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# SANTA CLARA REVISITED: THE DEVELOPMENT OF CORPORATE THEORY\*

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## I. INTRODUCTION

The 1886 decision of the United States Supreme Court in *Santa Clara Co. v. Southern Pacific Railroad*<sup>1</sup> has always been puzzling and controversial. From the time Progressive constitutional historians began to mount their attack on the Supreme Court after the *Lochner* decision in 1905,<sup>2</sup> the *Santa Clara* case became one of the prominent symbols of the subservience of the Supreme Court during the Gilded Age to the interests of big business.<sup>3</sup>

The *Santa Clara* case held that a corporation was a person under the fourteenth amendment, and thus entitled to its protection. That holding has been affirmed by the Supreme Court dozens of times, notwithstanding a famous announcement by Justices Black and Douglas in 1949 that recent historical writing had led them to conclude that the *Santa Clara* case was wrongly decided.<sup>4</sup> In our own time, in *First National Bank v. Bellotti*,<sup>5</sup> a five-to-four majority of the Supreme Court treated the *Santa Clara* case as if it in effect had already decided that corporations, like individuals, were entitled to the protection of the first amendment.<sup>6</sup> As far back as 1925, the Supreme Court assumed that the free speech clause was incorporated into the "liberty" protected by the fourteenth amendment.<sup>7</sup> In *Bellotti* the majority spoke as if it were simply axiomatic that the *Santa Clara* case settled the view that the free speech doctrine had been extended to corporations.<sup>8</sup>

For such a momentous decision, the opinion in the *Santa Clara* case is disquietingly brief—just one short paragraph—and totally without reasons or precedent. Indeed, it was made without argument of counsel. It declared:

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

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<sup>1</sup> *Santa Clara County v. Southern Pacific R.R.*, 118 U.S. 394 (1886).

<sup>2</sup> *Lochner v. New York*, 198 U.S. 45 (1905) (state regulations limiting the hours of employment in bakeries violates the right to freedom of contract guaranteed by U.S. Const. 14th amend.).

<sup>3</sup> See Graham, *Justice Field and the Fourteenth Amendment*, 52 YALE L.J. 851, 853 (1943); Graham, *The "Conspiracy Theory" of the Fourteenth Amendment*, 47 YALE L.J. 371, 403 (1938). See also C. BEARD, *CONTEMPORARY AMERICAN HISTORY: 1877-1913* 208, 210-13 (1936).

<sup>4</sup> *Connecticut Gen. Life Ins. v. Johnson*, 303 U.S. 77 (1938); *Wheeling Steel v. Glander*, 337 U.S. 562, *vacated*, U.S. Gypsum Co. v. Glander, 337 U.S. 951, *rev'd*, 337 U.S. 951 (1949).

<sup>5</sup> *First Nat'l Bank of Boston v. Bellotti*, 435 U.S. 765 (1978), *reh'g denied* 438 U.S. 907 (1978).

<sup>6</sup> *Id.* at 780 n.15.

<sup>7</sup> *Gitlow v. New York*, 268 U.S. 652 (1925).

<sup>8</sup> *Bellotti*, 435 U.S. at 778 n.14 (referring to Justice Rehnquist's dissenting opinion at 822). See *id.* at 780 n.15.

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.<sup>9</sup>

Can it be that so casual a declaration as this did in fact represent a major controversial step in American constitutional history? Did the decision actually represent a significant departure from American constitutional jurisprudence? I think not. The *Santa Clara* decision was not thought of as an innovation but instead was regarded as following a line of cases going back almost seventy years to the *Dartmouth College* case.<sup>10</sup>

But my interest in the *Santa Clara* case extends far beyond the question of whether it was consistent with previous constitutional decisions. Whatever the Supreme Court justices had in mind, the case is usually thought to express a new theory of the corporation or, as it soon became fashionable to call it, a new theory of corporate personality. The *Santa Clara* case is thus asserted to be a dramatic example of judicial personification of the corporation, which, it is argued, radically enhanced the position of the business corporation in American law.<sup>11</sup> There can be no doubt that recent cases like *Bellotti*, which recognizes a constitutional right of corporations to spend money to influence elections, *have* contributed enormously to the political and economic power of big business.

But the question remains whether the *Santa Clara* case did in fact proceed from a theory that the corporate entity was no different from the individual in its constitutional entitlements. To answer this question, I will attempt a long excursion into the history of the theories of the corporation that were prevalent when the *Santa Clara* case was decided. I hope to show, first, that the so-called "natural entity" or "real entity" theory of the corporation that the *Santa Clara* case is supposed to have adopted was nowhere to be found in American legal thought when the case was decided; second, that those who argued for the corporation as well as Supreme Court Justice Stephen Field, who decided in favor of the corporation in two elaborate circuit court opinions below,<sup>12</sup> clearly had no conception of a natural entity theory of the corporation; and, third, that when the natural entity theory emerged about a decade later, it was only then gradually absorbed into the *Santa Clara* precedent to establish dramatically new constitutional protections for corporations.

So initially, I wish to show not only that the real meaning of the *Santa Clara* decision has not been understood, but also that it did not express the pro-big-business theory of the corporation that only came to fruition shortly before the First World War.

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<sup>9</sup> *Santa Clara*, 118 U.S. at 396.

<sup>10</sup> *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

<sup>11</sup> Graham, *supra* note 3, 52 YALE L.J. at 853.

<sup>12</sup> *Santa Clara v. Southern Pac. R.R.*, 18 F. 385, 402-05 (C.C. Cal. 1883); *San Mateo v. Southern Pac. R.R.*, 13 F. 722, 746-48 (1882) (companion cases).

Yet, finally, this focus on the *Santa Clara* case and on the history of corporate theory is designed to explore a still more difficult question about the role of legal theory in legal decision. For almost forty years after 1890, American jurists, like their German, French, and English counterparts, were preoccupied with the theory of the corporation, or, as it was then frequently called, with corporate personality. Then the issue suddenly vanished from controversy. The last great analysis of the question, which is sometimes thought to have permanently put it to rest, appeared in a 1926 *Yale Law Journal* article,<sup>13</sup> by the philosopher John Dewey. Writing in sympathy with the powerful contemporaneous Legal Realist attack on "conceptualism,"<sup>14</sup> Dewey sought to show that theories of corporate personality were infinitely manipulable and that at different times the same theories had been used both to expand and to limit not only corporate but trade union powers. Let me quote Dewey's argument. "Each theory" of group personality he maintained "has been used to serve . . . opposing ends."

[I]t has been employed both to make the state the Supreme and culminating personality in a hierarchy, to make it but *primus inter pares*, and to reduce it to merely one among many. . . . Corporate groups less than the state have had real personality ascribed to them, both in order to make them more amenable to liability, as in the case of trade-unions, and to exalt their dignity and vital power, against external control. . . . The group personality theory has been asserted both as a check upon what was regarded as anarchic and dissolving individualism, to set up something more abiding and worthful than a single human being, and to increase the power and dignity of the single being as over against the state.<sup>15</sup>

There are very few discussions of corporate personality after Dewey. The Legal Realists in general had succeeded in persuading legal thinkers that highly abstract and general legal conceptions were simply part of what Felix Cohen, quoting von Jhering, derisively called "the heaven of legal concepts."<sup>16</sup> Only more concrete statements of functional relations, Cohen argued, were useful in deciding legal questions.

In our own time, the debate over concepts had revived once more within the Critical Legal Studies Movement, where one dominant trend had been to demonstrate the indeterminacy of concepts.<sup>17</sup> The issue is whether any abstract conception—"freedom" or "security" or "rights" are often used as examples—has any entailment in terms of more concrete legal doctrines or rules.<sup>18</sup>

By contrast, I will argue that most important controversial legal abstractions

<sup>13</sup> Dewey, *The Historical Background of Corporate Legal Personality*, 35 YALE L.J. 655 (1926).

<sup>14</sup> Fuller, *American Legal Realism*, 82 U. PA. L. REV. 429 (1934).

<sup>15</sup> Dewey, *supra* note 13, at 669-70.

<sup>16</sup> Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809 (1935).

<sup>17</sup> See, e.g., Dalton, *An Essay in Deconstruction of Contract Doctrine*, 94 YALE L.J. 997, 1006-07 (1985); Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1731-38 (1976); Singer, *The Player and the Cards: Nihilism and Legal Theory*, 94 YALE L.J. 1, 9-25 (1984); Unger, *The Critical Legal Studies Movement*, 96 HARV. L. REV. 561, 568-70 (1983).

<sup>18</sup> Kennedy, *The Structure of Blackstone's Commentaries*, 28 BUFFALO LAW REV. 205 (1979).

do have determinate legal or political significance. In the jargon of the current Critical Legal Studies debate, I wish to deny that legal conceptions are infinitely "flippable" and instead to insist that they do have "tilt" or influence in determining outcomes. Thus, for example, I wish to dispute Dewey's conclusion that particular conceptions of corporate personality were just as easily used to limit as to enhance corporate power. Instead, I hope to show that, for example, the rise of a "natural entity" theory of the corporation was a major factor in legitimating big business and that none of the other theoretical alternatives could provide as much sustenance to newly organized concentrated enterprise.

I do not wish to be understood to disassociate myself from those brilliant critical or Legal Realist attacks on legal reasoning.<sup>19</sup> The central thrust of the Realist legacy to which we are all still indebted ultimately derives from Holmes' classical statement, "General propositions do not decide concrete cases."<sup>20</sup> Holmes as well as John Dewey and Felix Cohen after him were attacking the formalist claim that one could deductively and without discretion reason from a general concept to a particular application. As a matter of legal *logic* their attack on formalism continues to be as powerful today as it was fifty years ago. But their attempt to discredit the then orthodox claim to a non-political, non-discretionary mode of legal *reasoning* led them to ignore the obvious fact that when abstract conceptions are used in specific historical contexts they have more limited meanings and more specific argumentative functions. We have spent too much effort repeating the demonstrations of the indeterminacy of concepts in a logical vacuum; but not enough time trying to show that in particular contexts the choice of one theory over another is not random or accidental because history and usage have limited their deepest meanings and applications.

## II. THE SANTA CLARA CASE IN CONTEXT

### A. *The Real Meaning of the Santa Clara Decision*

The *Santa Clara* case, along with several companion cases, came to the United States Supreme Court from California.<sup>21</sup> They presented the question whether the equal protection clause of the fourteenth amendment barred California from taxing corporate property—in this case railroad property—differently from individual property.

These California tax cases were clearly regarded as important and momentous events in giving meaning to the newly enacted fourteenth amendment. Above all, they represented another effort mounted by business interests after their narrow

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<sup>19</sup> Cohen, *The Ethical Basis of Legal Criticism*, 41 YALE L.J. 201, 215-19 (1931); Dewey, *Logical Method and Law*, 10 CORNELL L. REV. 17 (1924).

<sup>20</sup> *Lochner*, 198 U.S. at 76 (1905).

<sup>21</sup> *San Mateo*, 13 F. 745; *Sacramento v. Central Pac. R.R.*, 18 F. 385 (1883) (for taxes of 1882); *California v. Northern Ry.*, 18 F. 385 (1883); *California v. Central Pac. R.R.*, 18 F. 385 (1883); *California v. Southern Pac. R.R.*, 18 F. 285 (1883); *Santa Clara*, 18 F. 385.

failure to get the Supreme Court to broadly construe the fourteenth amendment in the *Slaughterhouse Cases*.<sup>22</sup> In that decision, Justice Samuel Miller, speaking for a five man majority not only offered an extremely narrow construction of the "privileges and immunities" clause but he also construed the "equal protection clause" as limited to protecting the status of recently freed slaves. In dissent, Justice Stephen Field, who argued for a much more expansive definition of each of the provisions of the fourteenth amendment, sought, in effect, to create a general federal charter of constitutional rights.<sup>23</sup>

The central issue in the *Slaughterhouse* case was whether the fourteenth amendment had radically altered the constitutional relationship between the states and the federal government. Justice Miller's "race theory" interpretation of the fourteenth amendment reinforced traditional fears of centralized power and was meant to produce as little change in the federal balance of power as possible. By contrast, Justice Field interpreted the fourteenth amendment as ratifying a dramatic alteration in the federal system as a consequence of the Civil War.<sup>24</sup>

So when the California tax cases came before Justice Field, sitting on circuit, the most basic and controversial question before him was whether it was possible after the *Slaughterhouse* decision to construe the equal protection clause to extend to non-race related questions. The central thrust of his decision was to continue his battle, which was eventually successful, to expand the meaning of the amendment beyond the boundaries of race relations. Indeed, the real significance of the Supreme Court's decision in *Santa Clara* may be precisely that it did go beyond Justice Miller's *Slaughterhouse* effort to confine the scope of the equal protection clause.

But our inquiry needs to focus elsewhere. How did Justice Field justify applying the equal protection clause to corporations when the language of the amendment was written to protect "persons."

Let us turn to the major argument in the brief on behalf of the corporation before the United States Supreme Court. Written by the eminent California lawyer, John Norton Pomeroy, the central argument was that the fourteenth amendment protects the property rights not of some abstract corporate entity but rather of the individual shareholders. As Pomeroy declared in his brief, provisions of state and federal constitutions "apply . . . to private corporation, not alone because such corporations are 'persons' within the meaning of that word, but because *statutes violating their prohibitions in dealing with corporations must necessarily infringe upon the rights of natural persons*. In applying and enforcing these constitutional guaranties, *corporations cannot be separated from the natural persons who compose them.*"<sup>25</sup>

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<sup>22</sup> The Slaughterhouse Cases, 83 U.S. (16 Wall.) 36 (1873).

<sup>23</sup> *Id.* at 100-01.

<sup>24</sup> *Id.* at 104-05.

<sup>25</sup> Argument for Defendant, *San Mateo v. Southern Pac. R.R. Co.*, 116 U.S. 138 (1882) (collected in *Cases and Points* at 12 (available in Harvard Law School Library)) (emphasis in original).

“That this conclusion *must* be true,” Pomeroy argued, “appears from the following principle:”

Whatever be the legal nature of a corporation as an artificial, metaphysical being, separate and distinct from the individual members, and whatever distinctions the common law makes, in carrying out the technical legal conception, between property of the corporation and that of the individual members, still in applying the fundamental guaranties of the constitution, and in thus protecting rights of property, *these metaphysical and technical notions must give way to the reality.* The truth cannot be evaded that, *for the purpose of protecting rights, the property of all business and trading corporations IS the property of the individual corporators.* A State act depriving a business corporation of its property without due process of law, does in fact *deprive the individual corporators of their property.* In this sense, and within the scope of these grand safeguards of private rights, there is no real distinction between artificial persons or corporations, and natural persons.<sup>26</sup>

Justice Field made exactly the same point in his circuit court opinion in the companion *San Mateo* case:<sup>27</sup>

Private corporations are it is, true artificial persons, but . . . they consist of aggregations of individuals united for some legitimate business. . . .It would be a most singular result if a constitutional provision intended for the protection of every person against partial and discriminating legislation by the states, should cease to exert such protection the moment the person becomes a member of a corporation. . . .On the contrary, we think that it is well established by numerous adjudications of the Supreme Court of the United States . . . that whenever a provision of the constitution, or of a law, guarantees to persons the enjoyment of property . . . the benefits of the provision extend to corporations, and that the courts will always look beyond the name of the artificial being to the individuals whom it represents.

The arguments of Pomeroy and Field are very different from a “real entity” or “natural entity” theory of corporate personality that is often ascribed to the *Santa Clara* case but which in fact only emerged some time after *Santa Clara* was decided. Only this later theory can truly be said to personify the corporation and treat it “just like individuals.”

#### B. *Corporate Theory in the Late Nineteenth and Early Twentieth Centuries*

The theory of corporate personality attributed to the *Santa Clara* case—the natural entity theory—was not really available at the time the case was decided. This is clear after reviewing the American legal struggle to reconceptualize the corporation and the philosophical debates that arose in the late nineteenth and early twentieth century on the nature of corporate personality.

<sup>26</sup> *Id.* at 10 (emphasis in original).

<sup>28</sup> *San Mateo*, 13 F. at 743-44.

## 1. The Philosophical Debates

There was a flood of writing on the subject of "corporate personality" in Germany, France, England, and America near the turn of the century. Why should so metaphysical a subject, even if it attracted the speculative instincts of German and French jurists, have appealed to the practical, earth-bound sensibilities of English and American legal thinkers?

The intellectual history of the subject is quite clear. It was introduced into Western thought by the publication of the German legal theorist Otto Gierke's great 1887 book on the history of associations in German legal theory.<sup>28</sup> By 1900, there were dozens of books written in French and German on "group personality," "corporate personality," or, as the French liked to call it, "moral personality."<sup>29</sup> It became accessible to English and American thinkers after 1900 when Maitland, the great English legal historian, published a portion of Gierke's work under the title, *Political Theories of the Middle Age*,<sup>30</sup> to which Maitland contributed an introduction. Between 1900 and 1904 Maitland published four other articles on the early history of corporations, culminating in his paper, "Moral Personality and Legal Personality,"<sup>31</sup> which sought to advance Gierke's idea that corporations were "real" or "natural" entities that possessed legal personalities deserving of recognition. In America, Gierke's work was first noticed by German-born and trained University of Chicago Professor Ernst Freund, who in 1897 published *The Legal Nature of the Corporation*.<sup>32</sup>

If the intellectual history of the subject is relatively clear, the question remains why so abstruse an inquiry should have engaged the attention of Anglo-American lawyers? Maitland, wrongly it turns out, lamented the fact that the English could not care less. He wondered, "Why we English people are not interested in a problem that is being seriously discussed in many other lands," and his article, "Trust and Corporation,"<sup>33</sup> sought to explain how the Trust "enabled us to construct bodies which were not technically corporations and which yet would be sufficiently protected from the assaults of individualistic theory."<sup>34</sup>

Americans, in fact, were especially receptive to questions involving group theory. Even before Gierke was known or Maitland's writings had crossed the Atlantic, American legal thinkers had begun to wrestle with the problem of conceptualizing group personality, and, in particular, the corporation. Beginning in the 1890s they too sought to develop a picture of the corporation as a "real" or "natural" entity

<sup>28</sup> O. GIERKE, *DAS DEUTSCHE GENOSSENSCHAFTSRECHT* (1887).

<sup>29</sup> For a good bibliography, see 4 R. POUND, *JURISPRUDENCE* 200-01 (1959) (unnumbered note).

<sup>30</sup> O. GIERKE, *POLITICAL THEORIES OF THE MIDDLE AGE* (F.W. Maitland ed. 1900).

<sup>31</sup> F.W. MAITLAND, *COLLECTED PAPERS* (H.A.L. Fisher ed. 1911).

<sup>32</sup> E. FREUND, *THE LEGAL NATURE OF CORPORATIONS* (1897).

<sup>33</sup> 3 F.W. MAITLAND, *supra* note 31, at 321.

<sup>34</sup> *Id.* at 317.



as well as to explain or justify the inscrutable holding of the United States Supreme Court in the *Santa Clara* case.

What united all of these inquiries, whether German, French, English, or American, was the spectacular rise to prominence during the late nineteenth century of the business corporation as the dominant form of economic enterprise. In 1890, Justice Stephen Field estimated that three-quarters of the wealth of the United States was controlled by corporations.<sup>35</sup> This growth in the corporate form of economic enterprise presented essentially two fundamental challenges to traditional Western legal theory. First, in all of these countries the corporation was treated as a "legal fiction" or an "artificial entity" created by the state. Gierke and his successors devoted themselves to showing that the corporation—indeed, group activity generally—was "real" and "natural," not "artificial" or "fictional." The proponents of Realism ranged all the way from overt apologists for big business, whose primary objective was to free the corporation from a theory that justified special state regulation, to those who for a variety of reasons wished to attack nineteenth century liberal individualism.

The challenge to individualism produced a second fundamental set of questions. On the continent, individualism was under attack, first, by romantic conservatives, who loathed the atomistic features of modern industrial life and yearned for a return to a pre-commercial, organic society composed of medieval status and hierarchies.<sup>36</sup> They were joined in their attacks by socialists who wished to transcend the anti-collectivist categories of liberal social and legal thought.<sup>37</sup> While the attack focused on the rise of corporations, it also sought to take account of the recent prominence of labor unions and trade and professional associations.<sup>38</sup> And even Maitland, whose legal history was devoted to affirming the liberal vision of individual property holding against the collectivist historians' search for pre-modern forms of communal property,<sup>39</sup> promoted the real entity theory and sympathetically regarded the trust as a fictional device covertly designed to evade "the assaults of individualistic theory."<sup>40</sup>

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<sup>35</sup> See 1 S. THOMPSON, COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS VI (1st ed. 1895) (preface).

<sup>36</sup> Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1057, 1083-90 (1980).

<sup>37</sup> Laski, *The Personality of Associations*, 29 HARV. L. REV. 404 (1916); See generally W.Y. ELLIOTT, THE PRAGMATIC BASIS OF POLITICS (1928).

<sup>38</sup> See R. WIEBE, THE SEARCH FOR ORDER: 1877-1920 (1967); Galambos, *Technology, Political Economy, and Professionalization: Central Themes of the Organizational Synthesis*, 57 BUS. HIST. REV. (1983); Galambos, *The Emerging Organizational Synthesis in Modern American History*, 44 BUS. HIST. REV. (1970).

<sup>39</sup> I.P. VINOGRADOFF, OUTLINES OF HISTORICAL JURISPRUDENCE 147-48 (1920); White & Vann, *The Invention of English Individualism*, 8 SOCIAL HISTORY 345, 352-54 (1983); D. SUGARMAN & G.R. RUBIN, *Towards a New History of Law and Material Society in England, 1750-1914* in *Law, Economy and Society* 28-30 (1984) (Rubin & Sugarman eds.)

<sup>40</sup> F.W. MAITLAND, *supra* note 30, at 317.

The corporation, in short, was the most powerful and prominent example of the emergence of non-individualistic or, if you will, collectivist legal institutions. The artificial entity theory of the corporation, by contrast, sought to retain the premises of what has been called "methodological individualism," that is, the view that the only real starting point for political or legal theory is the individual. Groups, in this view, were simply artificial aggregations of individuals. On the other hand, it was the goal of the Realists to show that groups, in fact, had an organic unity, that the group was greater than the mere sum of its parts. In all the Western countries, therefore, theories of corporate personality were associated with a crisis of legitimacy in liberal individualism arising from the recent emergence of powerful collective institutions.

## 2. The American Legal Struggle to Reconceptualize the Corporation

By the late nineteenth century in America, fundamental changes had already taken place in the legal treatment of the corporation. First, and by far the most important, was the erosion of the so-called "grant" or "concession" theory of the corporation, which treated the act of incorporation as a special privilege conferred by the state for the pursuit of public purposes.<sup>41</sup> Under the grant theory, the business corporation was regarded as an "artificial being" created by the state with powers strictly limited by its charter of incorporation. As we shall see, a number of more specific legal doctrines were also derived from the grant theory in order to enforce the state's interest in limiting and confining corporate power.

The political mechanism used to enforce the grant theory was the special charter of incorporation, passed by the state legislature after negotiation between private interests and the state. During the Jacksonian period, special charters were denounced for their encouragement of legislative bribery, political favoritism, and, above all, monopoly. As a result, the movement for "free incorporation" laws that would break the connection between the act of incorporation and political favoritism and corruption triumphed between 1850 and 1870.<sup>42</sup> Gradually, by making the corporate form universally available, free incorporation undermined the grant theory. Incorporation eventually came to be regarded not as a special state-conferred privilege but as a normal and regular mode of doing business.

The problem faced by legal thinkers during the late nineteenth century was how to reconceptualize the corporation after the demise of the grant theory. On one hand, free incorporation provided the opportunity to treat the corporation under ordinary contractual categories familiar to partnership law. On the other hand,

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<sup>41</sup> *Dartmouth College*, 17 U.S. (4 Wheat.) at 636 quoted in J. HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780-1970* 9 (1970).

<sup>42</sup> *Id.*

many of the special attributes<sup>43</sup> of the corporation could not be explained or defended by partnership analogies. As a result, during the last quarter of the nineteenth century, the legal literature is filled with discussions of the nature of the corporation—whether, like a partnership, it is a mere “aggregate” of individuals or whether, instead, it is an “entity,” separate from the individuals who compose it.

Up through the 1880s, there was a strong tendency to analyze corporation law not very differently from the law of partnership.<sup>44</sup> Indeed, many of the rules involving the internal governance of the corporation were borrowed from partnership law, the most important of which was the requirement of shareholder unanimity for “fundamental” changes in corporate purpose.<sup>45</sup> Moreover, the erosion of the grant theory seemed to leave no choice but to create a conception of the corporation with powers flowing from the bottom up—from shareholders to directors to officers. This basic model of the corporation, emphasizing the property rights of shareholders, is the one put forth in *Santa Clara* by John Norton Pomeroy and Justice Field.

Later, shortly before the First World War, the partnership conception could not equally accomplish the task of legitimation when the court turned to less material, less property-centered claims of corporate constitutional rights against unreasonable search and seizure and self-incrimination. Here, it was difficult to reduce the constitutional claim of the corporation to the constitutional rights of the shareholders. In constitutional law, therefore, the first Supreme Court “natural entity” opinion was the 1905 decision in *Hale v. Henkel*<sup>46</sup> extending fourth amendment protections to the corporation. But the Court’s continuing reluctance to entirely personify the corporation is underlined by its decision in the same case refusing to extend fifth amendment protection against self-incrimination to corporations.

Despite the Supreme Court’s continued hesitancy, by 1900, the “entity” theory had largely triumphed and corporation and partnership law had moved in radically different directions. The success of legal thinkers in reconceptualizing the corporation seems to have had important consequences for the legitimacy of the corporate entity.

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<sup>43</sup> See *infra* note 53 and accompanying text.

<sup>44</sup> See *infra* notes 146-150 and accompanying text.

<sup>45</sup> See *infra* note 120 and accompanying text.

<sup>46</sup> *Hale v. Henkel*, 201 U.S. 43 (1905). As late as 1904, the Supreme Court declared: “A corporation, while by fiction of law recognized for some purposes as a person, and for purposes of jurisdiction as a citizen, is not endowed with the inalienable rights of a natural person.” *Northern Securities Co. v. United States*, 193 U.S. 197, 362 (1904). And in 1906 it stated that “the liberty guaranteed by the fourteenth amendment against deprivation without due process of law is the liberty of natural, not artificial, persons.” *Western Turf Assoc. v. Greenberg*, 204 U.S. 359, 363 (1906) (citing *Northwestern Life Ins. Co. v. Riggs*, 203 U.S. 243, 255 (1906)).

This way of thinking began to crumble with *Hale*, 201 U.S. 43, and was finally put to rest in 1910 in a series of “unconstitutional conditions” cases involving foreign corporations. See *infra* note 71, and G. HENDERSON, *infra* note 67, at 132-47.

The triumph of the entity theory parallels another development in late nineteenth century corporate law—the tendency to shift power away from shareholders, first in favor of directors and later to professional managers.<sup>47</sup> By contrast, in 1875, by analogy to the partnership, American law tended to conceive of directors as agents of shareholders. After 1900, however, directors were more frequently treated as equivalent to the corporation itself.<sup>48</sup> This realignment of legal powers within the corporation thus made the entity theory ever more plausible. In turn, the entity theory produced court decisions that promoted oligarchical tendencies within the business corporation.

The collapse of the grant theory eventually produced the best of all possible worlds for the expansion of corporate power. By rendering the corporate form normal and regular, late nineteenth century corporate theory shifted the presumption of corporate regulation against the state. Since corporations could no longer be treated as special creatures of the state, they were entitled to the same privileges as all other individuals and groups. While the state thus lost any special claims—arising out of the original theory of corporate creation—to regulate corporations, the once powerful grant theory did make it easier to continue to conceive of the corporation as a supra-individualistic entity. As a result, late nineteenth century entity theorists drew on the early history of corporations to justify their assertion of its organic and collective nature at the same time as they disavowed the completely subordinate position that that theory had created for the corporation.

Thus, one can clearly see that the natural entity theory of the corporation ascribed to the *Santa Clara* case was only just being formulated at the turn of the century. In 1886 corporate theory was in a state of flux both legally and intellectually and the natural entity theory really was not yet available to justify the holding in the *Santa Clara* case. It was only afterwards that theorists began to recognize the reality of corporate growth.

### III. THE CONCEPT OF CORPORATE PERSONALITY AND ITS DETERMINATE LEGAL SIGNIFICANCE

#### A. *Corporate Personality*

The corporation occupied an anomalous position in American law throughout the nineteenth century. In a legal system whose categories were built around individual activity, it was not at all easy to assimilate the behavior of groups. Inherently individualistic legal conceptions like “fault” and “will” were difficult to apply to corporations. “How is it possible,” Ernst Freund asked in 1897, “upon any other basis [than the individual person], to deal with notions that are constantly

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<sup>47</sup> A. CHANDLER, *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* 161 (1983).

<sup>48</sup> See *infra* note 202 and accompanying text.

applied to the holding of rights, and which explain their most important incidents: intention, notice, good and bad faith, responsibility? How can we establish, unless we have to deal with individuals, the internal connection between act and liability?"<sup>49</sup>

Any conception of corporate rights, Freund emphasized, would involve "a departure from well-settled principles."

If the individual, private, and beneficial right is to measure and govern all rules relating to rights of whatsoever nature, then the corporate right will continue to be abnormal and illogical. If, on the other hand, we emancipate ourselves from the absolute recognition of one form of right as orthodox, . . . we may well arrive at the conclusion, that in dealing with associations of persons we must modify the ideas which we have derived from the right of property in individuals, and what has first seemed to be an anomaly will appeal simply as another but equally legitimate form of development.<sup>50</sup>

The corporation also stood in clear contradiction to a legal culture dominated by Lockean ideas of pre-social natural rights. In post-revolutionary America, there was no better example of the social creation of property than the chartered business corporation. As natural rights theories grew in power and scope after the Civil War,<sup>51</sup> the corporation thus seemed to constitute a standing contradiction to any claims to the pre-social character of property rights.

Three conceptions of the legal organization of the corporation competed for dominance after 1880. The traditional conception, derived from the ante-bellum grant theory, as well as older English corporation law, characterized the corporation as "an artificial entity created by positive law."<sup>52</sup> But as the movement for free incorporation eroded the force of the grant theory, two other conceptions of the corporation began to emerge with radically different implications for the development of corporation law. In substantially different ways, these two newer theories sought to convey the idea that incorporation was a normal and natural mode of business organization, not a special privilege bestowed by the state.

In reaction to the grant theory, some legal writers during the 1880s began to put forth a polar opposite conception of the corporation as a creature of free contract among individual shareholders, no different, in effect, from a partnership.

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<sup>49</sup> E. FREUND, *supra* note 32, at 10.

<sup>50</sup> *Id.* at 48.

<sup>51</sup> See generally C.G. HAINES, *THE REVIVAL OF NATURAL LAW CONCEPTS* (1930).

<sup>52</sup> The most dramatic, largely because it seems so out of place, is Chief Justice Marshall's effort in *Bank of United States v. Devereux*, 9 U.S. (5 Cranch) 61 (1809) to base the diversity jurisdiction of corporations on the residence of its shareholders. By the 1840s this approach was abandoned with the conclusive presumption that the shareholders were citizens of the state of incorporation. *Louisville R.R. v. Letson*, 43 U.S. (2 How.) 497 (1844). A more far reaching act of disaggregation—which remained ambiguous and muted—was the implied distinction in the *Dartmouth College* case between, on the one hand, the artificial and socially created corporation and, on the other hand, the vested rights of the shareholders. See also J. HURST, *supra* note 41, at 15-22.

In this conception, the corporation was not a creature of the state but of individual initiative and enterprise. It was "private," not "public."

A third theory which emerged during the 1890s also sought to represent the corporation as private, yet neither as "artificial," "fictional," nor as a creature of the state. This "natural entity" theory soon began to be projected onto the ambiguous opinion of the Supreme Court in the *Santa Clara* case.

The term "corporate personality" is itself an important clue to the intellectual crisis. The "aggregate" or contractual view of the corporation seemed capable of restricting corporate privileges and, in particular, the rule of limited liability. That there was a close relationship between the justification for limited liability and a conception of the corporation as a separate (though "artificial") entity distinct from its shareholders was clear to Chief Justice Taney as early as 1839. If the entity were disregarded, Taney wrote,

and . . . the members of a corporation were to be regarded as individuals carrying on business in their corporate name, and therefore entitled to the privileges of citizens in matters of contract, it is very clear that they must at the same time take upon themselves the liabilities of citizens and be bound by their contracts in like manner. The result of this would be to make a corporation a mere partnership in business, in which each stockholder would be liable to the whole extent of his property for the debts of the corporation; and he might be sued for them in any state in which he might happen to be found.<sup>53</sup>

Not only did Taney believe that there was a logical connection between an entity theory and limited liability; he also maintained in perfectly straightforward Jacksonian fashion that every effort of corporations to claim that they were constitutionally "entitled to the privileges of citizens" would erode the entity theory by forcing courts to turn to the rights of shareholders. There was a trade-off, he supposed, between the grant of corporate privileges and the claim of shareholder constitutional rights. He could not yet even imagine that the fictional entity itself could plausibly claim constitutional privileges. The effort to protect corporate property in *Santa Clara* through a conception of shareholder rights thus raised precisely the danger that Chief Justice Taney identified—it might undermine the justification for limited liability.

The effort of some legal thinkers beginning in the 1880s to treat the corporation as no different from a partnership was reinforced in a series of anti-consolidation cases in which courts looked behind the corporate entity to treat the shareholders as the real legal actors in the corporation. The most famous of these cases was the attack on the Standard Oil Trust by the State of Ohio.<sup>54</sup> Ohio brought *quo warranto* proceedings against the Standard Oil Company, maintaining that it had acted beyond its corporate powers in joining the trust. Since a majority of the

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<sup>53</sup> *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519, 586 (1839).

<sup>54</sup> *State v. Standard Oil Co.*, 49 Ohio St. 137, 30 N.E. 279 (1892).

individual shareholders had voted to transfer their stock to the trust, the corporation maintained that only the shareholders, not the corporation, had acted. In piercing the corporate veil, Ohio Supreme Court Justice Minshall treated the idea "that a corporation is a legal entity apart from the natural persons who compose it" as "a mere fiction."

It appears that the intense efforts of most judges and legal writers during the 1880s and 1890s to equate the corporation with its stockholders was motivated by a delegitimizing strategy, deriving from anti-corporate and anti-consolidation sentiment. Of course, the defendants of corporate property in *Santa Clara* also made use of this theory, which seemed to them at the time more favorable to the corporation than the traditional "artificial entity" theory. Yet, given the structure of American legal ideas, it may have seemed the only way to turn once the implications of the demise of the grant theory rendered the entity conception of the corporation more problematic.

#### B. *Ultra Vires*

[U]nfortunately, there is now in this country a newer growth of corporation lawyers and authors, fostered and fashioned in the same school, who would confuse the subject by regarding the rights, duties and powers of a corporation as identical with the rights, duties and powers of the individuals composing it. To recognize such an anomalous position would clearly nullify, in great measure, the whole doctrine of *ultra vires*.

Reuben A. Reese, *The True Doctrine of Ultra Vires in the Law of Corporations* (1897)<sup>55</sup>

The doctrine that a corporation cannot act beyond its legal competence is perhaps the best reflection of the traditional legal conception of the nature of the corporation. At one pole, to the extent that the corporation is fully thought of as an artificial entity created by the state, we would expect courts strictly to construe powers granted in the corporate charter and refuse effect to corporate activity regarded as beyond the powers conferred. At the opposite pole, to the extent that a corporation is regarded simply as a convenient device for conducting business activity, not as a privilege or concession derived from the state, we would expect the death of the *ultra vires* doctrine.

Before the Civil War, in fact, the *ultra vires* doctrine was strictly applied by American courts, thereby voiding most transactions held to be outside the grant of a corporation's powers.<sup>56</sup> By 1930, the *ultra vires* doctrine was, if not dead,

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<sup>55</sup> R. REESE, *THE TRUE DOCTRINE OF ULTRA VIRES IN THE LAW OF CORPORATIONS* 2 (1897).

<sup>56</sup> See Colson, *The Doctrine of Ultra Vires in United States Supreme Court Decisions* 1, 42 W. VA. L.Q. 179, 184-89 (1936).

substantially eroded in practice,<sup>57</sup> reflecting the triumphant view that corporate organization was a normal and natural form of business activity.

During the half century after 1880 we can trace the tension between those doctrines that reflected the old vision of corporate powers as a state-conferred privilege and the emergence of newer theories designed to represent the corporation as a "natural" form of business organization. It also represents one of many technical expressions of the conflict over political economy between small entrepreneurs and emergent big business over the legitimacy of large scale enterprise. In this setting, the doctrine of *ultra vires* provides us with one measure of conflict.

At first glance, the doctrine of *ultra vires* was still a powerful judicial tool as late as 1900, despite the seemingly contrary message of state general incorporation laws, which had become the norm between 1850 and 1870. Yet there was still a long ideological distance to travel between the first general incorporation laws, which continued to impose many restrictions on corporate financing and structure, and the New Jersey incorporation law, first enacted in 1889, whose major premise was that a corporation could do virtually anything it wanted.<sup>58</sup> Even within the context of early general incorporation, therefore, the state did not entirely renounce its role as creator and regulator.

While judicial decisions during the last decades of the nineteenth century thus continued to invoke the *ultra vires* doctrine and its underlying conception of the corporation as an artificial entity, many important changes in corporation law had strengthened the view that the *ultra vires* doctrine was an anachronism "now honored more in the breach than in the observance."<sup>59</sup> Even in jurisdictions that still dealt harshly with *ultra vires* acts, the definition of legitimate corporate powers had for a long time been expanding. "The courts," wrote William W. Cook in his 1894 treatise on corporation law, "are becoming more liberal, and many acts which fifty years ago would have been held to be *ultra vires* would now be held to be *intra vires*. The courts have gradually enlarged the *implied* powers of ordinary corporations until now such corporations may do almost anything that an individual may do, provided the stockholders and creditors do not object."<sup>60</sup>

Even concededly *ultra vires* activity had begun to receive recognition by the courts. Since corporations already had been made liable in tort as well as prosecuted criminally for *ultra vires* acts, the doctrine had increasingly reflected considerable internal contradiction. The exceptions, many commentators noted, were beginning to eat up the rule. Even within the last remaining bastion of the *ultra vires* rule, the law of contracts, courts after the Civil War had begun a retreat. While they

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<sup>57</sup> *Id.*

<sup>58</sup> See *infra* note 95.

<sup>59</sup> 5 S. THOMPSON, *supra* note 35, at 4629.

<sup>60</sup> I W. COOK, TREATISE ON STOCK AND STOCKHOLDERS, BONDS, MORTGAGES, AND GENERAL CORPORATION LAW 971-73 (3rd ed. 1894).



continued to refuse to enforce "executory" contracts—those where neither party had performed—they now refused to intervene to upset property rights acquired under "executed" ultra vires contracts. By the 1880s, the majority of state courts had gone one step further to enforce even contracts that, despite lack of corporate power, had been performed by one side to the agreement.<sup>61</sup> Yet, the United States Supreme Court, after a short flirtation with a "liberalized" ultra vires rule during the 1870s, became the most ardent defender of traditional doctrine, consistently rejecting the majority view that partially performed contracts could be enforced.<sup>62</sup> Until at least 1930, the Supreme Court continued to resist the trend of state decisions<sup>63</sup> as well as the appeals of legal scholars for relaxing ultra vires limitations.<sup>64</sup>

The contradictions and inconsistencies in ultra vires doctrine were becoming unmanageable. "The doctrine of *ultra vires* is disappearing," wrote William W. Cook in 1898. "The old theory that a corporate act beyond the express and implied corporate powers was illegal and not enforceable, no matter whether any actual injury had been done or not, has given way to the practical view that the parties to a contract which has been partially or wholly executed will not be allowed to say it was *ultra vires* of the corporation."<sup>65</sup> While judges thus continued to sound like ante-bellum grant theorists when they were deciding executory contract cases, the vitality and coherence of the grant theory and the regulatory premises that underlay it had long been eroded.

### C. Foreign Corporations

Despite the advent of general incorporation laws by the 1870s, we have seen that the Supreme Court continued into the twentieth century to treat the corporation as an artificial entity subject to ultra vires constraints.<sup>66</sup> It was only a series of state corporation statutes buttressed by Legal Realist attacks that finally destroyed most ultra vires limitations during the 1920s.

A second set of doctrines provides another measure of the gradual shift in the conception of the corporation from an artificial to a real or natural entity.

<sup>61</sup> 5 S. THOMPSON, *supra* note 35, at 4664-78.

<sup>62</sup> Compare *National Bank v. Matthews*, 96 U.S. 258 (1877) and *San Antonio v. McHaffy*, 96 U.S. 312 (1877) with *Thomas v. West Jersey R.R.*, 101 U.S. 71 (1879); See also *Colson*, *supra* note 56, at 207-09, 213 (1936).

<sup>63</sup> See *Colson*, *The Doctrine of Ultra Vires in United States Supreme Court Decisions* II, 42 W. VA. L.Q. 297, 330 (1936).

<sup>64</sup> See *Carpenter*, *Should the Doctrine of Ultra Vires be Discarded?*, 33 YALE L.J. 49 (1923).

<sup>65</sup> 1 W. COOK, *TREATISE ON THE LAW OF CORPORATIONS HAVING A CAPITAL STOCK*, vii-viii (4th ed. 1898). "In the federal courts . . . the old rule against *ultra vires* contracts is upheld in all its rigor and applied with all its severity. The tendency of modern jurisprudence to relax on that subject finds no favor in the federal courts" (7th ed. 1913).

<sup>66</sup> See *Colson*, *supra* notes 56 and 63.

They deal with the power of a state to exclude foreign corporations—corporations chartered in another state—from doing business within its boundaries.

The “original fountain head of the law of foreign corporations”<sup>67</sup> was Chief Justice Taney’s decision in *Bank of Augusta v. Earle*<sup>68</sup> (1839), which represents as clear a statement of the artificial entity theory as any in American law. The corporation “exists only in contemplation of law, and by force of the law,” wrote Taney. Since it is “a mere artificial being” of the state of its creation, “where that law ceases to operate, and is no longer obligatory, the corporation can have no existence.”<sup>69</sup> Thus, a state was not constitutionally obliged to allow foreign corporations to do business within its boundaries.

The doctrine of *Bank of Augusta v. Earle* was vigorously reaffirmed after the Civil War<sup>70</sup> and continued to find favor in the United States Supreme Court throughout the nineteenth century, even in the face of the Court’s assumption that the corporation was a “person” under the fourteenth amendment. By the end of the nineteenth century, however, there were signs of increasing strain not only between an expanding Supreme Court protection of interstate commerce and the foreign incorporation doctrine but also between the latter and the natural entity conception that was emerging in legal thought. And yet it was only in a group of cases in 1910 that the Supreme Court really put to rest the doctrine of *Bank of Augusta v. Earle*.<sup>71</sup> From that time on, expanding fourteenth amendment protections of the corporation swept aside Taney’s vision of the business corporation as an artificial creature of the state.

As with the history of ultra vires, we see that it was not the Supreme Court of the Gilded Age that renounced the artificial entity theory of the corporation but rather the judges and legal writers of the early twentieth century who came to understand the corporation as a normal and natural mode of doing business. And, as we shall see, it was a group of Legal Realist legal thinkers who developed and articulated this new conception of the corporation.

From the era of general incorporation onward, legal writers commented on the disparity between the reality of free incorporation and those “artificial” and “unrealistic” restrictions on corporate power that continued to derive from the ante-bellum grant theory. Yet, in the Supreme Court, an “old” conservative majority perpetuated the Jacksonian tradition of competitive capitalism and suspicion of

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<sup>67</sup> G. HENDERSON, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW 42 (1918).

<sup>68</sup> *Bank of Augusta*, 38 U.S. at 587-88.

<sup>69</sup> *Id.* at 588.

<sup>70</sup> *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868).

<sup>71</sup> *Western Union Telegraph Co. v. Kansas*, 216 U.S. 1 (1910); *Pullman Co. v. Kansas*, 216 U.S. 56 (1910); *Ludwig v. Western Union Telegraph Co.*, 216 U.S. 146 (1910); *Southern Ry. v. Greene*, 216 U.S. 400 (1910).

corporate power<sup>72</sup> not only by continuing to invoke legal doctrines derived from the artificial entity theory but by giving a strict literalist reading to the Sherman Anti-Trust Act.<sup>73</sup> Around 1910 or 1911, the "new" conservatives finally overthrew the strict construction of the Sherman Act in the *Standard Oil* case;<sup>74</sup> they also reversed those doctrines in corporation law based on a conception of the corporation as a creature of the state.

#### D. The "Inevitability" of Concentration

Are the large combination of capitalists and corporations known as "trusts" a logical and therefore proper development of the present economic system, or are they abnormal excrescences that can and should be eradicated by legislation?

Question to Professor William W. Folwell of the University of Minnesota by a Committee of the Minneapolis Socialist Labor Party (1888).<sup>75</sup>

The efforts by legal thinkers to legitimate the business corporation during the 1890s were buttressed by a stunning reversal in American economic thought—a movement to defend and justify as inevitable the emergence of large-scale corporate concentration.

Until the late 1880s, prevailing American economic thought refused to accept either the inevitability or the naturalness of large-scale concentrations of capital. Most discussion of the "monopoly problem" during the 1870s and early 1880s focused on the railroad, which was treated as something of a special case.<sup>76</sup> Whether defenders and opponents of railroad consolidation emphasized the "overproduction" of lines after the Civil War or whether they argued about a "natural monopoly" analysis of the railroad, they tended to regard the problem as unique. Before the late 1880s, few saw in the railroad problem any more general pattern of industrial concentration.

Popular attention began to be drawn to the question of industrial concentration with the publication of Henry D. Lloyd's muckraking articles on monopoly.

<sup>72</sup> Horwitz, *Progressive Legal Historiography*, 63 OR. L. REV. 679 (1984).

<sup>73</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897); *United States v. Joint Traffic Ass'n*, 171 U.S. 505 (1898); *Hopkins v. United States*, 171 U.S. 578 (1898); *Anderson v. United States*, 171 U.S. 604 (1898); *Addyston Pipe & Steel Co. v. United States*, 175 U.S. 211 (1899). The clearest statement of this "literalist" interpretation was given by Justice Peckham in *Trans-Missouri*:

When, therefore, the body of an act pronounces as illegal every contract or combination in restraint of trade or commerce among the several States, etc., the plain and ordinary meaning of such language is not limited to that kind of contract alone which is in unreasonable restraint of trade, but all contracts are included in such language, and no exception or limitation can be added without placing the act that which has been omitted by Congress.

*Trans-Missouri*, 166 U.S. at 328.

<sup>74</sup> *Standard Oil Co. v. United States*, 221 U.S. 1 (1911).

<sup>75</sup> See 3 J. DORFMAN, *THE ECONOMIC MIND IN AMERICAN CIVILIZATION* 138 (1949).

<sup>76</sup> See, e.g., S. DILLAYE, *MONOPOLIES: THEIR ORIGIN, GROWTH AND DEVELOPMENT* (1882).

His first magazine article, "The Story of a Great Monopoly,"<sup>77</sup> in 1881, was an attack on the Standard Oil Company. "As early as 1884 he asserted that combinations were dominating, most, if not all, industries in the country, from coffin-making to iron pipe foundries."<sup>78</sup> Above all, the attention paid to formation of the notorious "trusts" during the 1880s, raised more general questions concerning the causes of industrial concentration.

In 1882, the first great trust, the Standard Oil, was born, after "the sharp mind of Standard's legal counsel, S. L. T. Dodd, conceived of the new trust form of organization."<sup>79</sup> The trust was designed to bring about corporate consolidation while avoiding the prohibition under state corporation laws of one corporation holding the stock of another. Since the individual shareholders of the consolidating corporations tendered their stock to trustees in exchange for trust certificates, the resulting trust was not incorporated and hence was thought to be immune from the limitations of corporation law.

Five other successful, nation-wide trusts were organized during the 1880s: the American Cotton Oil Trust (1884), National Linseed Oil Trust (1885), the National Lead Trust (1887), the Whiskey & Sugar Trusts (1889). The "trust problem" therefore became a central issue of public policy only a few years before the Sherman Act was enacted in 1890. The Act itself reflected the still widely shared orthodox laissez faire position that industrial concentration was an unnatural interference with the laws of free competition and could only be achieved through conspiracy or illicit financial manipulation. Except for the relatively rare case of "natural monopoly," it was thought that the "laws" of the market—especially the "law of diminishing returns"—would continue to prevail.

Some orthodox theorists traced the causes of monopoly to illegitimate governmental interference in the economy—through tariffs and other intrusions on free competition, governmental grants to railroads, grants of corporate privileges, and the operation of the patent laws. But most were complacently confident that monopoly was inherently impermanent. "'Trusts', as a rule, are not dangerous," the Dean of the Columbia Law School, Theodore W. Dwight, wrote in 1888. "They cannot overcome the law of demand and supply nor the resistless power of unlimited competition."<sup>80</sup> Indeed, the intellectual paralysis of laissez faire theorists in the face of combination was captured best in 1891 by Judge Seymour Thompson of St. Louis, a vocal opponent of the Trust.

The problem . . . of restraining corporate and individual combinations and monopolies, is the problem of restraining a species of communism; it is communism

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<sup>77</sup> Lloyd, *The Story of a Great Monopoly*, 47 ATLANTIC MONTHLY 317 (1881).

<sup>78</sup> H. THORELLI, THE FEDERAL ANTITRUST POLICY: ORIGINATION OF AN AMERICAN TRADITION 134 (1954) (citing Lloyd, *Lords of Industry*, 138 N. AM. REV. 535-53 (1884)).

<sup>79</sup> A. CHANDLER, *supra* note 47, at 323.

<sup>80</sup> Dwight, *The Legality of Trusts*, 3 POL. SCI. Q. 592, 631 (1888).

against communism, and the question is, how far communism ought to go in restraining communism. The general rule is that it ought not to go at all. The general rule is that commerce should be free. . . .<sup>81</sup>

Beginning in the late 1880s, however, several writers began to ponder the question of whether large-scale enterprise was inevitable. Perhaps the earliest was Arthur T. Hadley, whose book, *Railroad Transportation* (1885), was the first to generalize from railroad consolidation to the inevitability of industrial concentration. Seeing "the present age" as "an age of industrial monopoly," Hadley argued that the American economy was moving away from free competition. Yet, the existing system of thought blinded men to the changes that were occurring.

All our education and habit of mind make us believe in competition. We have been taught to regard it as a natural if not necessary condition of a healthful business life. We look with satisfaction on whatever favors it, and with distrust on whatever hinders it. We accept almost without reserve the theory of Ricardo, that, under open competition in a free market, the value of different goods will tend to be proportional to their cost of production.<sup>82</sup>

But, ultimately, Hadley's analysis was limited by his effort to generalize from the railroad problem. He sought to explain the particular forms of "cut-throat competition" that enabled railroads to cut prices below marginal costs, but he did not propose any general analysis of how industrial concentration could be explained in terms of economic theory. That task fell to another writer, Henry C. Adams, the chief statistician for the newly formed Inter-State Commerce Commission.

Adams' brilliant and influential tract, "The Relation of the State to Industrial Enterprise" was the best expression of the new anti-laissez faire sentiment behind the recently formed American Economic Association.<sup>83</sup> It sought to define the conditions under which governmental regulation would be legitimate. Seeking to explain industrial concentration, Adams invoked John Stuart Mill's tripartite distinction among industries that displayed "constant," "diminishing," or "increasing" returns to scale. While the railroad was "a good illustration of this third class of industries,"<sup>84</sup> there were also "many other lines of business which conform to the principle of increasing returns, and for that reason come under the rule of centralized control."<sup>85</sup>

<sup>81</sup> S. THOMPSON, *The Power of the People Over Corporate and Individual Combinations and Monopolies*, in PROCEEDINGS OF THE ILL. STATE BAR ASS'N 81, 84 (1891). Thompson concluded that "as a general rule, we may safely trust to the operation of natural laws and to the inherent weakness of every human combination, for a sufficient remedy." *Id.* at 90.

<sup>82</sup> A. HADLEY, *RAILROAD TRANSPORTATION—ITS HISTORY AND ITS LAWS* 69 (1885) (quoted in W. COOK *supra* note 60, at 127).

<sup>83</sup> T. HASKELL, *THE EMERGENCE OF PROFESSIONAL SOCIAL SCIENCE* (1977).

<sup>84</sup> Adams, *The Relation of the State to Industrial Action*, 1 PUBLICATIONS OF THE AM. ECON. ASS'N 7, 61 (1887).

<sup>85</sup> *Id.* at 64.

Such businesses are by nature monopolies. We certainly deceive ourselves in believing that competition can secure for the public fair treatment in such cases, or that laws compelling competition can ever be enforced. If it is for the interest of men to combine no law can make them compete. For all industries, therefore, which conform to the principle of increasing returns, the only question at issue is, whether society shall support an irresponsible, extra-legal monopoly, or a monopoly established by law and managed in the interest of the public.<sup>86</sup>

Though it was thereafter expressed in many different ways, the argument for the inevitability of industrial concentration always represented some variation on Adams' original insight about increasing returns to scale.

Among the earliest to proclaim the inevitability of industrial concentration were social thinkers who were influenced by European socialism and Marx's prediction of the inevitability of monopoly capitalism. In 1889, President E. Benjamin Andrew of Brown University declared that the competitive system was fast disappearing and giving way to trusts and combinations.<sup>87</sup> Although competition had "hitherto been assumed as the certain postulate of all economic analysis and generalization," in fact "in a great variety of industries, perhaps a majority of all, permanent monopolies may be maintained, apart from any legislative or special aids. . . .No economic laws prevent the permanent existence of monopolies. . . ."<sup>88</sup>

In the same year, the Christian Socialist Edward Bellamy pronounced with satisfaction the "doom" of the competitive system. Competition was at odds with the fundamental principles of Christianity. "[T]he competitive system tends to develop what is worst in the character of all, whether rich or poor. The qualities which it discourages are the noblest and most generous that men have, and the qualities which it rewards are those selfish and sordid instincts which humanity can only hope to rise about by outgrowing."<sup>89</sup>

Moving from the "moral iniquities of competition,"<sup>90</sup> he turned to an analysis of the causes of consolidation. "It is a result of the increase in the efficiency of capital in great masses, consequent upon the inventions of the last and present generations. . . .The economies in management resulting from consolidation, as well as the control over the market resulting from the monopoly of a staple, are also solid business reasons for the advent of the Trust."<sup>91</sup>

The few economists who still seriously defend the competitive system are heroically sacrificing their reputations in the effort to mask the evacuation of a position which, as nobody knows better than our hard-headed captains of industry, has become untenable. . . .While the economists have been wisely debating whether we could

<sup>86</sup> *Id.*

<sup>87</sup> Andrews, *Trusts According to Official Investigations*, 3 Q.J. ECON. 117 (1889).

<sup>88</sup> Andrews, *The Economic Law of Monopoly*, 26 J. Soc. Sci. 1 (1890).

<sup>89</sup> E. BELLAMY, *PLUTOCRACY OR NATIONALISM—WHICH?* 2 (1889).

<sup>90</sup> *Id.* at 3.

<sup>91</sup> *Id.* at 5.

dispense with the principle of individual initiative in business, that principle has passed away, and now belongs to history.<sup>92</sup>

Except for his conclusion, Bellamy's vision of the inevitability of economic concentration was echoed by the new titans of industry. In 1888, the President of the American Cotton Oil Trust, John H. Flagler, defended the development of trusts as a reflection of "a steady, logical and wise evolution, or improvement in the method of conducting industrial affairs." There was an historical evolution in the conduct of business which passed through "successive stages of development" from individual to partnership to corporation and, now, to the trust. "This progressive development in the machinery for the conduct of business was impelled by the growing and ever-increasing demand for larger facilities, greater capital, greater energy, combination of activities, skill and intelligences."<sup>93</sup>

The courts did not yet agree. Beginning in the late 1880s, six different states brought *quo warranto* suits to revoke the charters of corporations that had become constituents of one of the great trusts.<sup>94</sup> The most famous lawsuits involved the successful Ohio and New York attacks on, respectively, the Standard Oil and Sugar Trusts.<sup>95</sup> In both cases, the courts dealt a set-back to any "entity" theory of the corporation, holding that the act of the individual shareholders in joining the trust was really the act of the corporation.

As the attacks on the trust form mounted, corporation lawyers realized that the earlier strategy of simply evading the restrictions of corporation law would no longer work. "It was considered wise to yield in the matter of form. The trusts were transformed into companies."<sup>96</sup> In the words of the biographer of one of these lawyers, William Nelson Cromwell, "[t]he vulnerability of the trust arrangement to the combination and conspiracy concept of the Sherman Act and to the legal analysis of the Ohio and New York decisions led to the finding of new legal techniques. The need was met by an amendment to the Corporation law of New Jersey."<sup>97</sup> Several corporation lawyers connected with Cromwell's firm "were among those active in the drafting of this amendment."<sup>98</sup> And, as Alfred D. Chandler has written, "The New Jersey legislature quickly obliged."<sup>99</sup>

<sup>92</sup> *Id.* at 1, 5.

<sup>93</sup> Address by Mr. John H. Flagler Before the Commercial Club of Providence, Rhode Island (December 15, 1888).

<sup>94</sup> *People v. Chicago Gas Trust Co.*, 130 Ill. 268, 22 N.E. 789 (1887); *People v. North River Sugar Refining Co.*, 22 Abb. N. Cas. 164 (1889); *State v. Nebraska Distilling Co.*, 29 Neb. 700, 46 N.W. 155 (1890). See *Louisiana v. American Cotton-Oil Trust*, 1 RY. & CORP. L.J. 509 (1887); *California v. American Sugar Refining Co.* 7 RY. & CORP. L.J. 83 (1890).

<sup>95</sup> See *North River Sugar Refining Co.*, 22 Abb. N. Cas. 164.

<sup>96</sup> E. VON HALLE, TRUSTS OR INDUSTRIAL COMBINATIONS AND COALITIONS 94 (1895).

<sup>97</sup> Dean, A Tribute to William Nelson Cromwell: An Address Delivered at the Cromwell Library of the American Bar Foundation, Chicago, Illinois (February 22, 1955) 69.

<sup>98</sup> *Id.* at 70.

<sup>99</sup> A. CHANDLER, *supra* note 47.

The New Jersey Act of 1889,<sup>100</sup> which permitted incorporation "for any lawful business or purpose whatever," was among the first to allow one corporation to own the stock of another, thus legalizing the holding company and making the trust device unnecessary. Cromwell, himself, seems to have been the first lawyer to use the New Jersey provisions. As counsel to the Cotton Oil Trust, he appears to have conceived of the need for the New Jersey law after a lower court in Louisiana in 1889 sustained the state's effort to dissolve several of the Trust's constituent corporations.

Pending the appeal of an adverse decision, Cromwell called special meetings of all of the constituent corporations, obtained the necessary proxies and quietly dissolved the Louisiana corporations and transferred all their assets to a Rhode Island corporation set up for that purpose, whose stock was held by the trustees. When the appeal came on, he announced to the consternation of the Attorney General of Louisiana that the relief requested was no longer necessary for the Corporations were no longer in existence. . . .<sup>101</sup>

In the same year, the American Cotton Oil Trust was reorganized once more as a New Jersey holding company, perhaps the first major enterprise to take advantage of the change in New Jersey law. The successful New York attack on the Sugar Trust also led it to reorganize as a New Jersey corporation. It soon received the additional benefit of immunity from the Sherman Anti-Trust Act, when the United States Supreme Court held in the *E.C. Knight Case*<sup>102</sup> that the Act could not constitutionally reach "manufacturing."

After the passage of the New Jersey Act, the entire expenses of the state of New Jersey were paid out of corporation fees. "[S]o many Trusts and big corporations were paying tribute to the State of New Jersey," noted New York corporation lawyer Charles F. Bostwick, "that the authorities had become greatly perplexed as to what should be done with [its] surplus revenue. . . ."<sup>103</sup> "[T]he relation of the state toward the corporations resembles that between a feudal baron and the burghers of old, who paid for protection," observed William H. Cook.<sup>104</sup> Lincoln Steffens simply called New Jersey "the traitor state."<sup>105</sup>

The passage of the New Jersey Corporation Act, followed by a rapid capitulation of many other states, marked the end of all serious efforts to use corporation law to regulate consolidation. Urging repeal of many New York restrictions on corporations, New York lawyer Charles F. Bostwick noted "the sudden exodus of hundreds upon hundreds of millions of dollars, controlled by corporate interests and financiers from New York into the State of New Jersey"<sup>106</sup> during the decade

<sup>100</sup> N.J. Laws, Ch. 269, § 4 at 414 (1889).

<sup>101</sup> See *supra* note 97, at 99.

<sup>102</sup> *United States v. E.C. Knight Co.*, 156 U.S. 1 (1894).

<sup>103</sup> C. BOSTWICK, *LEGISLATIVE COMPETITION FOR CORPORATE CAPITAL* 22 (1899).

<sup>104</sup> W. COOK, *supra* note 60 at vi.

<sup>105</sup> Steffens, *New Jersey: A Traitor State*, 25 *McCLURE'S MAG.* 41 (1905).

<sup>106</sup> C. BOSTWICK, *supra* note 103, at 1.



after the passage of the New Jersey law. "New York, although disclaiming any intention of entering into legislative competition for the securing of corporate capital within its jurisdiction, is, in fact, one of the most ardent bidders," Bostwick wrote.<sup>107</sup> For example, only three years after the passage of the New Jersey law, "the State of New York could no longer withstand the temptation, and the incorporation laws of this State were radically amended" to match the single most attractive New Jersey provision allowing holding companies. "[B]ut this came too late to get back any fugitive capital and still it continued to go elsewhere."<sup>108</sup>

The lesson, for Bostwick, was to further remove most restraints on corporations. "The *laissez faire* doctrine is good in government, and similar doctrine applied in politico-economic life is equally good," he concluded.<sup>109</sup> As state legislatures during the 1890s outbid each other in passing ever more "liberal" corporation laws that removed many of the remaining legal barriers to consolidation, the focus of those who hoped to preserve competition shifted to the Sherman Act.

But the New Jersey law confirmed the views of those who saw consolidation as inevitable, and during the 1890s, in both legal and economic writings, there is a marked shift towards the inevitability thesis.<sup>110</sup> By 1891, William W. Cook could declare that concentration was the result of "an established principle of economics." "It is a law of nature," he proclaimed. "These great concerns arise because by doing business on a large scale they can do it more cheaply."<sup>111</sup> "[M]ost of the younger economists of the country who have studied the question thoroughly," Von Halle reported in 1896, were "in favour of combinations." "Under the influence of historical thought, they feel convinced that the movement is an unavoidable step in an organic development, and that it finds its justification in the tendencies of modern capitalism . . . ."<sup>112</sup>

For the first time, the full implications of general incorporation laws began to be developed, and the view that legal forms cannot interfere with the natural evolution of the economy gained ascendancy. Commenting on the failure of legislation to check consolidation, Cook began the fifth edition of his celebrated treatise on corporation law with the aphorism, "The laws of trade are stronger than the laws of men."<sup>113</sup>

In these writings on corporations, we find the earliest articulation of that contempt for legal form that eventually came to characterize Legal Realism. "Whether true or false, the maxim 'combination is the life of trade,' is an economic and in no sense a legal proposition," wrote Arthur J. Eddy, the author of a well known

<sup>107</sup> *Id.* at 4.

<sup>108</sup> *Id.* at 15.

<sup>109</sup> *Id.* at 11.

<sup>110</sup> W. LETWIN, LAW AND ECONOMIC POLICY IN AMERICA 71-85 (1965).

<sup>111</sup> W. COOK, THE CORPORATION PROBLEM 226 (1891).

<sup>112</sup> E. VON HALLE, *supra* note 96, at 113.

<sup>113</sup> See W. COOK, *supra* note 65, at vii.

legal treatise on Combination, in 1901. "If sound, economic forces will protect it; if unsound, neither legislative enactments nor judicial utterance can give it life . . . the courts might as well try to conserve Gresham's law, the Malthusian theory, Ricardo's doctrine of rent, or any other economic, scientific or philosophic notion."<sup>114</sup>

Legal structures merely reflect the underlying economic substructure. "[T]he corporate form of co-operation has been like all other industrial, commercial, social and political forms a matter of development," Eddy explained. "[I]n some sort it existed prior to its recognition by law . . . the law simply sanctioned a form of organization which the commercial and industrial world found useful and indispensable." Even if there were no laws creating corporations, "men would necessarily act together . . . in joint associations. . . ." "Since the law is simply the application of common sense and reason to existing conditions . . . the law would follow the economic tendency, [and] the collective bodies would be recognized . . . there would inevitably spring up in a progressive community organizations in form similar to the modern corporation."<sup>115</sup> The large industrial corporation was, in short, a natural reflection of the rational economic tendency towards combination. "Consolidation," concluded William W. Cook, "is the spirit of the age, moving on resistlessly, regardless of human laws and hostile public sentiment."<sup>116</sup> Those who "disapprove of trusts and combinations [for] general anti-centralistic and individualistic reasons," wrote the economist Ernst von Halle in 1896, "play into the hands of socialism."<sup>117</sup>

### E. *Consolidation and Majority Rule*

If the private law of corporations—that is, the law regulating relations within the corporation as well as with private parties—had not changed after 1880, it is difficult to imagine how the enormous corporate consolidation of the next thirty years could have taken place. For until the First World War—by which time the centralization of the American economy was largely accomplished—state corporation law was centrally involved in the question of corporate consolidation.

After 1880, ultra vires doctrines continued to limit the power of corporations to consolidate. While courts still refused to enforce ultra vires executory contracts, they generally were not willing to unravel contracts that had already been performed. Most judicial decisions that stood in the way of corporate consolidation did so on the grounds that a corporation had no power to lease its property to another corporation or to transfer its stock to a holding company. The single area that dominated Supreme Court ultra vires decisions between 1880 and 1900 were cases

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<sup>114</sup> I A. EDDY, *THE LAW OF COMBINATIONS*, 665-66 (1901).

<sup>115</sup> *Id.*

<sup>116</sup> W. COOK, *supra* note 60, at vii (5th ed. 1903).

<sup>117</sup> E VON HALLE, *supra* note 96, at 113.

involving railroad consolidations. In a series of opinions during the last two decades of the nineteenth century, the Court consistently struck down as beyond corporate power arrangements by which one railroad leased all of its facilities to another line. The terms of these leases almost always exceeded the productive life of the assets transferred under them. Indeed, the Court occasionally gave its approval to the truly Draconian rule that the lessor under a void *ultra vires* agreement could not sue to recover the leased property or its value.<sup>118</sup> While these "loose" forms of consolidation confronted various legal impediments, an outright sale of corporate assets to produce a merger rarely ran afoul of *ultra vires* limitations since by the time the transactions were challenged in court they had already become "executed" contracts.

Some state courts were even noticeably unreceptive to the Supreme Court's views on leases used for consolidation. In 1886, the New Jersey Supreme Court treated such a lease as a fully executed contract that could not be interfered with.<sup>119</sup> And following a series of decisions generally hostile to the *ultra vires* doctrine, the New York high court in 1896 enforced the terms of a public utility lease, denouncing "the rank injustice" produced by the Supreme Court's *ultra vires* rule.<sup>120</sup> William W. Cook, the treatise writer on corporation law, cheered the New York decision as "breaking away entirely from the decisions of the Supreme Court of the United States and of the English courts on this subject . . . ." "The court," he wrote, "will not declare a contract void merely to satisfy a superannuated principle of law."<sup>121</sup> The lease cases caused even Judge Seymour Thompson of St. Louis, in his 1899 treatise on corporation law, to denounce "the abominable doctrine of *ultra vires*."<sup>122</sup>

It is quite clear that the Supreme Court's strict attitude towards *ultra vires* doctrine during the late nineteenth century was substantially related to hostility to corporate consolidation. An "old conservative" majority, favoring small competitive units of production and fearing large-scale enterprise, never really abandoned the traditional view of the corporation as an artificial creature of state power. It thus consistently deployed the *ultra vires* doctrine for the purpose of preventing further concentration.

There were essentially three stages in the efforts of corporations to achieve consolidation. The first stage, the "pool," represented a "loose" form of agreement employed by railroads, beginning in the 1870s, to fix rates and regulate traf-

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<sup>118</sup> Compare *St. Louis, Vandalia & Terre Haute R.R. v. Terre Haute & Indianapolis R.R.*, 145 U.S. 393 (1892) with *Pullman's Palace Car Co. v. Central Transp. Co.*, 171 U.S. 138 (1898). See Harriman, *Ultra Vires Corporation Leases*, 14 HARV. L. REV. 332 (1900); W.C. NOYES, A TREATISE ON THE LAW OF INTERCORPORATE RELATIONS 349-52 (1st ed. 1902).

<sup>119</sup> See *Camden & Atlantic R.R. v. May's Landing & Egg Harbor City R.R.*, 48 N.J.L. 530 (1886).

<sup>120</sup> *Bath Gas Light Co. v. Claffy*, 151 N.Y. 24, 34, 45 N.E. 390, 395 (1896).

<sup>121</sup> W. COOK, *supra*, note 60, at viii.

<sup>122</sup> 7 S. THOMPSON, *supra* note 35, at 7032 (2d ed. 1899).

fic. Through a combination of ultra vires and anti-trust attacks, this form of cartelization was eventually defeated, though it had already largely proved unstable and impossible to enforce.<sup>123</sup>

A second effort, the "trust" or holding company, was fiercely attacked by state *quo warranto* decisions brought against the constituent companies. The New Jersey Corporation Law of 1889 was drafted to save the trusts, since it was among the first statutes to allow corporations to own shares in other corporations.<sup>124</sup> But even before the federal power was successfully deployed against holding companies in the *Northern Securities* case<sup>125</sup> (1904), the trust form had lost favor, and was replaced by direct merger.

The merger movement of 1898-1903 seems to have been based on the legal conclusion that courts might not deploy the Sherman Act to attack consolidation if it took the form of outright purchase of other businesses. Arthur Eddy wrote in 1901:

The Courts having condemned simple combinations [e.g. pools or price fixing agreements] and the trust form of combination as contrary to public policy "the corporate form naturally suggested itself as a possible escape from the force and effect of the many decisions adverse to the other forms. It was argued that while the courts might deny the right of individuals, firms or corporations to meet together to form associations, pools or agreements with the intent to control prices and outputs, no court would deny the right of an individual, or of a partnership, or a corporation to purchase outright the assets, business and good-will of any individual, firm or corporation engaged in the same line of trade or manufacture . . . . So long as the state sanctions the creation of corporations without limitations as to power and capital, then it would seem to follow that within their chartered rights corporations have the same power to acquire property as has an individual."<sup>126</sup>

It was the task of legal theory to show that there was no difference between the rights of individuals and corporations to acquire property.

With the merger movement beginning in 1898, corporate strategists thus turned to outright consolidation. This strategy was undoubtedly encouraged by the unwillingness of both state and federal courts to use the ultra vires doctrine to unravel already consummated transactions.<sup>127</sup> While the Supreme Court throughout the 1890s had regularly supported attacks on "loose" forms of consolidation by refusing to enforce arrangements for long-term lease of corporate assets, the merger movement rendered ultra vires constraints practically irrelevant.

The new legal pressure point in attacks on corporate consolidation shifted to

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<sup>123</sup> H. THORELLI, *supra* note 78, at 73-76.

<sup>124</sup> See *supra* note 100 and accompanying text.

<sup>125</sup> *Northern Securities Co. v. United States*, 193 U.S. 197 (1904).

<sup>126</sup> I. A. EDDY, *supra* note 114, at 601-02.

<sup>127</sup> *Metcalfe v. American School Furniture Co.*, 122 F. 115 (W.D.N.Y. 1903).

the common law rule that unanimous shareholder consent was necessary for sale of corporate assets or, indeed, for any "fundamental" change in corporate purposes.

During the 1880s, nearly all courts required unanimous shareholder consent to corporate consolidations as well as to other "fundamental" corporate changes.<sup>128</sup> The rule of unanimous consent, it should be noted, is a dramatic example of the extent to which partnership-contract categories governed important aspects of corporation law in the period immediately after the Civil War.<sup>129</sup> Any fundamental corporate change was regarded as a breach of the individual shareholder's contract as well as, in effect, an unconsented "taking" of his property.<sup>130</sup>

The obstacle that unanimous shareholder consent presented for consolidation was seen as early as 1887 by New York lawyer William W. Cook whose successive treatises on corporation law proclaimed the inevitability of economic concentration. With respect to the legal rule permitting any shareholder to object to a sale of assets, Cook accurately predicted in 1887, that "large interests will require and in some way will obtain a removal of the legal right of stockholders to object to the changes toward which the times are rapidly approaching."<sup>131</sup>

By the time the merger movement began, nearly all the states had passed general consolidation statutes applicable to railroad corporations.<sup>132</sup> These statutes permitted consolidation of lines with less than unanimous shareholder consent. In addition, by 1901, fourteen states, including Delaware (1899), New York (1890), and New Jersey (1896), had authorized any corporation "carrying on any kind of business of the same or similar nature" to merge with less than unanimous shareholder agreement.<sup>133</sup> The earliest consolidation statutes, therefore, permitted "horizontal" integration, while still denying corporations the power to engage in "vertical" mergers among different lines of business.

<sup>128</sup> See, e.g., *Mason v. Pewabic Mining Co.* 133 U.S. 50 (1890); *State ex rel. Brown v. Bailey*, 16 Ind. 46 (1861); *McCray v. Junction R.R.*, 9 Ind. 358 (1857); *Stevens v. Ruthland & Burlington R.R.*, 29 Vt. 545 (1851); See also Carney, *Fundamental Corporate Changes, Minority Shareholders and Business Purposes*, AM. BAR FOUND. RESEARCH J. 69, 88-89 (1980).

<sup>129</sup> See ANGELL & AMES, *TREATISE ON THE LAW OF PRIVATE CORPORATIONS* 537, 569 (11th ed. 1882).

<sup>130</sup> I V. MORAWETZ, *A TREATISE ON THE LAW OF PRIVATE CORPORATIONS* iii (2d ed. 1886); See also Carney *supra* note 128, at 77-78.

<sup>131</sup> W. COOK, *supra* note 60 (1st ed. 1887).

<sup>132</sup> See statutes cited in W.C. NOYES, *supra* note 118, at 29 n.1.

<sup>133</sup> W.C. NOYES, *supra* note 118, at 36 n.1 and at 84 n.2. These states were: Alabama (1896), Colorado (1891), Connecticut (1901), Delaware (1899), Illinois (1895), Kentucky (1894), Louisiana (1874), Maryland (1888), Missouri (1889), Nevada (1883), New Jersey (1896), New York (1890), Pennsylvania (1901), Utah (1898). Noyes' list of thirteen states does not include the Pennsylvania statute of 1901. Actual dates of enactment for Colorado (1877), Illinois (1872), Kentucky (1893), Utah (1896) are found in the following compilations of state laws: MILLS, MILLS' ANNOTATED STATUTES OF THE STATE OF COLORADO 688 (1891); 2 W.C. JONES & K.H. ADDINGTON, *ANNOTATED STATUTES OF THE STATE OF ILLINOIS 1588-89* (1913); J. BARBOUR & J. CARROLL, *THE KENTUCKY STATUTES* 350 (3d ed. 1903); YOUNG, SMITH & LEE, *THE REVISED STATUTES OF THE STATE OF UTAH* 163 (1897).

Vertical integration, therefore, came about not through statutorily authorized consolidations but through sale of assets. It still had to confront the general common law rule that any sale of corporate assets to achieve consolidation required unanimous agreement of the shareholders.

There was one small exception to the unanimity rule which was first exploited by consolidating corporations to avoid the consequences of the rule. Where a corporation was insolvent and had no prospects of profit, courts had permitted a simple majority of shareholders to wind up the business and sell all of its assets. In the wake of the merger movement, courts began simply to "rubber stamp" the claims of the majority that the business was a failing one.<sup>134</sup> As a leading proponent of corporate consolidation put it in his 1902 treatise on Consolidation:

It has been urged that this power of a majority to wind up a corporation, and to dispose of its assets for such purpose, exists only in the case of failing concerns. The distinction is not well drawn. . . . The very best time to wind up the affairs of a corporation may be in view of future uncertainties when it is most prosperous and has accumulated a large surplus. The determination of the question when this action should be taken, must rest in the discretion of the majority.<sup>135</sup>

This position was soon adopted by courts. Since it was clear that a majority could dissolve an insolvent corporation, "must [they] wait until the stockholders' investment is all lost before taking action?" the New Hampshire Supreme Court asked in 1912. "If the majority may sell to prevent greater losses, why may they not also sell to make greater gains?"<sup>136</sup> As a student of the subject has concluded: "In many [cases], it was . . . clear that the losing business was not being abandoned but was instead being continued by the new corporate owner of the assets. . . . By steps, then, these asset sales became de facto consolidations."<sup>137</sup>

At the same time as the judiciary was "sliding ineluctably toward majoritarianism in major corporation decisions involving shareholders,"<sup>138</sup> state legislatures began to take the lead in passing statutes allowing a majority to sell corporate assets. One of the earliest was a New York statute of 1893, which overruled the leading New York case expounding the unanimity rule.<sup>139</sup> In addition, Delaware in 1899 and New Jersey in 1902 passed legislation providing for appraisal

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<sup>134</sup> *Metcalf v. American School Furniture Co.*, 122 F. 115; *Traer v. Lucas Prospecting Co.*, 124 Iowa 107, 99 N.W. 290 (1904); *Tanner v. Lindell R'y Co.*, 180 Mo. 1, 79 S.W. 155 (1904); *Beidenkopf v. Des Moines Life Ins. Co. & National Life Ins. Co.*, 160 Iowa 629, 142 N.W. 434 (1913); *Lange v. Reservation Mining and Smelting Co.*, 48 Wash 167, 93 P. 208 (1908); *Butler v. New Keystone Copper Co.*, 10 Del. Ch. 371, 93 A. 380 (1915).

<sup>135</sup> W.C. NOYES, *supra* note 118, at 174-75.

<sup>136</sup> *Bowditch v. Jackson Co.*, 76 N.H. 351, 82 A. 1014, 1017 (1912).

<sup>137</sup> *See Carney*, *supra* note 128, at 88-89.

<sup>138</sup> *Id.* at 90.

<sup>139</sup> *See In re Timmis*, 200 N.Y. 177, 93 N.E. 522 (1910) for the New York statutory history. The leading case on shareholder unanimity is *Abbott v. American Hard Rubber Co.*, 33 Barb. 578 (1861).

and "buy out" of the shares of dissenting minority stockholders.<sup>140</sup> By 1926, there was "hardly a state . . . where the dominant common law rule . . . ha[d] not been abrogated by statute or decision."<sup>141</sup>

The shift to majority rule in fact made the merger movement legally possible. It not only made consolidations much easier to effect, it also dealt the final blow to any efforts to conceptualize the corporation as a collection of contracting individual shareholders.

When the rule of unanimous shareholder consent began to be widely articulated by courts around the time of the Civil War, the leading treatise on corporations still regarded business corporations as "little more than limited partnerships, every member exercising through his vote an immediate control over the interests of the body."<sup>142</sup> As late as 1890, the leading decision of the United States Supreme Court did "not see that the rights of the parties in regard to [sale of] the assets of [a] corporation differ from those of a partnership on its dissolution."<sup>143</sup> It referred to a treatise on Partnership before reaffirming the rule of unanimity.

In his brilliant study, *The Legal Nature of Corporations* (1897), Ernst Freund understood that the emergence of majority rule within a corporation could only be justified by some entity theory of the corporation that moved beyond contractualism and conceptions of individual property rights. How could the "corporate will" be identified with a simple majority of shareholders, Freund asked.

The true corporate will would be expressed by unanimous action resulting from common deliberation and mutual compromise and submission; but for purposes of convenience the law stops the process of reaching the conclusion halfway, and is satisfied with the concurrence of the greater portion of those acting. The justification of this legal expedient lies in the fact that the will of the majority may be presumed to express correctly what would be the result of forced unanimity; a presumption not always agreeable to fact, but convenient and more practicable than any other. . . . In so far as the presumption fails to be correct, it cannot be denied that a will which is not identical with the corporate will is imputed to the corporation, just as we impute the will of the agent to the principal without insisting that it should in all cases accord with the principal's will. The same view must be taken of the acts of other corporate organs; they may likewise be presumed to voice correctly the corporate will, but their will is not the corporate will strictly speaking.<sup>144</sup>

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<sup>140</sup> The Delaware statute appears in W.C. Noyes *supra*, note 118, at 94 n.4.

The New Jersey statute, broadening an 1896 law, appears in W.C. Noyes, *supra* note 118, at 232 n.2 (2d ed. 1909). These appraisal statutes, Noyes wrote, "are probably broad enough to be available in aid of a reorganization through the transfer of corporate assets in exchange for stock." *Id.* at 232.

<sup>141</sup> Weiner, *Payment of Dissenting Stockholders*, 27 COLUM. L. REV. 547 (1927).

<sup>142</sup> ANGELL & AMES, *supra* note 129, at 166 (6th ed. 1858).

<sup>143</sup> *Mason v. Pewabic Mining Co.*, 133 U.S. 50, 59.

<sup>144</sup> E. FREUND, *supra* note 32, at 10.

While Freund was tempted to derive majority rule from unanimous shareholder consent, he was forced to admit that it was a fiction "not always agreeable to fact." He turned instead to a theory of a separate corporate entity, "imput[ing]" to the corporation the "will" of the shareholders. Above all, majority rule was another example of Freund's conclusion "that in dealing with associations of persons we must modify the ideas which we have derived from the right of property in individuals, and what has first seemed to be an anomaly will appear simply as another but equally legitimate form of development."<sup>145</sup>

#### F. *Attack on the Entity Theory*

The first sustained effort to reconceptualize the corporation in the light of the triumph of general incorporation laws began during the 1880s.

In 1882, Victor Morawetz published *A Treatise on the Law of Private Corporations* which proposed a radical reinterpretation of the legal status of the corporation. The corporation, Morawetz wrote, "is really an association formed by the agreement of its shareholders, and . . . the existence of a corporation as an entity, independently of its members, is a fiction."<sup>146</sup>

Morawetz treated corporations as virtually indistinguishable from partnerships. "[T]here is no reason of immediate justice to others, why a number of individuals should not be permitted to form a corporation of their own free will, and without first obtaining permission from the legislature, just as they may form a partnership or enter into ordinary contracts with each other."<sup>147</sup>

General incorporation laws "to a great extent . . . leave the right of forming a corporation and of acting in a corporate capacity free to all, subject to such limitations and safeguards as are required for the protection of the public." The only argument for restricting corporate powers, he claimed, was that notice of limited liability of shareholders needed to be communicated to potential creditors. "And this seems to be the chief office of the general incorporation laws which are now in force nearly everywhere."<sup>148</sup>

The source of corporate power was, for Morawetz, in the shareholders. The principle of majority rule was derived, as in a partnership, from *unanimous* shareholder consent. So the majority could not go outside of the purpose specified in its charter without the unanimity of shareholders. Thus, the doctrine of *ultra vires*, originally derived from the grant theory of the corporation, should be replaced by the requirement of unanimous shareholder agreement, as in a partnership. Regula-

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<sup>145</sup> *Id.* at 48.

<sup>146</sup> I V. MORAWETZ, *supra* note 130, at iii.

<sup>147</sup> *Id.* at 24 (1st ed. 1882).

<sup>148</sup> *Id.*



tion of the corporate activity would come, not from the state, but from the shareholders.

Morawetz' effort to "disaggregate" the corporation into freely contracting individuals must have seemed at the time the only entirely logical conclusion to draw in light of the triumph of general incorporation law. It not only dispensed with an increasingly fictional conception of the corporation as a creature of the state, it also made it possible to fit corporation law into the now dominant individualistic mode of private contract law.

The tendency to reconceptualize the corporation along partnership-contractualist lines continued during the 1880s. In 1884, two years after Morawetz' treatise, Henry O. Taylor, another New York lawyer, wrote *A Treatise on the Law of Private Corporations* which was aimed, he said, at "dismissing this fiction" of the "legal personality" of the corporation, so that "a clearer view" of individual rights and interests could be determined "without unnecessary mystification."<sup>149</sup>

Taylor was supported by John Norton Pomeroy, the California lawyer who was simultaneously putting forth this argument on behalf of the corporation in the *Santa Clara* case. Pomeroy emphasized the significance of general incorporation laws in rendering older conceptions of incorporation anachronistic. "The common-law conception of the 'legal personality' of the metaphysical entity constituting the corporation, entirely distinct from its individual [members], arose at a time when corporations were all created by special charters," Pomeroy wrote. All this had changed under general incorporation laws in which "persons complying with a few formal requisites can organize themselves into a company for almost any business purpose . . . these associations differ very little in their essential attributes from partnerships."<sup>150</sup>

It is not entirely clear to what extent the legal thinkers who advocated a partnership-contractualist conception of the corporation during the 1880s were motivated by any particular political vision or attitude towards corporations. Overtly, they seemed only to wish to bring corporation law into line with the new reality of free incorporation. Pomeroy and Justice Field clearly believed that the partnership theory offered the greatest chance of success in protecting the corporation under the fourteenth amendment. Yet, their individualistic language harkened back to earlier Jacksonian criticisms of corporations as "special privileges" and monopolies. And despite the fact that the clear tendency of attacks upon the traditional theory that corporations were creatures of the state was to undermine any claims to special state control of corporations, the partnership theory was soon treated as supporting an anti-corporate position.

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<sup>149</sup> H. TAYLOR, *A TREATISE ON THE LAW OF PRIVATE CORPORATIONS HAVING CAPITAL STOCK* iv (1884).

<sup>150</sup> Note, *The Legal Idea of a Corporation*, 19 AM. L. REV. 114, 115 (1885).

Perhaps that was a correct understanding of its ultimate tendency. For example, Henry O. Taylor, the New York lawyer and corporate law treatise writer, appears to have been aware that his effort to dismiss the "fiction" of corporate personality for producing "unnecessary mystification" might also call into question the legitimacy of limited shareholder liability. Like Chief Justice Taney,<sup>151</sup> Taylor observed that limited liability was "the logical outcome of the notion of a corporation as a person, as a subject of rights and liabilities distinct from its members,"<sup>152</sup> a notion he was doing his best to undermine.

There were many suggestions during the 1890s that a contractual theory might subvert corporate privileges. Writing in 1892, Dwight A. Jones focused on the delegitimizing tendency of the partnership theory.

[T]he main value of a corporate charter arises from the fact that powers and privileges are thereby acquired which individuals do not possess. It is this that makes the difference between a business corporation and a partnership. In the former there is no individual liability. . . . There is no death. . . . It is not policy therefore for a corporation to break down its own independent existence by burying its original character in the common place privileges of the individual. . . . *Any mingling of corporate existence of the stockholders will weaken corporate rights.*<sup>153</sup>

Indeed, opponents of corporate consolidation during the 1890s often advocated elimination of the corporate form and return to the partnership. One of the most influential American economists, Henry C. Adams, saw in the extension of the corporate form the root cause of the growth of economic concentration that was destroying competitive society. "[T]hese corporations," he wrote in 1894, "assert for themselves most of the rights conferred on individuals by the law of private property, and apply to themselves a social philosophy true only of a society composed of individuals who are industrial competitors."<sup>154</sup> Adams' solution was to limit the benefits of the corporate form to those "natural monopolies" that could actually demonstrate "increasing returns" to scale.<sup>155</sup>

Was there not good reason, then, to suspect that any contractualist theory of the corporation was only the first step toward attacking the corporate form itself? In 1900, Christopher G. Tiedeman published his *Treatise on State and Federal Control of Persons and Property in the United States*,<sup>156</sup> a greatly expanded and retitled-

<sup>151</sup> See *supra* note 53 and accompanying text.

<sup>152</sup> See H. TAYLOR, *supra* note 149, at 12.

<sup>153</sup> D. JONES, A CORPORATION AS "A DISTINCT ENTITY," 2 COUNSELLOR 78, 79 (1892).

<sup>154</sup> ADAMS, RELATION OF THE STATE TO INDUSTRIAL ACTION AND ECONOMICS AND JURISPRUDENCE: *Two Essays by Henry Carter Adams* (ed. J. Dorfman) intro. essay at 47-48 (1954).

<sup>155</sup> ADAMS, SUGGESTIONS FOR A SYSTEM OF TAXATION, Publications of the Michigan Political Science Ass'n (Ann Arbor, Mich.) 1, no.2, 60 (May, 1894).

<sup>156</sup> I. C. TIEDEMAN, A TREATISE ON STATE AND FEDERAL CONTROL OF PERSONS AND PROPERTY IN THE UNITED STATES (2d. ed. 1900).

ed version of his influential *Treatise on the Limitation of Police Power* (1886). The later book is filled with the anguish of the old conservative witnessing the rise of industrial concentration. Tiedeman wrote:

It does not take a very keen observer to note that, for the past fifteen or twenty years, the tending to the establishment of all-powerful and all-controlling combinations of capital . . . has been increasing year by year in this country. . . . The rapid accumulation of vast fortunes has inspired some of their possessors with the desire for the acquisition of power through the control of industries of such great extension and scope, that they may earn the appellation of *kings* instead of *princes* of industry. If this economic tendency were left unchecked, either by economic conditions or law, the full fruition of it would be a menace to the liberty of the individual, and to the stability of the American States as popular governments. . . .<sup>157</sup>

Finally Tiedeman brought the power of incorporation itself into focus.

[A]ll attempts to suppress and prevent combinations in restraint of trade must necessarily prove futile, as long as the statutes of the State permit the creation of private corporations. . . . The grant of charters of incorporation . . . only serves to intensify the natural power which the capitalist in his individual capacity possesses over the noncapitalist, by the mere possession of the capital. I advocate, as a return to a uniform recognition of the constitutional guaranty of equality before the law, the repeal of the statutes which provide for the creation of private corporations.<sup>158</sup>

The contractualist view of the corporation as essentially no different from a partnership began to come under attack from the moment it was presented. Its most forceful claim was that any entity theory of the corporation was a fictional and anachronistic carryover from a bygone era of special corporate charters. Yet, the picture of the corporation as a contract of individual shareholders was itself becoming a nostalgic fantasy at the very moment the partnership view was most forcefully put forth.

Some of the contractualists seemed to have in the back of their minds an ideal of what in a later age would be called "shareholder democracy." But during the 1880s it was beginning to become clear that management, not shareholders, were the real decision-makers in large publicly owned enterprises.<sup>159</sup> Ironically, Morawetz published his contractualist theory in the same year as Standard Oil was organized into the first of the great Trusts. Soon, the "oligarchic" tendency of the Trusts became a point of standard observation.

During the 1880s, the judicially imposed requirement of shareholder unanimity for fundamental corporate changes continued to provide the doctrinal foundation for a "partnership" theory of the corporation. But during the 1890s, several states including the commercially significant jurisdictions of Delaware, New York, and

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<sup>157</sup> *Id.* at 382-83.

<sup>158</sup> *Id.* at 609-10.

<sup>159</sup> Shiras, *Classification of Corporations*, 4 *YALE L.J.* 97, 99-100 (1895).

New Jersey, passed statutes that overthrew the unanimity rule for corporate consolidations. Many of these statutes also substantially enhanced the power of the board of directors to initiate such action.<sup>160</sup>

By the time of the First World War, it was common for legal writers to observe that "the modern stockholder is a negligible factor in the management of a corporation."<sup>161</sup> "It cannot be too strongly emphasized," another wrote, "that stockholders today are primarily investors and not proprietors."<sup>162</sup>

#### G. *The Demise of the Trust Fund Doctrine: The New Relationship of the Shareholder to the Corporation*

One of the best measures of the shift in the conception of shareholders from "members" to "investors" in the corporation is the demise of the so-called "Trust Fund Doctrine" beginning in the 1890s. The demise of the Doctrine was paralleled by the growth of corporations, diversification in corporate ownership, and the subsequent expansion of the stock market.

The rise of the "natural entity" theory, at the same time, presented a picture of the corporation that legitimated the Doctrine's demise.

The origin of the Doctrine goes back to Justice Story's celebrated opinion in *Wood v. Dummer*<sup>163</sup> (1824) declaring that the capital stock of a corporation was a trust fund for the benefit of corporate creditors. Its central significance was to make the stockholders of an insolvent corporation liable for their failure to pay the full or par value of any stock to which they subscribed from a corporation.<sup>164</sup> This question of the extent of shareholder liability for "watered stock"—stock issued for less than par value—represented one of the two or three most important issues in corporate law during the late nineteenth century and generated hundreds of cases and thousands of pages of legal writing.

Accusations of widespread corporate fraud and financial manipulation focused on the "watered stock" question. And amid the wreckage of the 1893 Depression, judges and legal writers faced the fact that enforcement of the Trust Fund Doctrine had "punished the innocent and unsettled hundreds of millions of dollars of investments."<sup>165</sup>

<sup>160</sup> *Beardstown Pearl Button Co. v. Oswald*, 130 Ill. App. 290, 294-95 (1906).

<sup>161</sup> G. HENDERSON, *supra* note 67, at 169.

<sup>162</sup> J. CARTER, *THE NATURE OF THE CORPORATION AS A LEGAL ENTITY* 160 (1919).

<sup>163</sup> *Wood v. Dummer*, 3 Mason 308, 30 Fed. Cas. 435 (1824). The Supreme Court adopted the Trust Fund Doctrine in *Sawyer v. Hoag*, 84 U.S. (17 Wall.) 610 (1873).

<sup>164</sup> A second question was whether, in the absence of a national bankruptcy law, the Trust Fund Doctrine prevented an insolvent corporation from exercising a preference about the order in which it paid its creditors, since it was concededly legal for an insolvent individual to exercise such discretion.

<sup>165</sup> I W. COOK, *supra* note 60, at vii.

In one case, prior to the Depression, the United States Supreme Court held stockholders liable on "watered stock" more than twenty-five years after the company failed.<sup>166</sup> In observing the changes that the Depression had produced, William W. Cook wrote: "Corporation ruin has created corporation law."<sup>167</sup>

### 1. History of Limited Shareholder Liability

It is not usually appreciated that truly limited shareholder liability was far from the norm in America even as late as 1900.<sup>168</sup> Though by the time of the Civil War the common law had evolved to the point of presuming limited shareholder liability in the absence of any legislative rule, in fact most states had enacted constitutional or statutory provisions holding shareholders of an insolvent corporation liable for more than the value of their shares. The most typical provision, which first appeared in the 1848 New York statute providing for general incorporation of manufacturing companies,<sup>169</sup> imposed "double liability" on shareholders. By the end of the nineteenth century, this provision "ha[d] been copied, in its essential features, in almost every State in the Union."<sup>170</sup> Many other constitutional or statutory enactments imposed even more extensive potential liability on shareholders.<sup>171</sup> As a result, the distinction between the liability of the "members" of a corporation and a partnership, so clear to modern eyes, was still regarded rather as a matter of degree than of kind throughout the nineteenth century. And even within the strictest of limited liability jurisdictions, the Trust Fund Doctrine promulgated by courts made innocent shareholders potentially liable for the difference between the par value and the purchase price of their shares.

When the Doctrine came under attack during the 1890s, its defenders emphasized that its main function was to protect creditors who had a right to suppose that the stated capital stock of a corporation reflected its real value. For a corporation

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<sup>166</sup> *Hawkins v. Glenn*, 131 U.S. 319 (1889); *Glenn v. Liggett*, 135 U.S. 533 (1890); *Glenn v. Taussig*, 135 U.S. 533 (1890); *Pincoffs, Corporations: Capital Stock A Trust Fund For Creditors*, 26 AM. U.L. REV. 100, 102 (1892).

<sup>167</sup> 1 W. COOK, *supra* note 60, at v (4th ed. 1898).

<sup>168</sup> The emphasis in histories of limited shareholder liability has been on identifying the periods in which shareholder liability to creditors of an insolvent corporation diverged from unlimited partnership liability. From this perspective, any limitation on otherwise unlimited liability is significant. See, e.g., *Dodd, The Evolution of Limited Liability in American Industry: Massachusetts*, 61 HARV. L. REV. 1351, 1379 (1948) (identifying when the American common law diverged from England and assumed limited liability as the norm in the absence of a legislative provision for liability). As a result, scholars have tended to underemphasize the fact that, in most jurisdictions throughout the nineteenth century, the usual statutory provision made the shareholder liable for much more than—normally twice—the value of his shares.

<sup>169</sup> 1848 N.Y. Laws, ch. 40.

<sup>170</sup> 1 W. COOK, *supra* note 60, at 203-06.

<sup>171</sup> See 3 S. THOMPSON, *supra* note 35, at chs. 46, 50 (1st ed. 1895).

to sell shares at discount was, they argued, a fraud on subsequent creditors. But unlike its original "partnership" rationale this argument for the Trust Fund Doctrine already conceded that corporations were separate entities and that the stockholders were only investors, not owners, managers, or members of a corporation. If the Trust Fund Doctrine was simply designed to give notice to protect creditors, the Doctrine's opponents replied, it can only apply to subsequent creditors since existing creditors could not have relied on a subsequent issue of watered stock.

By degrees, courts beginning in the 1890s gradually eroded the Trust Fund Doctrine. One of the most important immediate influences in producing the change was the rise of a national stock market, which definitively converted shareholders into impersonal investors. Yet, this was only the culmination of a long-term transformation by which shareholders, once regarded as "members" of a corporation, not fundamentally different from partners, came to be treated as completely separate from the corporate entity itself.

## 2. The Structural Transformation of the Corporation

In order to comprehend the changes in legal doctrine during the 1890s, we should first understand the dramatic changes in the structure of the business corporation as well as the market for stock that took place during the 1880-1900 period.

The major changes were in the size and scale of industrial companies. Before 1890, only railroads constituted "large, well-established, widely known enterprises with securities traded on organized stock exchanges, while industrials, though numerous, were small, scattered, closely owned, and commonly regarded as unstable."<sup>172</sup> Most of the manufacturing enterprises of the 1880s have been described as "small" companies, with net worth under \$2 million. For the sake of comparison, there were extremely few "very large" companies worth more than \$10 million, and even enterprises classified as "large" (worth between \$5 million and \$10 million) were also "fairly rare."<sup>173</sup> By contrast, "each of the country's ten largest railroads had more than \$100 million of net worth and the largest of them all, the Pennsylvania Railroad, had over \$200 million."<sup>174</sup>

In manufacturing, "the partnership form of organization predominated. . . . Where enterprises were incorporated, and, therefore, had outstanding securities, these were generally held by a small group of persons and were infrequently offered for sale to the public."<sup>175</sup>

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<sup>172</sup> Navin & Sears, *The Rise of a Market for Industrial Securities, 1887-1902*, 29 *BUS. HIST. REV.* 105, 106 (1955).

<sup>173</sup> *Id.* at 109.

<sup>174</sup> *Id.* at 109 n.4.

<sup>175</sup> *Id.* at 109.

Most of the leading manufacturing companies were family-owned. Even two of the "very large" companies, Singer Manufacturing and McCormick Harvesting Machine, were controlled by and had a majority of their stock owned by the family. And Andrew Carnegie's combined steel interests, which constituted among the very largest of manufacturing enterprises, were organized as closely owned partnerships until they converted to the corporate form in 1892.<sup>176</sup>

Nearly all of the distributive enterprises—wholesalers like Marshall Field in Chicago, R. H. Macy's in New York, and John Wanamaker in Philadelphia—were organized as partnerships as were companies in gold mining and oil drilling. And while the processing branch of industry—oil refining, sugar refining, lead smelting—was the first category in which large-scale publicly owned enterprises (besides railroads) developed during the 1880s, the meat processing giants, Swift and Armour, retained the partnership form well into the 1880s.

Before 1890 a man with excess capital to invest was likely to put his money into real estate. If he chose to buy securities, he had a relatively narrow range from which to select. The principal type of security investment was in railroading. Industrial securities, except in the coal and textile industries, were almost unknown.<sup>177</sup>

Those industrial securities that did exist were usually exchanged only in "direct person-to-person sales."<sup>178</sup> Between 1890 and 1893, however, industrials began to be listed on the Stock Exchange and to be traded by leading brokerage houses. And only after 1897, in the midst of the merger movement, did companies publicly offer shares of stock, replacing the system of "private" subscriptions that had prevailed throughout the nineteenth century. It is perhaps at this moment that we can clearly identify the beginning of the shift away from "the traditional point of view" of shareholders as "the ultimate owners, the corporate equivalent of partners and proprietors."<sup>179</sup>

### 3. The Overthrow

When Seymour Thompson published his six-volume treatise on corporation law in 1895, he lamented the fact that the Trust Fund Doctrine had only recently "been greatly modified" by American courts—"so much so, that it may now be doubted whether the capital of a corporation is a trust fund for its creditors in any different sense than the sense in which the property of a private person is a trust fund for his creditors."<sup>180</sup>

Beginning in 1887, the New York Court of Appeals overthrew the Trust Fund

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<sup>176</sup> *Id.* at 109-10.

<sup>177</sup> *Id.* at 106.

<sup>178</sup> *Id.* at 137.

<sup>179</sup> A.A. FREIDRICH, *Stocks and Stock Ownership*, 14 *Encyclopedia of Social Sciences* 403 (1937).

<sup>180</sup> I S. THOMPSON, *supra* note 35, at vii (1st ed. 1895).

Doctrine.<sup>181</sup> And, in a widely followed opinion, the Minnesota high court held in 1892 that only fraud could permit a creditor to recover against a holder of "watered stock."<sup>182</sup> The most important consequence of this shift to a fraud theory was that in a majority of jurisdictions only subsequent creditors—those who presumably had relied on representations about the capital stock of the corporation—could sue on, "watered stock."<sup>183</sup>

But the most controversial departures from the Trust Fund Doctrine appeared in a series of cases decided by the United States Supreme Court in 1891 through 1893. In the leading case of *Handley v. Stutz*<sup>184</sup> (1891), the high court, while purporting to reaffirm the Trust Fund Doctrine, distinguished between the original subscription to corporate shares, to which traditional trust fund shareholder liability applied, and a subsequent issue of shares at a discount by a "going concern," which created nonliability. Even Seymour Thompson conceded that where an established corporation "finds itself in urgent need" of money, "it would be a hard and perhaps a mischievous rule that would prevent it from reselling the shares at their market value."<sup>185</sup> Yet, he protested that, taken together, Supreme Court decisions had "overturn[ed] all former rulings" of the Supreme Court and "totally obliterate[d]"<sup>186</sup> the Trust Fund Doctrine.

*Handley v. Stutz* and companion cases provided the opportunity for those who wished to attack the Trust Fund Doctrine. In its different treatment of the original and subsequent stock issues, wrote George Wharton Pepper, the Supreme Court had undertaken "the impossible task of distinguishing on principle between the status of two sets of stockholders."<sup>187</sup> Based on the Court's decisions, he concluded, the Trust Fund Doctrine "is neither a theory nor a doctrine."<sup>188</sup>

The seeming incoherence of the Court's distinction between the liability of different classes of shareholders encouraged advocacy of the more restricted fraud theory of liability.<sup>189</sup> Indeed, between 1891 and 1893, the Supreme Court itself

<sup>181</sup> *Christensen v. Eno*, 106 N.Y. 97, 102, 12 N.E. 648 (1887); *Southworth v. Morgan*, 205 N.Y. 293, 93 N.E. 490 (1912); *Jeffrey v. Selwyn*, 220 N.Y. 77, 115 N.E. 275 (1917). See generally W. Cook, *TREATISE ON THE LAW OF CORPORATIONS HAVING A CAPITAL STOCK* (4th ed. 1898).

<sup>182</sup> *Hospes v. Northwestern Mfg. Co.*, 48 Minn. 174, 50 N.W. 1117 (1892).

<sup>183</sup> Ballantine, *Stockholders Liability in Minnesota*, 7 MINN. L. REV. 79, 88 (1923); Note, *The Nature of the Stockholder's Liability for Stock Issued at a Discount*, 29 HARV. L. REV. 854, 856 (1916).

<sup>184</sup> *Handley v. Stutz*, 139 U.S. 417 (1891). See also *Clark v. Bever*, 139 U.S. 96 (1891); *Fogg v. Blair*, 139 U.S. 118 (1891).

<sup>185</sup> 2 S. THOMPSON, *supra* note 35, at 1295 (1st ed. 1895).

<sup>186</sup> *Id.* at 1296.

<sup>187</sup> Pepper, *Recent Development of Corporation Law by the Supreme Court of the United States II*, 34 AM. LAW REG. 448, 457 n.2 (1895).

<sup>188</sup> *Id.* at 456. See also Pepper, *The "Trust Fund Theory" of the Capital Stock of a Corporation*, 32 AM. LAW REG. 175 (2d sev.) 6 (1893).

<sup>189</sup> See, e.g., Harriman, *Corporate Assets as a "Trust Fund for the Benefit of Creditors,"* 3 N.W. L. REV. 115, 206 (1894); McMurtrie, *Is Unpaid Capital a Trust Fund in Any Proper Sense?*, 25 AM. L. REV. 749 (1891).



wavered between theological reaffirmation of the Trust Fund Theory and statements that went to the verge of overruling the Doctrine.<sup>190</sup>

The root of the problem was that the relationship of the shareholder to the corporation had begun fundamentally to change during the 1890s. "[T]he liability of the stockholder to pay in full for his stock was an obligation placed upon him because of his relation to the corporation." Under "the traditional point of view," the shareholders were "the ultimate owners, the corporate equivalent of partners and proprietors."<sup>191</sup>

But as the market for shares widened, the relation of the shareholders to the corporation began to be redefined. For example, one of the major limitations on the Trust Fund Doctrine began to take shape even before *Handley v. Stutz* was decided. Was a subsequent bona fide purchaser of "watered stock" liable to creditors? No, answered the influential jurist, John F. Dillon in an 1879 railroad stock case. "Millions of dollars of stocks are sold in this country every week," Dillon wrote, "and there is no practice on the part of purchasers, and no understanding that the law requires of them that they shall ascertain . . . that certificates of full-paid stock have, in fact, been fully paid. . . . Besides, on what principle is it that a purchaser of the company's shares is to be held to be the guardian of the rights of the company's creditors and bound to protect them?"<sup>192</sup>

As the marketing of corporate shares moved away from formal "private" subscriptions, the meaningfulness of the Supreme Court's distinction between original and subsequent issues of stock began to collapse. So too, as Judge Dillon had suggested, the difference between bona fide purchasers of original and subsequent shares. "Certificates of stock have become such important factors in trade and credit, and general investment by all classes," wrote William W. Cook in 1898, "that the law is steadily tending towards the complete protection of a *bona fide* purchaser of them in open market. . . . The constant tendency of the courts to increase the negotiability of certificates of stock will probably establish the rule that the purchaser in good faith of a certificate of stock is not liable on any unpaid subscription price thereof, unless such liability is stated on the face of the certificate itself. Indeed, even now this may be said to be the established rule."<sup>193</sup>

<sup>190</sup> Compare *Camden v. Stuart*, 144 U.S. 104 (1892) with *Hollins v. Brierfield Coal & Iron Co.*, 150 U.S. 371 (1893). See *Pepper*, *supra* note 187, at 450.

<sup>191</sup> Note, *supra* note 183, at 856.

<sup>192</sup> *Stacy v. Little Rock Railroad*, 5 Dill. 348, 373-74, 22 F. Cas. 1142, 1152 (E.D. Ark. 1879) (No. 13,329).

<sup>193</sup> 1 W. Cook, *supra* note 60, at 498 n.1, (4th ed. 1898). This idea first appeared in Cook's treatise, Section 257, n.2, as early as 1889 (2d ed.), except that he predicted that "some time hereafter" the rule of full negotiability would be established. The statement in the text, from the third edition (1895), was the first to declare it as "the established rule." By the eighth edition in 1923, Cook eliminated the statement that it had already become the "established rule," and simply cited cases for the proposition that it was "the better opinion, and the one most in accord with the usages and demands of trade." 2 W. Cook, *supra* note iii at 854, section 257 n.2.

With the development of investment banking after 1900, even the marketing of original shares of corporate stock no longer entailed a formal relationship between the corporation and a subscriber. The original investor who purchased shares in the market for less than par value now was in a position no different from the subsequent bona fide purchaser whom courts had already been protecting against creditors.<sup>194</sup>

The establishment of a complete market for stock thus made an anachronism of the Trust Fund Doctrine. Indeed, New York in 1912 and Delaware in 1917 permitted the issue of stock without par value, and by 1924 thirty-four states had followed suit.<sup>195</sup> The Delaware law "in effect though not in form . . . cut off the creditors' remedy of shareholders' liability" when stock was issued for property or services.<sup>196</sup> By 1925, James C. Bonbright noted "that many lawyers with a long and extensive practice in corporation cases have never had a single suit involving a shareholder's liability on watered stock."<sup>197</sup> Little more than a generation earlier, by contrast, such suits had been the stock in trade of legal writing on corporation law.

When the Trust Fund Doctrine first came under attack during the 1890s, George Wharton Pepper noted that "many fundamental questions in regard to the legal status of corporations are still unsettled. . . . [I]t may be doubted whether any six learned judges would to-day give explanations even substantially similar of the difference between corporations and joint stock companies or statutory partnerships."<sup>198</sup> Indeed, as Pepper noted, one of the theories that might make the Trust Fund Doctrine coherent was a partnership theory, "the view that the corporation is identical with the members that compose it. . . ."<sup>199</sup> But the tendency of courts to distinguish between prior and subsequent purchasers of "watered stock"—a shift from the trust fund to the fraud doctrine—had already begun to erode such a conception.

When George Wharton Pepper introduced Maitland's work on Gierke to an American audience in 1901, he was quick to notice that a natural entity theory of the corporation made the Trust Fund Doctrine "unnecessary."<sup>200</sup> And a year later, a critic of the Doctrine charged the Supreme Court with "refus[al] to accept the consequences" of an entity theory of the corporation, which meant, he believed, overthrow of the Trust Fund Doctrine.<sup>201</sup>

<sup>194</sup> See Navin & Sears, *supra* note 172, at 137-38 (8th ed. 1923).

<sup>195</sup> J. W. COOK, *supra* note 60, at 291 n.4, 5; Bonbright, *The Dangers of Shares Without Par Value*, 24 COL. L. REV. 449, 458 (1924).

<sup>196</sup> Bonbright, *supra* note 195, at 460.

<sup>197</sup> *Id.* at 432.

<sup>198</sup> Pepper, *Recent Development of Corporation Law by the Supreme Court of the United States I*, 34 AM. LAW REG. at 296 (1895).

<sup>199</sup> Pepper, *supra* note 187, at 453.

<sup>200</sup> Pepper, *A Brief Introduction to the Study of the Law of Associations*, 40 AM. LAW REG. 255, 267 (o.s.) 49 (1901).

<sup>201</sup> Hunt, *The Trust Fund Theory and Some Substitutes For It*, 12 YALE L.J. 63, 67 (1902).

The natural entity theory of the corporation thus emerged at virtually the same moment as the Trust Fund Doctrine began to collapse. As we have seen, one of the major organizing premises of the natural entity theory was to posit the existence of a sharp distinction between the corporate entity and the shareholders. It was precisely this picture that ultimately subverted the coherence of the Trust Fund Doctrine.

#### H. *The Corporate Entity and the Power of Directors*

At some point at the beginning of the twentieth century, American legal opinion began decisively to shift to the view that "the powers of the board of directors . . . are identical with the powers of the corporation."<sup>202</sup> Earlier, the dominant view, as expressed by the United States Supreme Court, was that "when the charter was silent, the ultimate determination of the management of the corporate affairs rests with its stock holders."<sup>203</sup> "The law," said one federal court in 1881, "recognizes the stockholders as the ultimately controlling power in the corporation. . . ."<sup>204</sup> But modern corporate legislation, passed during the first quarter of the twentieth century, ratified a new "absolutism" that courts themselves had already begun to bestow upon corporate directors.<sup>205</sup>

Writing in 1895, Seymour Thompson identified "three radically different views"<sup>206</sup> that were still entertained by courts and legal thinkers concerning the nature and limits of the powers of corporate directors.

1. That the directors, being chosen representatives of the corporation, constitute, for all purposes of dealing with others, *the corporation itself*; hence, that within the scope of the objects and purpose of the corporation they have all the powers of the corporation itself.
2. That the directors have all the powers of *general agents* in the management of corporate affairs.
3. That they have only the powers of *special agents*. . . .<sup>207</sup>

In an early Supreme Court case involving the Bank of the United States, the Court, per Justice Story, had clearly rejected, over a dissent by Chief Justice Marshall, the first, most expansive, definition of the powers of directors.<sup>208</sup> "In ordinary business corporations," Thompson concluded, "the powers of the board of directors . . . fall far short of being co-equal with the powers of the corporation."<sup>209</sup>

<sup>202</sup> H. SPELLMAN, A TREATISE ON THE PRINCIPLES OF LAW GOVERNING CORPORATE DIRECTIONS 237 (1931).

<sup>203</sup> Union Pacific R.R. v. Chicago R.R., 163 U.S. 564, 596 (1896).

<sup>204</sup> Cass v. Manchester Iron & Steel Co., 9 F. 640, 642 (W.D. Pa. 1881).

<sup>205</sup> H. SPELLMAN, *supra* 202, at 6 n.24.

<sup>206</sup> 3 S. THOMPSON, *supra* note 35, at 2878 (1st ed. 1895).

<sup>207</sup> *Id.* at 2878-79.

<sup>208</sup> Bank of the U.S. v. Dandridge, 25 U.S. 64, 76, 78, 114-15 (1827).

<sup>209</sup> 3 S. THOMPSON, *supra* note 35, at 2881.

In England, the judges had limited the directors' powers even further by classifying them within the most restrictive category of special agents. "On the whole," Thompson concluded, "judicial theory, at least in America, greatly preponderates in favor of the proposition that the directors of a business corporation are its *general* or managing agents."<sup>210</sup>

The classification of directors as agents itself underwent some important changes. The leading antebellum treatise on corporation law, by Angell and Ames, best reflects the earlier understanding of the limited legal position of the board of directors in the corporation. Whereas Judge Thompson's 1895 treatise devoted almost 500 pages to the legal status of directors, there is not even a separate chapter on the subject in the 1861 edition of Angell and Ames. Their discussion of directors is scattered throughout a chapter on "Agents of Corporations," which indiscriminately lumps together officers and directors. They confidently declared that, in the absence of any contrary legal provisions, "the power to appoint officers and agents rests, of course, like every other power, in the body of the corporators" or shareholders.<sup>211</sup> And, most importantly, they announced the widely held view that directors have no inherent power "to appoint subagents to contract for the corporation . . . and accordingly contracts made by such subagents will not be binding on the corporation."<sup>212</sup>

In his 1877 treatise on corporation law, George W. Field observed that it was "usual" for corporations to confer the authority for managing the business "upon a limited number of the members usually called directors or managers, who act, in most respects . . . as agents for and in place of the corporation, and of the stockholders." In the absence of any other legal provision, wrote Field, "it is evident, on general principles, that the corporators [stockholders] would possess such power."<sup>213</sup> However, when in 1897 Professor Ernst Freund addressed the question of whether the relation between the board of directors and "the members at large of the corporation" was the same as or different from "that of principal and agent," he concluded that "both views have found judicial support."<sup>214</sup> While Freund saw that the agency analogy broke down to the extent that a majority shareholder resolution could not supersede the managing authority of the board, he did insist that, logically, unanimous shareholder action was the ultimate authority in the corporation. Indeed, Freund seemed to have endorsed "the view that the members at large are the true and ultimate holders of the corporate rights."<sup>215</sup>

The judicial reaction to the idea that corporate directors, being agents, could not delegate their powers to subagents is perhaps the best litmus test for identifying

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<sup>210</sup> *Id.* at 2881-82.

<sup>211</sup> ANGELL & AMES, *supra* note 129, at 257.

<sup>212</sup> *Id.* See also 3 S. THOMPSON, *supra* note 35, at 2862-63.

<sup>213</sup> G. FIELD, *LAW OF PRIVATE CORPORATIONS* (1877).

<sup>214</sup> E. FREUND, *supra* note 32, at 53.

<sup>215</sup> *Id.* at 48.

the changing legal status of directors. Only in the early twentieth century did courts widely assert that, because the directors were "the primary possessors of all the powers which the charter confers," the board's powers were therefore "original and undelegated" and hence could be conferred upon agents.<sup>216</sup>

The leading twentieth century treatise on the power of corporate directors was written to reflect this shift in legal opinion. "The enlargement of facilities for the purchase and sale of corporate securities," wrote Howard Holton Spellman in 1931, "the tendency toward combinations of corporations, and the consequent desirability of diversification of individual investments have joined to create a class of stockholders who regard themselves as investors rather than co-entrepreneurs. . . . Accordingly, modern decisions tend toward an emphasis of the directors' absolutism in the management of the affairs of large corporations; the board of directors has achieved a super-control of corporate management and of the corporation's legal relations. . . ." <sup>217</sup>

This shift in the internal constitution of the corporation was among the most important reasons for the demise of the partnership-contract theory of the corporation after 1900. Ernst Freund's "representation" theory of the corporation, for example, was directly dependent on "the view that the members at large are the true and ultimate holders of the corporate rights."<sup>218</sup> In 1897, Freund could still suppose that the realities of internal corporate organization could support such a theory. Yet, he already saw that "where the whole sum of corporate powers is vested by law directly in a board of directors . . . such an organization . . . allows us to see in a large railroad, banking or insurance corporation rather an aggregation of capital than an association of persons."<sup>219</sup>

### I. *The Natural Entity Theory*

For orthodox legal writers of the 1880s, it still seemed sufficient to quote John Marshall's view of the corporation as an "artificial entity" in order to combat the partnership theory. They could also cite an abundance of Supreme Court *ultra vires* decisions which continued to treat the corporation as a creature of the state.

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<sup>216</sup> *Manson v. Curtis*, 223 N.Y. 313, 322, 119 N.E. 558, 562 (1918). H. SPELLMAN, *supra* note 202, at 9-12. The leading case on the subject became *Hoyt v. Thompson's Exec.*, 19 N.Y. 207 (1859), which was largely ignored by the New York courts until it later became a favorite "old" citation for recognizing plenary power in the board of directors. See *Beveridge v. New York Elevated Railroad Co.*, 112 N.Y. 1, 22-23 (1889); *People ex rel. Manice v. Powell*, 201 N.Y. 194, 200 (1911); *Manson*, 223 N.Y. at 322, 119 N.E. at 562. A second early favorite, frequently cited in the twentieth century, was an opinion by Chief Justice Shaw in *Burrill v. Nahant Bank*, 43 Mass. 163 (1804). More typical cases reflecting the early view of directors as agents who could not delegate their powers are *Mechanics Bank v. New York & New Haven Railroad Co.*, 22 N.Y. 258, 295 (1860) (opinion of Selden, J.); *Brokaw v. New Jersey Railroad Co.*, 32 N.J.L. 328, 332 (1867).

<sup>217</sup> H. SPELLMAN, *supra* note 202, at 4-5.

<sup>218</sup> E. FREUND, *supra* note 32, at 58.

<sup>219</sup> *Id.* at 60.

Above all, the artificial entity theory stood in the way of corporate consolidation. For those who, like Arthur Eddy, wished to argue that "corporations have the same power to acquire property as has an individual,"<sup>220</sup> it was essential that the artificial entity theory be overthrown. For Eddy, theories such as that of the New York Court of Appeals in the celebrated Sugar Trust Case, amounted to "a positive restriction of that liberty which is guaranteed by free institutions." The New York court had written:

It is not a sufficient answer to say that similar results may be lawfully accomplished; that an individual having the necessary wealth might have bought all these sugar refineries, manned them with his own chosen agents, and managed them as a group, at his sovereign will; for it is one thing for the state to respect the rights of ownership and protect them out of regard to the business freedom of the citizen, and quite another thing to add to that possibility a further extension of those consequences by creating artificial persons to aid in producing such aggregations. The individuals are few who hold in possession such enormous wealth, and fewer still who peril it all in a manufacturing enterprise; but if corporations can combine and mass their forces in a solid trust or partnership, with little added risk to the capital already embarked, without limit to the magnitude of the aggregation, a tempting and easy road is opened to enormous combinations, vastly exceeding in number and strength and in their power over industry any possibilities of individual ownership; and the state, by the creation of the artificial persons constituting the elements of the combination . . . becomes itself the responsible creator, the voluntary cause, of an aggregation of capital which it simply endures in the individual as the product of his free agency. What it may bear is one thing; what it should cause and create is quite another.<sup>221</sup>

During the 1890s, one finds a growing movement to attack this "artificial entity" theory of the corporation. Perhaps the original appeal of the contractualists to the underlying meaning of general incorporation laws had begun to sink in. Or, perhaps, the casual declaration by the Supreme Court in 1886 that the business corporation was a "person" under the fourteenth amendment was beginning to have an effect, though the real significance of that doctrine was still in the future. More probably, the phenomenal migration of corporations to New Jersey after 1889 made legal thinkers finally see that, in fact as well as in theory, corporations could do virtually anything they wanted to. The literature of the 1890s on the inevitability of concentrated enterprise reflected this new reality by emphasizing for the first time the epiphenomenal nature of legal forms.

Beginning in the 1890s and reaching a high point around 1920, there is a virtual obsession in the legal literature with the question of corporate "personality."<sup>222</sup> Over and over again, legal writers attempted to find a vocabulary that would enable

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<sup>220</sup> 1 A. EDDY, *supra* note 114, at 602.

<sup>221</sup> New York v. North River Sugar Refinery, 121 N.Y. 582, 625 (1890).

<sup>222</sup> See, e.g., W. Jethro Brown, *The Personality of the Corporation and the State*, 21 L.Q.R. 365 (1905).

them to describe the corporation as a "real" or "natural" entity whose existence is prior to and separate from the state. What the contractualists first tried to express, with only the vocabulary and concepts of natural rights individualism then available to them, the entity theorists completed.

Along with the contractualists, they sought to represent the corporation as entirely separate from the state and therefore really "private." Contrary to the contractualists, they insisted that groups were just as "real" as individuals and that, in addition, the corporation was separate and distinct from its shareholders.

The earliest group of these "natural entity" theorists, writing in ignorance both of Gierke and Maitland, simply repeated over and over again that the corporation was not fictional, but "real," and that it was a "fact" like any other holder of rights.<sup>223</sup> Corporations were "autonomous, self-sufficient and self-renewing bod[ies]," and "they may determine and enforce their common will." "[N]either the group nor its functions is created by the state."<sup>224</sup>

The most brilliant of these early efforts to express the reality of groups was University of Chicago Professor Ernst Freund's *The Legal Nature of Corporations* (1897). Influenced by the work of Gierke on the nature of the corporation, Freund sought to translate Gierke's Hegelian analysis for a practical-minded and anti-metaphysical American Bar.

For Freund, the basic conflict was between the fiction theory, which denied the idea of a distinct legal personality in the corporation, and the organic theory, propounded by many German jurists, "who insist that the distinctiveness of the corporate personality is as real as the individuality of a physical person."<sup>225</sup> The proponents of the fiction theory, by contrast, argued that a corporate entity "is nothing but the sum of its parts,"<sup>226</sup> ultimately reducible to the reality of individual wills.

Running through Freund's argument is the effort to overcome the traditional private law emphasis on the individual character of legal rights. "If the individual, private and beneficial right is to measure and govern all rules relating to rights of whatsoever nature, then the corporate right will continue to be abnormal and illogical."<sup>227</sup> On the other hand, the organic theory was "illusory" in encouraging "the impression that . . . corporate personality possesses an absolute unity and distinctiveness. . . ."<sup>228</sup> Its emphasis on the psychological cohesiveness and organic unity of groups did not really describe the business corporation, whose members were "without any noticeable psychological connection" even though they "may

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<sup>223</sup> D. JONES, *supra* note 153, at 80-81.

<sup>224</sup> Davis, *The Nature of Corporations*, 12 POL. SCI. Q. 273, 278 (1897).

<sup>225</sup> E. FREUND, *supra* note 32, at 13.

<sup>226</sup> *Id.* at 11.

<sup>227</sup> *Id.* at 48.

<sup>228</sup> *Id.* at 51.

easily exercise common rights.”<sup>229</sup> Above all, German organicist theory had lost itself “in metaphysical speculations and refined distinctions of little substantial value.”<sup>230</sup>

Between individualism and organicism, Freund presented a theory of “representation,” which portrayed the corporation as a representative democracy governed by majority rule. When “we speak of an act or an attribute as corporate, it is not corporate in the psychologically collective sense, but merely representative, and imputed to the corporation for reasons of policy and convenience.”<sup>231</sup>

But Freund acknowledged the radical break with individualism he was proposing for corporate theory. He was, after all, attempting to justify the power of the corporate majority to bind the minority.

That each person should fully answer for all his acts, and should not answer for the acts of others, is indeed a maxim of extraordinary importance, and it seems to be violated in the admission of representative action not resting upon express delegation. Against this it can only be urged that the maxim without modification is unjustifiable, because it antagonizes or prevents the full protection of joint interests, which, as we have seen, demand representation. The foundation of all liability upon principles of moral responsibility is a legal conception which may be carried to excessive lengths; even if fully justified where liability is penal and the moral quality of the act is of the essence of its legal aspect, it may be inadequate where it is simply a question of adjusting conflicting interests in accordance with prevailing ideas of justice and equity.<sup>232</sup>

Yet, as with the earlier contractual theorists, Freund had his greatest difficulty in accounting for the oligarchic tendencies that were already becoming dominant within the large corporation. Many statutes vested corporate powers directly in the board of directors, he noted. At that point, he acknowledged, “corporate capacity would thereby be shifted from the members at large to the governing body. . . . Such an organization reduces the personal cohesion between the [shareholders] to a minimum, and allows us to see in a large railroad, banking or insurance corporation rather an aggregation of capital than an association of persons.”<sup>233</sup>

At the very moment, then, at which Freund sought to derive the corporate personality from majority rule of the shareholders, the corporate entity itself was becoming virtually independent of the shareholders. It required a still more abstract justification of corporate personality, divorced entirely from any pretense that, ultimately, the shareholders ruled.

Two years after Freund wrote, Henry Williams attempted that justification. In an article in the *American Law Register*, he asserted that shareholders “possess

<sup>229</sup> *Id.*

<sup>230</sup> *Id.* at preface, 5.

<sup>231</sup> *Id.* at 52.

<sup>232</sup> *Id.* at 47.

<sup>233</sup> *Id.* at 59-60.



no actual existing legal interest . . . whatever" in a corporation. Even in the case of dissolution, "when their actual legal rights first accrue," shareholders' rights were "entirely subsidiary" to creditors. "The stockholders," he concluded, "are in the position of the heirs, or next of kin or residuary legatees of a living person."<sup>234</sup>

In the flood of articles on corporate personality after the turn of the century, legal writers continued to reinforce the notion that a group must be treated as "an organic whole . . . which cannot be analyzed into the mere sum of its parts."<sup>235</sup> The corporation, these writers insisted, was a "real" entity, a "fact," not a "fiction."<sup>236</sup> University of Chicago Law Professor Arthur W. Machen summed up these views in an influential 1911 article, emphasizing "the naturalness and indeed inevitableness of the conception of a corporation as an entity."

In these days it has become fashionable to inveigh against the doctrine that a corporation is an entity, as a mere technicality and a relic of the Middle Ages; but nothing could be further from the truth. A corporation is an entity—not imaginary or fictitious, but real, not artificial but natural.<sup>237</sup>

Following the inevitability theorists, Machen underlined the new view that the corporation existed prior to law. "All that the law can do is to recognize, or refuse to recognize, the existence of this entity. The law can no more create such an entity than it can create a house out of a collection of loose bricks. . . ."<sup>238</sup>

What was the political significance of the thousands of pages devoted to the question of corporate personality? The argument between entity and contractual theorists during the 1880s and 1890s was, at bottom, a conflict over whether the individual or group was the appropriate unit of economic, political, and legal analysis. Some contractualists were openly hostile to big business and offered the partnership model as an alternative to the corporate form, to which they ascribed most of the evils of consolidation and monopoly. But other contractualists were not so much opposed to the corporation as they were to its oligarchic tendencies. Contractualism was, for them, a way of reasserting the primacy of shareholder control.

In one important respect, contractualism prepared the way for the triumph of the natural entity theory. Reasoning from individualist premises so prominent in the decades immediately after the Civil War, the contractualists were the first to see the anomalous character of the "artificial entity" theory of the corporation, not only because it clashed with the underlying spirit of general incorporation laws, but also because of its hostility to any theory of natural rights. Every bit as much as the natural entity theorists, the contractualists worked from a conception of

<sup>234</sup> Williams, *An Inquiry into the Nature and Law of Corporations*, 38 AM. L. REG. (n.5) 1, 3 (1899).

<sup>235</sup> Brown, *supra* note 222, at 379.

<sup>236</sup> See RAYMOND, *THE GENESIS OF THE CORPORATION* 216 (1906).

<sup>237</sup> Machen, *Corporate Personality*, 24 HARV. L. REV. 253, 261-62 (1911).

<sup>238</sup> *Id.*

property as existing prior to the state. By contrast, the artificial entity theory represented a standing reminder of the social creation of property rights.

The main effect of the natural entity theory of the business corporation was to legitimate large scale enterprise and to destroy any special basis for state regulation of the corporation that derived from its creation by the state. Indeed, the demise both of the ultra vires doctrine as well as of constitutional restrictions on foreign corporations was an expression of the triumph of the natural entity theory. An entity theory was also helpful for advocating even more limited shareholder liability while justifying the growing irrelevance of the shareholders in the modern business corporation. Finally, it obliterated the claim that corporate mergers were different from individual acquisitions of property.

In their emphasis on corporate "personality," early natural entity adherents attempted simply to capitalize on the language of natural rights individualism by portraying the corporation as just another right-bearing person. Most later progressive legal thinkers, however, followed Ernst Freund's more "realistic" effort, dismissing the idea of corporate "personality" as merely a "metaphor." But the progressives were at one in seeking to demonstrate the "real" and "natural" character of corporations.

If the natural entity theory arose to legitimate emerging large scale enterprise, it became in the hands of Progressive thinkers a way of being realistic about social and economic trends. Large corporations were here to stay, and, as one of the ablest Progressive legal writers, Gerard Henderson, put it in 1918, the natural entity theory "looks upon a corporation . . . as a normal business unit, and its legal personality as no more than a convenient mechanism of commerce and industry. . . . [T]he material basis is the growing internationalism of business, of trade, of investment."<sup>239</sup>

By the time Henderson wrote, Progressives had struggled to emancipate themselves from legal conceptions rooted in natural rights individualism. If the central goal of earlier natural entity theorists had been to extend the natural rights of individuals to the corporate "personality," the Progressives instead sought to show that all rights, both corporate and personal, were entirely the creature of the state. "When we speak of a corporation being the subject of rights," Henderson wrote, "we mean that it has the capacity to enter into legal relations—to make contracts, own property, bring suits. Rights, in this sense, are pure creatures of the law. . . . There is no reason, except the practical one, why, as some one has suggested, the law should not accord to the last rose of summer a legal right not to be plucked."<sup>240</sup>

Thus, the "corporate device" was "not an expression of any philosophic quality in the group—of any group will or group organism. It is no more than a conve-

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<sup>239</sup> G. HENDERSON, *supra* note 67, at 3.

<sup>240</sup> *Id.* at 166.

nient technical device . . . to achieve the practical results desired, of unity to action, continuity of policy [and] limited liability. . . ."<sup>241</sup>

Both the "fictional" and the "realist" schools had unnecessarily assumed that only "persons" could be the bearers of legal rights, Henderson argued. "The assumption that a person alone can be the subject of rights is based on the conception of a right as a philosophic entity, springing out of the nature of man, independent of the law and anterior to it."<sup>242</sup> This view, "modern jurisprudence has very generally rejected."<sup>243</sup>

Henderson echoed Pound in arguing that there were, in fact, not "rights" but "interests."<sup>244</sup> Thus, the "practical" recognition of the corporate entity in no way implied special privileges or protections for corporations. "The social purposes for which legislation may override private interests are of the broadest sort, and fortunately their scope is constantly growing. . . . All legislation must be tested . . . by the fundamental criterion whether it is reasonably adapted to securing these interests. . . ."<sup>245</sup>

However often the Progressives ridiculed discussions of corporate "will" and "personality" as a metaphysical inquiry derived from outmoded natural rights conceptions, they were not indifferent to whether the corporation should be treated as a real entity. Here they stood together with earlier "realist" thinkers in insisting that the recognition and protection of group interests was a "practical" necessity of modern life. "The commercial world," wrote Henderson, "whose habits of thought so largely influence the development of law, has come to regard the business unit as the typical juristic entity, rather than the human being. . . . New economic phenomena, railroads, industrial combinations, the emergence of hitherto disregarded social classes, determine its growth."<sup>246</sup>

It was the task of Realist legal thinkers to adjust legal conceptions to these changes. For example, the earlier conception that the stockholders constitute the corporation, Henderson wrote, "is of no value under modern conditions. The modern stockholder is a negligible factor in the management of a corporation."<sup>247</sup> Standing behind the pragmatism of the Progressive view of corporations, then, was an acceptance of the recent triumph of the corporate form as "a normal business unit."<sup>248</sup> No longer was it necessary to resort to "metaphysics" to establish the legitimacy of the business corporation. It had become a *fait accompli*.

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<sup>241</sup> *Id.* at 167.

<sup>242</sup> *Id.* at 165-66.

<sup>243</sup> *Id.* at 165.

<sup>244</sup> *Id.* at 174.

<sup>245</sup> *Id.*

<sup>246</sup> *Id.* at 5, 8.

<sup>247</sup> *Id.* at 169.

<sup>248</sup> *Id.* at 3.

## IV. CONCLUSION

The *Santa Clara* case did not represent the triumph of a "natural entity" theory of the corporation. In 1886, when old conservatism still dominated the world view of Supreme Court justices, any such conception of corporate personality would have been received with hostility by a court still actively suspicious of corporate power and the emergence of concentrated enterprise. The 1905 case of *Hale v. Henkel*,<sup>249</sup> underlines how late it was before the Supreme Court ambivalently began the move towards a "natural entity" theory in corporate constitutional jurisprudence. Its opinion that the search and seizure provisions of the fourth amendment apply to the corporation while the fifth amendment's self-incrimination clause does not, still wavers between the past and the future.

In *Santa Clara* a "natural entity" theory was unnecessary for the immediate task of constitutionalizing corporate property rights. An "aggregate" or "partnership" or "contractual" vision of the corporation—with well established roots going back to the *Dartmouth College Case*<sup>250</sup>—was sufficient to focus the conceptual emphasis on the property rights of shareholders. Either a partnership or natural entity view could equally successfully have subverted the dominant "artificial entity" view of the corporation as a creature of the state.

If the choice between a "natural entity" and partnership theory was a toss-up when *Santa Clara* was decided, other nonconstitutional considerations soon pushed American legal theory towards the entity conception.

First, by 1900 it was no longer easy to conceive of shareholders as constituting the corporation. Changes in the conception of the shareholder from active "owner" to passive "investor" weakened the evocative power of partnership theory. Moreover, the entity theory was better able to justify the weakened position of the shareholders in internal corporate governance.

Second, the partnership theory represented a threat to the legitimacy of limited liability of shareholders. The entity theory, by contrast, emphasized the distinction between corporations and partnerships.

Third, while the partnership theory pushed in the direction of requiring shareholder unanimity for corporate mergers, the entity theory made the justification of majority rule possible.

Fourth, the entity theory was superior to the partnership theory in undermining Chief Justice Taney's foreign corporation doctrine which represented a substantial legal threat to the emergence of national corporations doing business in each of the states. The foreign corporation doctrine's reversal, shortly before World War I, can be associated with the triumph of the entity theory.

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<sup>249</sup> *Hale v. Henkel*, 201 U.S. 43 (1905). See also cases cited *supra* note 46.

<sup>250</sup> *Dartmouth College*, 17 U.S. (Wheat.) 518.

Finally, let me now remind you of why, if I am correct, these conclusions are important for general legal theory.

While it might be possible at some high level of abstraction divorced from concrete social understandings to demonstrate that the partnership theory could be manipulated to accomplish any of the legitimating tasks for which I have claimed the natural entity theory was superior, in many of the specific historical contexts I have identified the two conceptions of corporate personality did not have equal evocative or persuasive power. Indeed, they carried with them considerable legal and intellectual baggage that did not permit random deployment or infinite manipulability.

While John Dewey may have been correct in identifying the contradictory or random deployment of these conceptions as applied to labor unions and business corporations, he could not, I believe, have successfully demonstrated that each theory of *corporate* personality could have equally legitimated the practices of emergent large scale business enterprise.

An important task of legal theory, then, is to uncover the specific historical possibilities of legal conceptions—to “decode” their true concrete meanings in real historical situations. We have spent much too much intellectual energy in the increasingly sterile task of discussing legal theory in a historical vacuum. That is one of the reasons why Anglo-American jurisprudence constantly seems to get no further than repeated rediscoveries of the wheel. By contrast, in more specific settings, one finds that legal theory does powerfully influence the direction of legal understanding.