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# Shareholder Democracy and the Economic Purpose of the Corporation

Donald J. Smythe\*

## *I. Introduction*

Interdisciplinary scholars often speak at cross-purposes. At times, their efforts may elicit little more than bemused indifference. But scholars with an interest in the corporation clearly need to communicate across disciplinary boundaries. We will never have a complete understanding of the corporation as a social, political, and economic entity unless we understand it coherently in all its dimensions, and we will never understand it coherently in all its dimensions unless we examine it rigorously from all perspectives. History is a source from which scholars across the humanities and social sciences draw insight, and so a symposium on understanding corporate law through history provides a rare opportunity for scholars from various disciplines to exchange alternative points of view.

Colleen Dunlavy has undertaken an extensive study of the governance mechanisms of nineteenth century corporations.<sup>1</sup> As she has carefully documented, the common law rule of one-vote-per-shareholder persisted well into the nineteenth century.<sup>2</sup> This is surprising because it seems to contradict the usual alignment of wealth and economic power in a market-based economy. Professor Dunlavy attributes the persistence of the one-vote-per-shareholder rule to the social conception of the corporation in early nineteenth century America as a "body politic" and to norms that treated shareholders more like

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1. See Colleen A. Dunlavy, *From Citizens to Plutocrats: Nineteenth-Century Shareholder Voting Rights and Theories of the Corporation*, in *CONSTRUCTING CORPORATE AMERICA* 66, 68 (Kenneth Lipartito & David B. Sicilia, eds., 2004) (discussing the four elements of Dunlavy's analysis of nineteenth century corporate governance).

2. See *id.* (discussing the emergence of plutocratic voting rights in the 1850s).

citizens in an egalitarian polity than modern-day investors in a profit-making business venture.<sup>3</sup>

There is no disputing Professor Dunlavy's facts—the one-vote-per-shareholder rule was much more prevalent at the start of the nineteenth century than it was at the end of it—but one might demur at her explanation. This Comment suggests an alternative view: The persistence of the one-vote-per-shareholder rule in the early nineteenth century and the transition to one-vote-per-share by the end of the nineteenth century may have had more to do with the economic purpose of the corporation than with the early nineteenth century social conception of the corporation as a body politic. Indeed, from this perspective the social conception of the nineteenth century corporation was bound up with its economic purpose, and it changed as the economic purpose and function of the corporation evolved.

## *II. The Corporation as a Market Institution*

The corporation is a market institution and, like all market institutions, it is a social construct with important social, political, and moral implications. Corporations make decisions that affect the allocation of scarce economic resources, the distribution of income, domestic political outcomes, and the scope of human rights. They decide, for instance, how much steel to buy, how many SUVs to produce, how to finance their employees' retirement plans, whether to outsource customer service operations, and whether to transact with suppliers that use child labor. In spite of all the important social and political implications, they do not make their decisions democratically, at least not as the term is commonly understood. Indeed, as Professor Dunlavy points out, under the one-vote-per-share rule that predominates in the United States today, decision-making power among the shareholders of the corporation is distributed quite plutocratically.<sup>4</sup> In theory, a shareholder's voting power is in proportion to her property rights in the corporation; the larger her stake, the greater her influence.<sup>5</sup>

Of course, it is well known that in most public corporations today shareholders exercise little control over the directors and senior executives.<sup>6</sup>

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3. *See id.* at 67–68 (discussing the democratic nature of early nineteenth century corporate governance).

4. *See id.* at 67 (stating that modern corporations base shareholder power on the amount of capital invested).

5. *See id.* (discussing the relationship between capital investment and shareholder control).

6. Indeed, the modern debate about the scope of shareholder democracy is more

Under state corporation statutes, responsibility for the management of the corporation is vested in the board of directors.<sup>7</sup> In practice, the board of directors necessarily delegates many decisions to the senior executives and is usually dependent on the senior executives for most of the information that it uses in making any other decisions.<sup>8</sup> Unless they happen to own a controlling stake, shareholders thus usually have little, if any, influence over the corporations in which they own shares. In fact, most stock investors today hold a diversified portfolio of stocks and other financial assets, and it would be almost impossible for them to acquire the knowledge and expertise in all of the various facets of the business activities that their corporations engage in for them to participate in any meaningful way in corporate decision-making. Most shareholders are in fact quite content to leave corporate decisions to the directors and senior executives of the corporation.

Of course, in theory, the shareholders could always coalesce around an issue or cause and exercise some control over the corporation through their power to elect or remove directors.<sup>9</sup> And decisions that effect fundamental corporate changes, such as the decision to merge with another company, liquidate assets, or change the corporate charter usually do require a shareholder vote.<sup>10</sup> Moreover, the management may submit some of their decisions for shareholder approval regardless of whether they are strictly required to do so by the state's corporation laws.<sup>11</sup> But for the most part, shareholders do not exercise much influence over corporate decisions, and they do not appear to have much interest in doing so. In practice, the modern American corporation is even less democratic than the one-vote-per-share rule suggests.

In that regard, the corporation is no different from other market institutions. All market institutions are social constructs, and the delegation of social decisions to markets always has political consequences.<sup>12</sup> Indeed, there

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concerned with the accountability of corporate managers to their shareholders than with the distribution of voting power among shareholders.

7. See STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 9 (2002) (stating that the operation of corporations are generally vested by statute in the board of directors).

8. See *id.* (discussing the delegation of managerial decisions).

9. See, e.g., MODEL BUS. CORP. ACT §§ 7.28, 8.08 (2003) (discussing the procedures by which shareholders elect or remove corporate directors).

10. See *id.* §§ 10.03, 11.04, 12.02 (2003) (outlining the voting power of shareholders).

11. See BAINBRIDGE, *supra* note 7, at 441 (pointing out that the vast majority of corporate decisions are made by the directors or senior executives).

12. There are basically two ways of organizing social decision-making: one is by delegating decision-making power to the individual participants in private market transactions, and the other is through the command and routine of government bodies and bureaucracies.

is an inveterate strain of libertarian thought that views the delegation of social decisions to markets as necessary to protect individual liberties against the tyrannies of the collective decision-making processes of governments. Milton and Rose Friedman, for instance, have famously argued that governments tend to be controlled by special interests and that their actions are often confounded by misaligned bureaucratic incentives and inadvertent bureaucratic incompetence.<sup>13</sup> Moreover, their decisions typically constrain and bind all, without exception.<sup>14</sup> Thus, an individual voter cannot exempt herself from a draft, or opt out of the tax obligations of a new Medicaid prescription drug benefit, or decline to participate in the social security system. From a libertarian perspective, delegating decisions to the market (in these examples, by choosing to have voluntary armed forces and private health care and pension systems) frees individuals from the tyranny of special interests and the incompetence and indifference of government bureaucrats and widens the scope of personal liberties.<sup>15</sup>

Delegating social decisions to markets also has important economic consequences. Most economists are wont to argue that it is much more efficient to delegate decisions over the allocation of scarce social resources to private individuals acting on their own initiative and in accordance with their own preferences in decentralized markets rather than to make them through the collective decision-making process of government.<sup>16</sup> Indeed, in the light of recent world history even some left-leaning critics of capitalism have conceded that markets are often highly efficient.<sup>17</sup> To paraphrase Robert Heilbroner, we live in the age of the triumph of capitalism, and markets play a central role in a capitalist economy.<sup>18</sup>

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13. MILTON FRIEDMAN & ROSE FRIEDMAN, *FREE TO CHOOSE: A PERSONAL STATEMENT* 115–19 (1980) (discussing the effects of special interest groups on government spending).

14. See CHARLES LINDBLOM, *POLITICS AND MARKETS* 65 (1977) (describing governments, or "authority systems," as having "strong thumbs, [but] no fingers").

15. See FRIEDMAN & FRIEDMAN, *supra* note 13, at 298–301 (advocating an "economic" Bill of Rights).

16. The First Fundamental Theorem of welfare economics states that a "Walrasian" equilibrium (a free market equilibrium that satisfies the conventional economic assumptions) is "Pareto" efficient. See HAL VARIAN, *MICROECONOMIC ANALYSIS* 191–203 (2d ed. 1984) (discussing the Pareto efficiency of a competitive equilibrium). Thus, it would be impossible to reallocate resources in such a way that any one person could be made better off without at least one other person being made worse off. *Id.*

17. See Robert Heilbroner, *The Triumph of Capitalism*, *THE NEW YORKER*, Jan. 23, 1989, at 98 (acknowledging that the fall of the Berlin Wall and the transformation of Eastern Europe at the end of the twentieth century was, at its heart, a rejection of central planning in favor of the market).

18. See *id.* (discussing the growth of democracy and the importance of the market

But markets are also highly plutocratic. In a free market, the buyer with the most purchasing power has the most influence over what gets produced and who gets to consume it.<sup>19</sup> Individual consumers decide whether they are going to buy a summer house, drive a Ferrari, or give to the local food bank. Obviously, a wealthy person's decisions have a much bigger impact on the allocation of resources than a poor person's, and for the most part, the rich and wealthy choose to exercise their economic power primarily for their own benefit. But since markets are inherently plutocratic, and since the corporation is a market institution, how could the corporation ever have been anything less than plutocratic? If market mechanisms were just as plutocratic in the early nineteenth century as today, why should the corporation have been any less so?

### *III. Democracy and the Social Meaning of the Nineteenth-Century Corporation*

As Professor Dunlavy and others have documented, the corporation was not always as plutocratic as we might have expected—or at least, it did not always *appear* to be as plutocratic as we might have expected. Shareholder voting rules in the American corporation appeared to be much more democratic at the start of the nineteenth century than they are today.<sup>20</sup> Professor Dunlavy focuses on the transition from one-vote-per-shareholder to one-vote-per-share to put corporate governance in a historical perspective.<sup>21</sup> From her vantage point, corporate decision-making became less democratic and more plutocratic as the nineteenth century unfolded.<sup>22</sup>

But if we are going to try to understand the social meaning of the transition from one-vote-per-shareholder to one-vote-per-share, we should also put the social meaning of democracy in historical perspective. The fundamental fabric of American social, political, and economic life changed

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economy).

19. One of the implications of the Second Fundamental Theorem of Welfare Economics is that very different Pareto efficient allocations of resources can be achieved through alternative distributions of initial property rights. See VARIAN, *supra* note 16, at 191–203 (explaining Pareto efficiency).

20. See Dunlavy, *supra* note 1, at 72–76 (discussing the impact of democratic ideals on corporate governance in the early nineteenth century).

21. See *id.* at 67 (stating that early nineteenth-century norms "tended to treat shareholders more like citizens in a relatively egalitarian polity").

22. See *id.* at 86–87 ("The power of the small shareholder declined" and "the corporation appeared more private than public and . . . the multitude of stockholders seemed more like passive investors than citizens of the corporate polity.").

quite dramatically during the nineteenth century.<sup>23</sup> Ironically, if we track the evolution of the American people's voting rights through the nineteenth century, the United States appeared to become much more democratic rather than less. In fact, in the early nineteenth century American society appeared to be highly plutocratic at precisely the time when the corporation appeared to be more democratic.

Most black Americans in the early nineteenth century were slaves. It was not until the Fifteenth Amendment to the United States Constitution was ratified in 1870 that black men were given any kind of constitutional right to vote, and even then it was only in federal elections.<sup>24</sup> Moreover, in the years after the Fifteenth Amendment was ratified, most Southern states enacted poll taxes and other voter qualifications that effectively disenfranchised most black males.<sup>25</sup> These poll taxes and voter qualifications also disenfranchised some poor white males and recent white male immigrants.<sup>26</sup> Indeed, most Eastern states had some form of property qualification that restricted the voting rights of poor white males even before the Civil War; voting rights were usually broader in the western states and territories, but possibly only because problems with land titles made property qualifications difficult to administer.<sup>27</sup> Poll taxes and other property qualifications were not made unconstitutional in federal elections until the Twenty-Fourth Amendment was ratified in 1964, and they

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23. This may sound like a platitude, since any nation must surely change in significant ways over the course of an entire century, but the United States changed in much more fundamental ways during the nineteenth century than the twentieth century. Consider some of the important changes: fundamental developments in constitutional law (e.g., the power of judicial review), the Civil War, the Emancipation Proclamation, westward expansion, the canals and railroads, and the Second Industrial Revolution.

24. See GEOFFREY R. STONE, LOUIS M. SEIDMAN, CASS R. SUNSTEIN, & MARK V. TUSHNET, *CONSTITUTIONAL LAW* 847–48 (1996) (discussing the history of suffrage in the United States). It is interesting to note that the equal protection clause of the Fourteenth Amendment did not automatically confer a constitutional right to vote on black males. U.S. CONST. amend. XIV, § 2. In fact, Section 2 of the Fourteenth Amendment acknowledged that states might use voter qualifications to limit adult males' voting rights and specified a scheme for reducing their representation in Congress for doing so. *Id.*

25. In addition to poll taxes, some of the Southern states also enacted literacy and residency requirements that disenfranchised many black males. Black males may have been even more effectively disenfranchised in the years immediately after the Civil War, however, by white-on-black electoral violence and intimidation. See RICHARD M. VALELLY, *THE TWO RECONSTRUCTIONS: THE STRUGGLE FOR BLACK ENFRANCHISEMENT* 91–96, 123–31 (2004) (discussing the various techniques used to keep black voters away from the polls during Reconstruction).

26. See DANIEL HAYS LOWENSTEIN & RICHARD L. HASEN, *ELECTION LAW* 30 (2d ed. 2001) (discussing the impact of secret ballots on poor and illiterate whites).

27. See *id.* at 26–28 (discussing possible explanations for broader voting rights in the western states).

were not made unconstitutional in state elections until *Harper v. Virginia Board of Elections*,<sup>28</sup> in 1966, in which the Supreme Court held that poll taxes violated the equal protection clause of the Fourteenth Amendment.<sup>29</sup>

White women did not have the right to vote in any part of the country until the territory of Wyoming extended them suffrage in 1869.<sup>30</sup> Colorado was the first state to grant women suffrage in 1893.<sup>31</sup> And it was not until the Nineteenth Amendment's ratification in 1920 that women had a constitutional right to vote. Perhaps not coincidentally, the expansion in women's voting rights through the nineteenth century was correlated with an expansion in their property rights. Under the common law that prevailed in all states at the start of the nineteenth century, a woman's husband acquired a right to possess and transfer her real property as soon as they were married.<sup>32</sup> The common law was not displaced until the states enacted various versions of the Married Women's Property Act.<sup>33</sup> Mississippi was the first state to do so in 1839; the other states enacted similar statutes throughout the remainder of the nineteenth century.<sup>34</sup> But even these still delegated married women to subordinate domestic roles.<sup>35</sup>

28. *Harper v. Va. Bd. of Elections*, 383 U.S. 663 (1966).

29. *See id.* at 666 ("[A] State violates the Equal Protection Clause of the Fourteenth Amendment whenever it makes the affluence of the voter or payment of any fee an electoral standard."). *Harper* did not confer a constitutional right to vote in state elections, it merely declared that voter qualifications based on wealth violate the equal protection clause. *Id.*; *see also Davis v. Bandemer*, 478 U.S. 109, 133 (1986) ("[W]e would reject . . . the holding that *any* interference with an opportunity to elect a representative of one's choice would be sufficient to allege or make out an equal protection violation."). Interestingly, the Court has upheld property qualifications where they are narrowly tailored to meet the purposes of government units with limited spheres of authority. *See, e.g., Ball v. James*, 451 U.S. 355, 373 (1981) (upholding a property qualification in elections for directors of a water reclamation district in Arizona); *Salyer Land Co. v. Tulare Lake Basin Water Storage Dist.*, 410 U.S. 719, 730 (1973) (upholding a property qualification in water storage district elections in California).

30. *See* Karen McGill Arrington, *The Struggle to Gain the Right to Vote: 1787-1965*, in *VOTING RIGHTS IN AMERICA: CONTINUING THE QUEST FOR FULL PARTICIPATION* 25, 32 (Karen McGill Arrington & William L. Taylor, eds., 1992) (discussing the emergence of women's suffrage in the United States).

31. *See id.* (discussing the spread of suffrage throughout the states). By then Wyoming had also become a state. Colorado was followed by Utah and Idaho in 1896. *Id.* Even by the time the Nineteenth Amendment was ratified by Congress, however, only twenty states had extended the franchise to women. *Id.*

32. *See* JESSE DUKEMINIER & JAMES E. KRIER, *PROPERTY* 383-84 (5th ed. 2002) (discussing women's property rights under the common law).

33. *See id.* at 384 (stating that the Married Women's Property Act preempted state common law).

34. *See id.* (discussing the history of the Married Women's Property Act).

35. *See id.* ("The Married Women's Property Acts . . . did not give the wife full equality.").



The task of achieving full equality for women has largely been left to private litigants and the courts.<sup>36</sup>

Throughout the first half of the nineteenth century, therefore, both women and blacks were denied both property rights and voting rights. Some white males who lacked property were also denied voting rights. In the latter half of the nineteenth century, poll taxes and other voter qualifications were used to disenfranchise black males; they also disenfranchised some poor white males. With a few exceptions, primarily at the end of the nineteenth century, states continued to deny women suffrage until the twentieth century. By any standard of comparison, therefore, American society was highly plutocratic in the early nineteenth century. There was an emerging ideology rooted in Puritan values and natural rights theories that emphasized political equality and this may well have helped to advance the idea of universal suffrage,<sup>37</sup> but universal suffrage remained an idea rather than a fact until well into the twentieth century.

The social meaning of the corporation no doubt changed in important ways during the nineteenth century, but so, obviously, did the social meaning of democracy. Ironically, the United States in general appeared to be far more plutocratic and much less democratic at a time when the corporation appeared to be more democratic and less plutocratic. Indeed, against the social and political background of early nineteenth century America, it is remarkable that the corporation appeared to be so democratic. But was the corporation of the early nineteenth century really all that much more democratic than the corporation today? And to the extent that it was, was this really because the emerging democratic values of the nineteenth century pervaded the conduct of business?

#### *IV. Shareholder Voting Rights and the Economic Purpose of the Corporation*

We have very little systematic evidence about early nineteenth century corporate governance, so these questions are difficult to answer. One recent study by Eric Hilt, however, implies that the early nineteenth century corporation may not have been nearly as democratic as Professor Dunlavy

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36. See Reva B. Siegel, *The Modernization of Marital Status Law: Adjudicating Wives' Rights to Earnings, 1860-1930*, 82 GEO. L.J. 2127, 2130 (1994) (discussing the courts' role in reforming women's rights statutes in the nineteenth century).

37. See LOWENSTEIN & HASEN, *supra* note 26, at 27 (discussing the effect of private litigation on the evolution of women's rights).

suggests.<sup>38</sup> Hilt has compiled a data set using the records collected by the state of New York from 1825–1828 in administering a capital tax that it implemented in 1823 and from the state's grants of corporate charters.<sup>39</sup> From the records he was able to obtain, he inferred that, on average, early nineteenth century corporations in New York had only about 72 shareholders, and that a majority of the shares was usually held by the ten largest shareholders.<sup>40</sup> Moreover, most of the shareholders were residents of the same county as the corporation.<sup>41</sup> On average, only ten percent of the shares were held by out-of-state owners.<sup>42</sup> As Hilt observes, many charters were granted to corporations that either never began operations or soon failed and ceased operations.<sup>43</sup> Of the corporations that remained in operation in 1827, over 60% of them were governed under a one-vote-per-share rule,<sup>44</sup> and another 32% were governed under a graduated voting rule;<sup>45</sup> less than six percent were governed under the common law rule of one-vote-per-shareholder.<sup>46</sup>

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38. See Eric Hilt, *Corporate Ownership and Governance in the Early Nineteenth Century*, (Apr. 2006) (analyzing the ownership and voting structures of corporations in New York state in the early nineteenth century) (unpublished manuscript on file with the Washington and Lee Law Review).

39. See *id.* at 6–7 (discussing the sources of Hilt's statistical analysis).

40. *Id.* at 10 (finding that, on average, the largest shareholder controlled 25% of the shares).

41. *Id.* at 11 ("[A]bout two-thirds of the shares were typically owned within the corporation's county.").

42. *Id.* Perhaps not surprisingly, a significant percentage of the shares were usually held by owners in New York City, even for firms located in other counties.

43. See *id.* at 13 (discussing the disproportionately high rate of failure among corporations).

44. Bainbridge notes that the early nineteenth century corporation may have been much more plutocratic than these figures suggest. See BAINBRIDGE, *supra* note 7, at 451 (suggesting that large shareholders were able to circumvent restrictions on their voting power by transferring their shares to straw men who would vote as directed). This practice apparently dated back to the eighteenth century and was legal unless proscribed by statute. *Id.* at 451 n.21.

45. See Hilt, *supra* note 38, at 16 (noting that under graduated voting rules, shareholders usually had one vote per share up to some amount and then less than one vote per share thereafter). The total number of votes per shareholder might also be capped. *Id.*

46. A one-vote-per-shareholder rule was specified in only 1.8% of the corporate charters, but 4.1% of the charters did not specify any voting rule. *Id.* Since the common law default rule was one-vote-per-shareholder, these additional firms may also have been governed under that rule, although, as Hilt points out, some of them may have specified alternative voting rules in their bylaws. See *id.* (discussing corporations' use of alternative voting rights in corporate bylaws). Although the New Jersey Supreme Court subsequently held that the common law rule could not be superseded by corporate bylaws in *Taylor v. Griswold*, 14 N.J.L. 222 (N.J. Sup. Ct. 1834), the New York courts never addressed the question and New York corporations may have used their bylaws to specify shareholder voting rights both before and after *Taylor*.

Perhaps most interesting of all, Hilt notes that there was a significant difference in shareholder voting rules across different types of corporations.<sup>47</sup> Over 90% of the corporations engaged in manufacturing or insurance adopted a one-vote-per-share rule;<sup>48</sup> while, only three percent of the corporations formed to construct and operate turnpikes adopted a one-vote-per-share rule.<sup>49</sup> The one-vote-per-share rule was also adopted by only 50% of the corporations formed to construct and operate bridges.<sup>50</sup> This is significant because there were important differences in the economic purposes of these corporations.

In the early nineteenth century, turnpikes and bridges were essentially local public goods. Between about 1790 and 1820 the population of New York roughly tripled in size and so did the demand for transportation infrastructure.<sup>51</sup> There was widespread opposition to providing new public turnpikes and bridges because people believed that this would result in tax increases.<sup>52</sup> Franchise corporations were thus formed to finance and build the turnpikes and bridges as an alternative to financing and building them publicly.<sup>53</sup> These franchise corporations therefore fulfilled a public purpose. As Alfred Chandler has observed, early nineteenth-century merchants viewed them as "private enterprise in the public interest."<sup>54</sup> Indeed, the charters of the franchise corporations typically regulated the conduct of their business in some detail, and the corporations rarely yielded profits for their shareholders.<sup>55</sup> Profits were not the real objective: the real objective was to provide a public good.

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47. See Hilt, *supra* note 38, at 18 (discussing the differences in voting rights across various industries).

48. See *id.* at 18. Hilt notes that New York enacted a general incorporation statute in 1811 that set a default rule of one-vote-per-share. *Id.* at 4 (discussing the New York statute). However, some manufacturing firms continued to incorporate through special acts of the legislature. Moreover, this was only a default rule and so they were free to specify an alternative in their certificate of incorporation. See BAINBRIDGE, *supra* note 7, at 451 (discussing the latitude in incorporation under the New York incorporation statute).

49. See Hilt, *supra* note 38, at 18 (providing a statistical analysis of the corporate governance mechanisms used by various industries in the early nineteenth century).

50. See *id.* (providing comparative statistical analyses of various industries' choices of corporate governance).

51. See NATHAN MILLER, *THE ENTERPRISE OF A FREE PEOPLE; ASPECTS OF ECONOMIC DEVELOPMENT IN NEW YORK STATE DURING THE CANAL PERIOD, 1792-1868* 4 (1962) (discussing the growth and expansion of New York City between 1790 and 1820).

52. See *id.* at 9 (discussing the resistance to the construction of public infrastructure).

53. See ALFRED D. CHANDLER, *THE VISIBLE HAND* 28 (1977) (discussing the growth of private corporations as alternatives to public works projects).

54. *Id.* According to Chandler, the use of franchise corporations to build turnpikes was common in all of New England and the middle states until later in the nineteenth century. *Id.* at 34.

55. See Hilt, *supra* note 38, at 13 (discussing the initial charters of early franchise

The majority of the shareholders of the franchise corporations were typically local residents and merchants who stood to benefit from the new bridge or turnpike.<sup>56</sup> Given the public purpose of the franchise corporations it is hardly surprising that they typically featured more democratic governance provisions. The precise location chosen for a bridge or turnpike could have had a major impact on the distribution of its benefits. Under a one-vote-per-share rule, a small minority of shareholders could have used their control of the corporation in their own interests and to the detriment of the majority. Hilt thus suggests that the New York legislature favored some qualification of the one-vote-per-share rule in the charters of the franchise corporations as a check against the abuse of the public interest for which the corporations were formed.<sup>57</sup>

It is interesting to contrast the franchise corporations in Hilt's sample with the manufacturing corporations. One of the surprising results of Hilt's study was the particularly high rate of failure for manufacturing corporations—over 70% during the period of his sample.<sup>58</sup> This probably explains why the manufacturing corporations were generally closely held by a relatively small number of shareholders. It also suggests why the one-vote-per-share rule was the norm for manufacturing corporations, since this would have facilitated tight control and aligned decision-making power with the size of shareholders' stakes and their exposure to the risks. The failure rate for franchise corporations was also high but only because of the difficulty of acquiring land and the protracted litigation that sometimes resulted from the efforts to do so.<sup>59</sup> The franchise corporations did not need to make nearly as many important investment and managerial decisions as the manufacturing corporations. Thus, the scope of more "democratic" shareholder voting rights seems to have been limited not only to those corporations that served a clearly defined public

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corporations). In fact, in 1807 a law was enacted which standardized these provisions. *Id.* at 5.

56. *See id.* at 13 (discussing the benefit to local businesses that resulted from new construction).

57. *See id.* at 18 (discussing the risk of a private shareholder using his voting power for personal gain rather than fulfillment of a public good). The regulations appeared to have the intended effects: Although the franchise corporations were on average much smaller than manufacturing corporations, they also had more shareholders and more shareholders were required for majority control. *See id.* at 12 (comparing the shareholder makeup and voting power of franchise corporations and manufacturing corporations).

58. *See id.* at 13 (showing that of 237 manufacturing charters granted prior to 1827, only 62 resulted in an operating corporation in 1827).

59. *See id.* at 13 (discussing the challenges franchise corporations faced in formation and continued viability)

interest, but also to those in which the exercise of shareholder voting rights was less important to recouping a return on the shareholder's investment.

The relative prevalence of the one-vote-per-shareholder rule and qualifications of the one-voter-per-share rule in the early nineteenth century may thus have had more to do with the economic purpose and function of the nineteenth century corporation than they did with any social conception of the justness of power relations between investors. The social meaning of the corporation was no doubt very different then than it is now, but perhaps in large part because its economic purpose was often different. As the nineteenth century proceeded, local and state governments increasingly began to displace franchise corporations as the providers of transportation infrastructure.<sup>60</sup> As the relative number of franchise corporations diminished, the one-vote-per-share rule quickly became prevalent.<sup>61</sup> In Hilt's sample, turnpike corporations accounted for over 80% of all new corporate charters at the start of the nineteenth century, but less than 20% of new charters by 1825. Manufacturing corporations, on the other hand, were rare at the start of the nineteenth century, but accounted for over 20% of new charters by 1825.<sup>62</sup> By 1825, over 80% of the new corporate charters in New York were for corporations that were governed under a one-vote-per-share rule.<sup>63</sup>

### V. Conclusion

The social meaning of the corporation no doubt changed quite dramatically during the nineteenth century, but so did its economic purpose and function. At the start of the nineteenth century the corporation was usually created through a special act of the state legislature. It often had a sphere of monopoly power and was thought to be a privilege conferred upon the firms' owners by the state legislature. It often served as a means of pooling the finances of a limited number of investors and securing limited liability for a profit-making business venture. But it also commonly had a clear public purpose; in fact, at the start of the nineteenth century the corporation was commonly used to pool the finances of local residents and merchants for the

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60. See CHANDLER, *supra* note 53, at 34 (discussing the re-emergence of state-sponsored infrastructure construction).

61. See Hilt, *supra* note 38, at 19 (showing the increase of the one-vote-per-share rule as franchise corporations became less prevalent).

62. See *id.* (providing a statistical analysis of industrial composition among charters issued between 1800 and 1825).

63. See *id.* (providing a statistical analysis of the voting rights present in all corporate charters issued between 1800 and 1825).

purpose of providing local public goods, particularly turnpikes and bridges. The persistence of the one-vote-per-shareholder rule into the nineteenth century probably had much to do with the use of the franchise corporation for the provision of these local public goods. As the nineteenth century proceeded, local and state governments increasingly began to replace the franchise corporations in fulfilling this function, and the role of the corporation changed.

Indeed, as the nineteenth century unfolded and the canals and railroads connected the far reaches of the country in a national transportation network, the market for many commodities and manufactured products became national in scope. With the potential size of their markets so vastly expanded, companies began to adopt new technologies that allowed them to realize enormous economies of scale and produce new and better products at lower costs. Because the new technologies required larger capital investments, and because the investments were often risky, business entrepreneurs needed better ways of raising large amounts of capital without compromising their control of the businesses. The common law rule of one-vote-per-shareholder clearly would have impeded the growth of these new mass-production industries, and so it is no surprise that it had faded long before the end of the nineteenth century.

But it is doubtful whether the corporation was ever truly democratic in any important sense. The persistence of the one-vote-per-shareholder rule in the early nineteenth century probably had more to do with the public purpose served by the franchise corporations than with any emerging nineteenth century political ideology or social norms. Further research will no doubt help to clarify exactly how important democratic values were to the governance of the nineteenth century corporation. But, in the end, the transition from one-vote-per-shareholder to one-vote-per-share may prove to be interesting as much for what it reveals about the forces that drive important changes in corporate law and governance as for what it reveals about the social meaning of the corporation. The lesson may well be that the social meaning of the corporation derives from its economic purpose and function.

