Lecture I: The First Corporations

Whereas France and Spain established colonies in the New World through state action, Holland and England relied primarily on private investors – albeit with considerable governmental support -- to establish their foothold in North America and the Caribbean. These early joint-stock companies – the Dutch East India, the Hudson Bay, the Virginia, the Plymouth, etc. – received royal "patents" to establish colonies on land grants from their respective national governments. The most important company for our immediate purposes is the Virginia Company, formed in 1606 to establish a colony in the area south of New England and north of the Carolinas. The Company was financed by a group of investors whose motive was to make a profit through the sale of land, and also the products of the land, both the lands owned directly by the Company and those owned by entrepreneurs who bought land from the Company, paying for it largely with products grown on the land. These "plantations" came in various sizes, some land grants were quite large and the purchasers sought to resell portions of them to newly arriving planters as well as retaining large sections of land for their own use. Many of the early arrivals from England had no interest in farming, hoping instead to stumble upon a gold mine, become instantly rich, and return to England and live like a lord.

Unfortunately for the Virginia Company, the difficult conditions in early 1600s Virginia meant that many of the early settlers died from disease (malaria was endemic to the areas along the James River, for instance) and others found it impossible to grow a money-making crop and gave up and returned to England. Much of the early effort had been directed at finding a cash crop that could be exported. Finally, in 1618, the colonists succeeded in cultivating a form of tobacco pleasing to the European (especially Dutch) taste. However, the Crown insisted any tobacco exported had to pass through England and pay a duty. This, together with growing disenchantment among the investors, led by 1624 to the abrogation of the Company's charter by the king and the creation of a Crown Colony with a Royal Governor in place of the Company. The labor supply during these years was made up largely of indentured servants, although some enslaved Africans were purchased from Dutch and Portuguese slave traders. The indentured servants were poverty stricken people who the Company recruited from the poor houses around England or somewhat more well-to-do people (mainly male) who thought to get rich by farming the fertile lands of the New World after serving their seven-year indenture. (The Companies advertising brochures greatly exaggerated the ease with which one could make a small fortune in Virginia.)

Thus, the first corporation to do business in America had a very short life span, from 1606 to 1624. Massachusetts was similarly settled by people known as Pilgrims, religious dissenters from the Church of England, who made up the bulk of the Plymouth Company's early arrivals in the New World. The Plymouth Company, like the Virginia Company, had received a royal patent to establish a colony on lands claimed by England along the Atlantic coast of North America. The Company's first attempt to establish a colony, in present-day Maine, proved a failure. In 1619, a restructured Plymouth Company agreed to finance a colony by the Pilgrims, advancing them money to establish the settlement. Due to navigational error and ill winds, the settlers on the *Mayflower* ended up landing on the coast of present-day Massachusetts instead of further south, which had been their intention. Like the Virginia settlement, that at Plymouth was not a financial success, and the Plymouth Company investors, like those of the Virginia Company, ended up losing their stake in the venture. The Pilgrim settlement continued, however, as a separate entity until 1691, when it was absorbed by the Massachusetts Bay settlement around Boston. The Massachusetts Bay Company, established in 1628 in England with a royal grant of land covering much of present-day Maine and Massachusetts turned out to be the most successful of the early English settlements and ended up paying dividends to the investors, many of whom actually came as settlers to the colony in 1630 and the following years. These Puritans proved to be the best business people of all the early English settlers. They generally had more money than the Pilgrims or the bulk of the Virginia population and also were better educated.

The final corporation to be cited is the Dutch West India Company, established in 1621 with the objective of building a trading post on present-day Manhattan Island to buy furs from the Native American Indians. Unlike the English colonies, the Dutch company's intention was to make a profit in trade, not through the cultivation of the land. Eventually, however, Dutch settlers did arrive in the New World and settled along the Hudson River north to present-day Albany, then called New Orange. The Company maintained a profitable trade in furs, but lacked the ability to defend itself and the Dutch were forced to cede the colony to the English in 1674.

The point of this brief synopsis of early corporations is to show how England and the Netherlands invented and used private joint-stock companies to settle and exploit the resources of their colonies in North America. For the next two hundred and fifty years the main source of wealth in what came to be the United States was the land and its natural resources. Early corporations were almost all ventures in real estate development, with numerous investors buying shares in a company that would then purchase land from the English (later British) crown, or, after 1783, the new United States Government. The land was then resold to settlers. The earliest large-scale private company in the new United States was that formed by John J. Astor to purchase furs in the Northwest and transport them to China, Europe, and around Cape Horn to ports on the East Coast of the United States. Astor, in other words, pursued the same business objective as the Dutch West India Company had in the 1600s. America's wealth was (and in many respects still is) its abundant natural resources: its fertile soil, timber-filled forests with millions of fur-bearing animals, and, from time to time, a mine than produced gold, but usually some less valuable ore. Exploiting this natural wealth on a large scale pushed early capitalists to form corporations that could amass the capital needed for such ventures and could spread the risk over a large number of investors.

Most interesting for our purposes is the story of the Ohio Company of Associates, otherwise known as the Ohio Company, which acting before the creation of the United States under the new Constitution, purchased 1,500,000 acres of public land in 1787 from the Confederation government for a down payment of one million dollars. Over the next fifteen years, the whole of what came to be the state of Ohio (which entered the Union in 1803), had been sold to private developers by the new U.S. Government. These real estate developers then resold the land to settlers, reaping large profits and creating some of America's first fortunes. Of course land, as with other natural resources, must be sold to realize a profit and, in a sense, all such speculations are "self liquidating." Once all the land is sold, the company goes out of business, or invests its profits in some other enterprise. From its very origin up to the present day, land (and its "improvements," i.e., buildings and other amenities) has been the source of wealth for a large number of Americans. We are fortunate in this country in that the expanse of real estate from the Atlantic to the Pacific between 25 and 50 degrees north latitude is perhaps the best land on the face of the earth. It was heavily forested to begin with, and lumber was in great demand for building, and much of it is very fertile, allowing the production of bountiful crops year after year. The climate is temperate – not too hot, and not too cold in most places. The American landscape, in other words, provided a matchless canvass on which to create the prosperous and happy land we see today; one which people from all corners of the world seek to come in order to realize their dreams.

Shortly after the establishment of the new United States of America under the Constitution, Congress passed and George Washington signed a law authorizing the founding of the first Bank of the United States, with a charter that allowed the bank to operate for twenty years, subject to renewal (1791 to 1811). This was a public-private venture in which wealthy individuals purchased eighty per cent of the shares in the bank and the government purchased the other twenty per cent. Needless to say, the purchasers of the shares were the wealthiest individuals in the country, giving rise to the notion that the institution, despite its avowed purpose of supporting the nation's finances, was actually a gift to the rich. Treasury Secretary Alexander Hamilton stressed that the Bank was indeed a private corporation rather than a governmental one and therefore Constitutional. In fact, the U.S. Government at the time had so little revenue coming in, it had to borrow money from the Bank itself (i.e., the other investors) to purchase its two million dollars in shares. The purpose of the Bank was to make loans to businesses and to the government and, eventually, to state banks, in order to facilitate business by advancing credit throughout the country. The Bank died in 1811 when the Madison administration opposed the renewal of its charter. A wealthy Philadelphian, Stephen Girard, purchased most of the Bank's stock in 1811 and turned it into an entirely private institution known, appropriately, as the Girard Bank. This state of affairs continued until 1816, when the Monroe Administration realized it needed a national bank's services to finance the nation's involvement in the War of 1812 against Great Britain and a new Second Bank of the United States was established by Congress along much the same lines as the previous First Bank. Girard's bank continued as a separate private institution.

The belief that a joint-stock company required a charter from the national government to operate harks back to the old system of royal charters that had permitted the operation of such entities as the Virginia and Massachusetts Bay companies. Such charters established the legal right of the company to do business of a certain sort within a certain geographic area and also protected the investors from personal liability should the venture go sour. Charters also established de facto monopolies, one of the key reasons investors were willing to put their money on the line. In the case of the two Banks of the United States, the monopoly only extended to the national government and state governments were free to charter state banks on much the same terms, which led to the rapid founding of numerous such local banks. These banks were mostly owned entirely by private investors and did not enjoy monopoly status on the state level, i.e., there could be (and were) many separate banking houses in each state, competing for deposits and making loans. As we shall see, corporate law in the United States stems primarily from acts of state legislatures rather than from the federal government and companies are, in fact, "incorporated" by state governments.

Up to about 1850, most businesses, even many of the new textile manufacturing companies established in New England, were privately-owned or partnerships, not joint-stock companies. The impetus for the corporate form of business organization came from the immense capital demands of the new railroad companies being formed in the 1840s. Railroad construction and the rolling stock to operate the roads, together with the salaries of the thousands of workers needed to staff the new lines required unprecedented amounts of money, more than any single individual or partnership could muster. Thus, the issuance of stocks and bonds became the favored method of financing these giant investments. In some instances, state and even local governments provided some financing or granted public land and facilitated easements though private property for the construction of the rail lines. On the whole, however, the railroads started and remained private enterprises.

Key to the development of American corporations was the concept of limited liability. In fact, "the world's first limited liability law was enacted by the state of New York in 1811," according to an article in *The Economist* magazine cited by Wikipedia. It is fitting that the United States should be the first country in the world to establish this legal principle. The private assets of shareholders in chartered companies were not at risk before this, of course, as long as they had not themselves engaged in some sort of fraudulent transaction. But the New York law, and future similar statutes elsewhere in the U.S., had the effect of protecting even many dishonest entrepreneurs from legal liability. One English critic of limited liability wrote in 1855 that "he who shares the profits of an enterprise ought also to be subject to its losses." But, unless the individual investor, who is often a manager of the company, has engaged in actual fraudulent actions to enrich himself, he stands only to lose his investment in the company, but not any other personal wealth he may have. As we shall see, very few American entrepreneurs have been held liable for their company's debts when it declares bankruptcy and goes out of business, leaving its creditors to bear the losses. Limited liability is essential to major entrepreneurial investments, it seems, but the "moral hazard" it creates by allowing the investor to protect his private wealth while benefiting from the company's profits has long been viewed as an unjust and dangerous practice.

Another aspect of "limited liability" that became increasingly evident was the employer's limited liability for the physical welfare of company employees engaged in hazardous work. The railroads and eventually heavy industries like coal mining and steel manufacturing proved to be especially hazardous places to work. The concept of "workmen's compensation" for injury or death suffered on the job did not take hold until well into the 20th century. During the first, pioneering years of the industrial revolution in the United States, corporations had little responsibility for insuring the welfare of their workforce. Except for cases of gross negligence by their employer, workers were more or less "on their own" after they accepted a job that they knew could be hazardous. A Maryland court ruling in 1896 in a case of a steelworker seeking damages for injuries suffered on the job declared that "If a servant has knowledge of the circumstances under which an employer carries on his business, and chooses to accept the employment, or continue in it, he assumes the risks incident to the discharge of his duties, as are open and obvious." (Quoted in Reutter, *Sparrows Point*," p. 54.) Corporate responsibility for damages connected with the conduct of company business has since become an accepted legal concept, not just in compensating for the death and injury of workers, but also for damage to the environment as a result of the businesses conduct. But for almost a century liability for the "collateral damage" inflicted on the environment by industry went unrecognized by the law and it is still controversial as a legal concept in certain quarters.

The 1830s and after also saw the advent of state legislatures passing "general incorporation laws," which ended for all practical purposes the old system of exclusive state charters that essentially amounted to legal monopolies. By throwing open the advantages of the corporate form of business organization to all comers, the new laws enacted the Jacksonian principle of equal opportunity and no special privileges. This trend was most notable in the rampant formation of state-chartered banks, but was also evident in Jackson's veto of the charter renewal of the Bank of the United States in 1832 in which he denounced the bank as a privileged corporation that enriched the few at the expense of the many. The only answer to such abuses, he said, was to make banking, like every other economic endeavor, open to all. Since the 1830s, the American economic system has come to be based on the idea that anyone should be able to start a company and to simply register it with the state, thereby gaining the right of limited liability. By breaking down the old notion that the corporation was an organization that enjoyed some sort of monopoly rights and need not fear competition, Jacksonian democracy infused the American economic system with unprecedented vitality, but also with a penchant for high risk, boom and bust activity.

The Supreme Court enshrined this new economic philosophy in the Charles River Bridge decision of 1837 when it found that the original charter granted to a bridge company to build a toll bridge over the Charles River in Boston did not preclude the eventual construction of a free bridge over the same river, even if the new bridge undercut the business of the toll bridge (and led to the loss of income by the stockholders in the bridge company). The decision, written by the new Chief Justice Roger B. Taney, overthrew the old Federalist notion that a corporate charter granted by the state amounted to an un-revocable privilege and opened the road to free competition, or, in this case, the construction of a public bridge to compete with a private – for profit – one.

Ironically, the legalization of the corporate form of organization also opened the road to the formation of trade unions, previously considered illegal associations. In his book *Democracy in America,* published in the early 1830s, the French aristocrat and traveler Alexis de Tocqueville noted the penchant of Americans for associations of all sorts. He saw in this tendency a uniquely American approach to social organizations. What in France would have been done by the government, or in England would have been sponsored by a group of prominent noblemen, came to be done in America by groups of citizens intent on carrying forward some project – whether to build a road, start a business, or to launch a temperance campaign. This same mentality applied to the creation of business corporations and tradesmen's unions soon produced a huge number of such associations.