States, these laws grew out of the widespread colonial use of the corporate device to organize religious congregations, units of local government, and occasionally a local internal improvement project. New York was studied because it was one of the earliest states to industrialize and because it showed exceptional energy in exploiting the commercial opportunities of large interstate markets.

The first class of business corporation to undertake interstate business on a large scale was banks, and as Joseph A. Schumpeter observed, it was the enormous creation of bank credit that fueled the economic transformation of the United States. The second major class of corporation that accelerated economic growth was railroads because, by 1855, they were on the verge of becoming the most efficient means of long-distance, all-weather overland transportation. Business corporations, particularly banks and railroads, were promoted by individuals operating almost entirely under state laws because, after the destruction of the second Bank of the United States, the national government used only a small portion of its power (the best known are the tariff and land

grants after 1850) to mobilize and allocate resources to socially desirable investments. Therefore, the best way to see how new technologies and enlarged markets were exploited (from 1825 to 1855) is to focus on one state, and preferably one of the most industrially advanced states. To do otherwise would lead to a serious distortion in understanding the policies desired by pioneer corporate entrepreneurs because it was the energy of these businessmen that was a leading factor in creating the nation's industrial base and laying the foundation for the national market.

The business corporation had, by 1840, become a device that allowed popular participation in the profitable exploitation of larger markets and advanced technology. The policy that guided its use during the Jacksonian era was laissez faire, which was best implemented by the passage of general incorporation statutes for business enterprises. The economic, social, and political issues connected with the passage of these laws form the vehicle that helps explain the relationship of law to the economic transformation of the United States.

This study makes two major assumptions, which have guided the use of source materials: first, that the American political system, and particularly that of New York, was highly responsive to the needs of major interest groups and to the aspirations of its citizens because fundamental changes in economic policy were achieved without resort to violence. Second, the legal record (statutes, legislative documents, court opinions, and constitutional conventions) and especially the legislative record supply the best indication of what the people wanted because, during the period of this study, the preponderance of political power resided in democratically elected state legislatures. The political stability that allowed these orderly changes to take place was rooted in the social and religious heritage of the nation and New York, as profoundly modified by the winning of national independence and the achievement of national political stability under the Constitution of 1787.

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THE ORIGINS OF THE AMERICAN BUSINESS CORPORATION, 1784-1855



Introduction

This study traces the development of the American business corporation by focusing on the origins of general incorporation statutes in New York and on the policy considerations that prompted most states to adopt such statutes by 1855. General incorporation statutes allowed the self-incorporation of private associations at the option of the promoters, without any political intermediary. Soon after the end of the Revolutionary War, the New York legislature passed general incorporation statutes for several classes of benevolent public service organizations. The one for religious congregations was the most prominent because it implementated a policy of denominational equality by offering the advantages of incorporation to all religious congregations without discrimination.

In colonial North America, there had been few counterparts of the municipal and ecclesiastical organizations that existed in England. The colonial organizations were not recognized as corporations under common law, and in order to possess corporate privileges, they had to be incorporated by statute law. During the colonial period, all major classes of organizations were incorporated, and all of the legal devices to create corporations were used. Numerous municipalities (cities, villages, and towns) were chartered by colonial assemblies, as were some prominent educational and charitable institutions, plus a few large business corporations like the Proprietors of the Long Wharf of Boston.

Massachusetts was the leading colonial government in creating corporations. The Massachusetts General Court passed a general

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regulatory statute for towns as early as 1635 and modified it in 1670, 1692, and 1694. In 1713, the legislature passed a de facto general incorporation statute for persons who held land in an undivided parcel. These persons were usually the heirs of the oldest settlers in a town. They claimed that the town's common land was the personal property of the earliest settlers who had received the land as a grant from the assembly to help bear the heavy expenses of initial settlement, such as clearing roads, building wharves, and erecting a meeting house. The commonly held lands that were not sold to later settlers remained as the private property of these initial settlers and their descendants. In 1735, another de facto general incorporation statute was passed for the owners of wharves and water-powered mills (grist, saw, fulling, forge), and for the types of internal improvement and community service enterprises owned by several persons. Incorporation was a means of dividing ownership by shares without physically dividing the property, and it was also a way of assessing taxes to pay for necessary public improvements like fencing, ditching, and highway maintenance. In 1755, an explicit general incorporation statute was passed for dissenting religious congregations (mainly Baptist).

In the early national period, the advantages of incorporation were eagerly sought by business promoters (especially those with a New England heritage), and the New York legislature readily granted incorporation to businesses that had not existed in the colonial economy. Incorporation of business enterprises offered several advantages: it helped protect the collective ownership of real property: it facilitated the mobilization of capital: it offered a means of limiting risks in speculative enterprises; and it allowed easy access to the courts. For practically the whole period covered by this study, business corporations in New York were limited to the few classes of enterprises that did not compete with single proprietors or partnership businesses. For new types of enterprises, like turnpikes and banks, the corporation was the usual form of organization. The new classes of incorporated businesses were usually fairly large-scale and they often had a high risk factor; and very frequently they required the grant of special powers from the state before they could begin operations. Furthermore, incorporation provided a means of centralized management that large-scale enterprises required, and it was a flexible instrument of organization that could be applied to a large variety of businesses.

The earliest method of creating a corporation was by granting an individual charter. This mode of creation assumed that corporations were legally privileged organizations that had to be closely scrutinized by the legislature because their purposes had to be made consistent with public welfare.

The second stage of corporation creation was the passage of general incorporation statutes for benevolent organizations, beginning with religious congregations. The principle of religious equality was a legacy of the Revolution, and soon after peace was restored the New York legislature passed general incorporation statutes for religious congregations and then for academies and libraries. Thereafter, whenever a class of benevolent organizations was recognized as being essentially nonpolitical and noncontroversial, general incorporation laws were readily passed. Most states had these laws by the end of the eighteenth century.

The third stage of corporation creation was the enactment of general regulatory statutes, which listed all of the powers and limitations possessed by one class of corporation; but these statutes still required that the legislature pass an individual charter for each company. This mode of incorporation was mainly used for franchise corporations that constructed internal improvements. One of the vital needs of all eighteenth-century communities was improved transportation. The Massachusetts colonial legislature had passed laws that encouraged building wharves, and after independence the New York legislature encouraged the building of turnpikes by passing charters of incorporation whenever applied for. The general regulatory statute of 1807 systematized this process.

Franchise corporations such as turnpikes required special powers, like eminent domain, limited liability, and the right to collect a public toll, before they could begin operations; therefore, they needed individual consideration. Individual consideration ensured that a public hearing would be held to ascertain if the improvement was needed and desired, and in the case of turnpikes, that it would actually follow the route described in the petition for incorporation. All of this information had to be a matter of public record before a franchise was granted.

Most franchise and benevolent corporations had equal social utility. It was relatively immaterial whether the services performed by one of these corporations was for private profit or was benevolent. A turnpike and church building were both visible and useful public improvements and all communities needed them. A turnpike was a business corporation that was undertaken for private profit. but because, in the eyes of the community, it performed a vital public service (as important as religious instruction), the state legislatures during the early national period gave equal encouragement to both forms of corporations as a matter of public policy: one by a general incorporation statute and the other by a general regulatory statute coupled with the pro forma passage of all charters.

The fourth stage of corporation creation was reached when general incorporation statutes were passed for franchise and nonfranchise businesses. They were most frequently passed in New York in the 1840s and 1850s when steam technology was successfully applied to railroads and increasingly used as stationary power plants for manufactories. At the same time, markets grew very rapidly, thereby creating a popular demand for a cheap legal means of encouraging the exploitation of these new conditions. General incorporation laws fulfilled this demand. The reasoning behind their passage was the same as behind the general incorporation law for religious congregations: they equalized the opportunity to secure the legal advantages of incorporation and encouraged the formation of organizations that performed public services. However, the process of recognizing and defining the public service function of some classes of business corporations often involved a great deal of political controversy. More importantly, general incorporation laws equalized the opportunity for entrepreneurs to secure corporate business profits by which some of them would get rich, which had the effect of democratizing entrepreneurship during the early stages of industrial growth. They also equalized the opportunity for different sections of the state to undertake local improvement projects with their own resources without having to bargain politically for the privilege.

The fifth stage of corporation creation took place long after 1855. It was achieved when general incorporation codes were passed that allowed incorporation for virtually any legitimate purpose. A code extended the privilege of self-incorporation to all classes of businesss for profit and to most classes of benevolent associations. A general incorporation code could not be adopted, however, until public opinion allowed the general incorporation of those business enterprises that were traditionally organized as single proprietorships or partnerships, such as retail and wholesale merchants.

In this whole development, there were many overlappings, so that these categories were not consecutive for any one class of corporation in any one state. Nevertheless, these five stages of corporation creation describe the transfer of the public service function from benevolent corporations (primarily religious congregations and academies) to internal improvement corporations (turnpikes and bridges) to business corporations that exploited an anonymous market (manufactories). This final transfer took place during a time of rapid technological innovation and attendant expansion in the size of regional markets, which inspired many men to organize because they saw the possiblity of becoming rich in a short period of time.¹

NOTES

1. Ronald E. Seavoy, "The Public Service Origins of the American Business Corporation," Business History Review, Vol. 52, 1978, 30-40, 59-60. James W. Hurst, The Legitimacy of the Business Corporation in the Laws of the United States, 1780-1970, 13-57. Simeon E. Baldwin, Modern Political Institutions, 174-175, 184-187. Simeon E. Baldwin, "American Business Corporations before 1789," American Historical Review, Vol. 8, 1903, 450-453. Roy H. Akagi, The Town Proprietors of the New England Colonies, 1620-1770, 3-5, 55-57, 67-68, 85-88, 124-129.