The Evolution of Shareholder Voting Rights: Separation of Ownership and Consumption

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Abstract

The nineteenth century saw the standardization and rapid spread of the modern business corporation around the world. Yet those early corporations differed from their contemporary counterparts in important ways. Most obviously, they commonly deviated from the one-share-one-vote rule that is customary today, instead adopting regressive voting schemes that favored small over large shareholders. In recent years, both legal scholars and economists have sought to explain these schemes as a rough form of investor protection, shielding small shareholders from exploitation by controlling shareholders in an era when investor protection law was weak.

We argue, in contrast, that regressive voting rules generally served not to protect shareholders as investors, but to protect them as consumers. The firms adopting such rules were commonly local monopolies that provided vital infrastructural services such as transportation, banking, and insurance. The local merchants, farmers, and landholders who used these services were the firms’ principal shareholders. They commonly purchased shares not in the expectation of profit, but to finance collective goods. Regressive shareholder voting assured that control of the firms’ services would not fall into the hands of monopolists or competitors. In effect, the corporations had much the character of consumer cooperatives. This perspective also sheds light on the unusual importance given to the doctrine of ultra vires in the nineteenth century. While current legal and economic scholarship has focused incessantly on the separation between ownership and control, the prior separation between ownership and consumption, accomplished by the late nineteenth century, was another fundamental but generally overlooked turning point in the history of the business corporation.
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I. Introduction

Adam Smith, an early critic of business corporations, identified two principal shortcomings of that form of organization. The first was that corporations were commonly monopolies, to the disadvantage of their consumers. The second was what we would now label as agency costs. Today, the latter problem – the costs imposed by managers acting opportunistically toward shareholders, or by controlling shareholders acting opportunistically toward noncontrolling shareholders – dominates discourse about corporate governance. Recently, scholarship in both law and economics has also come to view agency costs as the major element shaping the historical evolution of the corporate form, interpreting the peculiar features of corporate law and practice in earlier periods as means to protect small shareholders from exploitation by managers or controlling shareholders. This is particularly true of the nineteenth century – the era that established the principal forms of enterprise organization, including conspicuously the business corporation, in their modern garb. Some scholars have even suggested that corporate governance practices from the early nineteenth century might usefully be adopted today in developing economies that, like even the most advanced economies of the nineteenth century, lack strong legal institutions for shareholder protection.

This approach is, however, anachronistic. In the late eighteenth and early nineteenth century, the main economic evil linked to the corporate form was not managerial or controlling shareholder opportunism toward small shareholders, but rather Adam Smith’s first concern: monopoly. Prior to 1860, most corporate charters were granted by special acts of the state legislature, and as a consequence often had a degree of monopoly power conferred on them. More importantly, many corporations were natural monopolies due to economies of scale. The peculiar features of early corporate law and practice were frequently designed to minimize the abuse of that market power. They did not seek to protect the corporation’s shareholders as investors, as is conventionally assumed today, but rather to protect them as consumers.

A critical but underappreciated feature of corporate enterprise in the early republic is the lack of separation between ownership and consumption. In many corporations of the time, the principal shareholders were also the firm’s principal

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1 Adam Smith, The Wealth of Nations (1776).
3 See notes 13-14 infra.
4 After more than a century of relative stability, we are now in the midst of another period of rapid change in legal forms of enterprise organization. See Henry Hansmann, Reinier Kraakman & Richard Squire, The New Business Entities in Evolutionary Perspective, 2005 U. ILL. L. REV. 5.
6 As the U.S. Supreme Court has recently noted, “[m]ost of the Founders’ resentment towards corporations was directed at the state-granted monopoly privileges that individually chartered corporations enjoyed.” Citizens United v. Federal Election Comm’n, 130 S. Ct. 876 (2010) (opinion of Kennedy J.).
customers. These customers were the owners of businesses – farmers, merchants, and manufacturers. And the corporations were commonly providing infrastructural goods and services that were critical for the success of those local businesses.

There were two reasons for this pattern of ownership. First, for many corporations, local merchants and farmers were apparently the most effective source of capital at a time when capital markets were poorly developed and governmental financing was not generally available. Second, by controlling their service providers, the consumers protected themselves from monopolistic exploitation. In essence, early American business corporations were often, in effect, consumer cooperatives. And, as is commonly true of cooperatives in general, they served importantly to protect their consumer-owners from the exercise of monopoly power.  

Appreciation of this ownership pattern illuminates important features of early business corporations that have recently attracted attention from scholars in both law and economics. Most prominent in this respect are the peculiar rules of shareholder voting. In the late eighteenth century and much of the nineteenth century, U.S. corporations frequently had schemes of shareholder voting that deviated from the one-share-one-vote rule that subsequently became the norm. In particular, many nineteenth-century corporations restricted voting in ways that made it difficult for a single shareholder to obtain control of the firm. Such voting schemes were of three types: graduated voting, in which the number of votes exercisable by a single shareholder increased less than proportionately with the number of shares owned; capped voting, in which a ceiling was imposed upon the total number of votes that a single shareholder could exercise regardless of the amount of stock he or she held; and per capita voting, which is the rule of one shareholder, one vote.

These regressive voting rules first came clearly to the attention of legal scholars through the work of David Ratner9 and Colleen Dunlavy10, both of whom documented the frequency of the phenomenon and offered a similar interpretation of it. That interpretation did not focus on economic factors such as agency costs and monopoly, but instead saw regressive corporate voting rights as driven by, as Dunlavy put it, a “social preference for particular types of governance.”11 In particular, they reflected a “social conception of the corporation” that was more “democratic” than the “plutocratic” approach to governance represented by the rule of one share, one vote.12

Subsequently, the reasons for the regressive voting rules have been taken up by a number of other scholars, all of whom have – in contrast to Ratner and Dunlavy –

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8 There is, to be sure, deviation from that norm again today, for reasons not universally understood. These modern deviations are progressive rather than regressive.
11 Id. at 1354.
12 Id. at 1354-1356. See also Colleen A. Dunlavy, Corporate Governance in Late 19th-Century Europe and the U.S.: The Case of Shareholder Voting Rights, in COMPARATIVE CORPORATE GOVERNANCE (Klaus Hopt et al. eds., 1998) [hereinafter “Shareholder Voting Rights”].
emphasized explanations rooted in economic considerations. Specifically, reflecting the contemporary emphasis on agency costs, these authors almost uniformly interpret regressive voting rules as “designed to attract the participation of small shareholders by offering them some measure of protection from dominance by large shareholders.”\(^{13}\) Under this view, regressive voting – which was usually imposed by the corporation’s own individual charter – was “the most important protection offered to early-nineteenth-century small investors,” thus compensating for the weakness of the corporate law of the time in affording adequate minority shareholder rights.\(^{14}\)

As their proponents concede, however, both the democracy and the investor protection accounts have difficulty in explaining two important elements of the corporate voting patterns in the nineteenth century. First, why did regressive voting appear in certain industries – such as turnpikes, canals, railroads, banks, and insurance companies – while they were largely nonexistent in other industries, such as manufacturing? Second, why did regressive voting largely disappear from all types of corporations by roughly the end of the nineteenth century?\(^{15}\)


Two articles in the legal literature are noticeable exceptions to the investor protection view. Donald J. Smythe, *Shareholder Democracy and the Economic Purpose of the Corporation*, 63 Wash. & Lee L. Rev. 1407, 1416-18 (2006), in a thoughtful comment on Dunlavy, “Social Conceptions,” supra note 10, proffers briefly the hypothesis, similar to ours, that the distinctive voting rules in corporations providing amenities such as bridges and turnpikes might be explained by their character as suppliers of local public goods. Joseph H. Sommer, *The Birth of the American Business Corporation: Of Banks, Corporate Governance and Social Responsibility*, 49 Buffalo L. Rev. 1011, 1034 et seq. (2001), likewise observes that banks in the early republic frequently had the character of clubs or cooperatives.

\(^{15}\) Both of these questions are well documented but so far unexplained in the literature. *See, e.g.*, Pauline Maier, *The Revolutionary Origins of the American Corporation*, 50 William & Mary Q. 51, 78 (1993) (noting that “[voting] [r]estrictions were sometimes applied to certain types of corporations but not to others, or they might be abandoned in a process of change that has never been fully traced or explained”).
We seek to shed light on these questions by offering an alternative explanation for the observed pattern of regressive voting in the nineteenth century. Our interpretation is essentially economic in character, attributing changes in shareholder voting schemes to the different economic purposes and problems associated with business corporations in the early nineteenth century compared to their present-day counterparts. In short, we argue that voting restrictions generally served as a consumer protection device in corporations that were, in a rough sense, consumer cooperatives. And the economic role they played often paralleled that of the many other nineteenth-century firms that were explicitly organized as cooperative or mutual corporations. It is telling that while voting restrictions have virtually disappeared from charters and statutes governing business corporations—which are now overwhelmingly investor-owned—they have in large part subsisted as the voting rule applicable to cooperatives and mutual companies.  

Interpreting voting restrictions as a consumer protection device goes far to explain their relative incidence across different industries and firm ownership structures. Nineteenth-century transportation companies (turnpikes, canals, and railroads), as well as banks and insurance companies, commonly had substantial market power; manufacturing firms, by contrast, did not. Moreover, the firms adopting voting restrictions were typically local monopolies that provided vital ancillary services to local merchants. With surprising frequency, those merchants were at the same time the principal customers and the principal shareholders of early business corporations, for two important reasons. First, local merchants had an interest in helping form and finance an element of economic infrastructure that would be important to the success of their businesses. Second, this ownership pattern served to ensure that control over this element of the infrastructure did not fall into the hands of profit-oriented investors who would charge the merchant monopoly prices for its use, or into the hands of one of the merchant’s competitors, who would use his control to discriminate in favor of his own business and against others in terms of the price, quantity, or quality of services that the firm would provide.  

This consumer protection account helps explain why voting restrictions tended to disappear in the late nineteenth century. First, economic development and improvements in transportation and communication reduced the market power of firms that had previously dominated the local market for their services. And greater market competition was, in turn, reinforced by then recent legal developments. Over the course of the nineteenth century, the franchise view of the corporation was all but abandoned. Since the U.S. Supreme Court decision in Charles River Bridge in 1837, monopoly privileges were no longer implied by the mere grant of a corporate charter, and they became increasingly rare thereafter. Moreover, general incorporation laws, which allowed

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16 HANSMANN, supra note 7, at 15. Indeed, one area in which the transition was at least partially towards rather than away from restricted voting was that of mutual insurance. While an 1859 Wisconsin statute authorized the grant of voting rights proportionately to the firm’s patronage, a subsequent law of 1929 law reverted back to the rule of one vote per member. See Ratner, supra note 9, at 9.  
17 See, e.g., ALFRED D. CHANDLER, THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 28 (1977) (describing the creation of early U.S. corporations by merchants interested in obtaining “essential specialized ancillary services to support their profit-making commercial activities”).  
18 In Charles River Bridge v. Warren Bridge, 36 U.S. 420 (1837), the U.S. Supreme Court construed a corporate charter of a bridge company narrowly and refused to imply an exclusive privilege to operate a
firms to incorporate without the need to obtain special legislative charters and conferred no exclusive privileges, became gradually dominant after the mid-nineteenth century; by the end of the century, they were the most popular basis for incorporation, rendering the corporate form easily available to entrepreneurs seeking to raise outside capital.

Second, share ownership with regressive voting is an unstable means of restraining monopolistic behavior. Over time, increasing numbers of consumer-shareholders are likely to sell their shares to non-consumers whose only benefit from the shares comes from distributed profits. When the latter shareholders, no matter how fragmented, come to hold a majority of the votes among themselves, they have an incentive to turn the firm toward profit maximization rather than consumer protection. Moreover, the constraint of regressive voting structures can often be evaded by various forms of subterfuge, such as breaking up a large block of shares into smaller – and hence higher-per-share-vote – blocks whose nominal ownership is distributed among family and friends.

Third, by the late nineteenth century government had stepped in to assume the major role in financing the types of physical infrastructure – such as roads, bridges, canals, and railroads – that had previously been undertaken by private corporations. Prior to that, government at the national, state, and local levels generally played a modest role in the provision of non-military services. The advent of public provision removed the need to finance such projects through voluntary financing in which prospective beneficiaries purchased non-remunerative shares in private corporations. Moreover, governmental ownership removed the threat of private monopoly. In effect, the shift from provision by a private corporation with regressive voting to provision by government involved the replacement of a makeshift type of cooperative with a much more durable one, since local governments are effectively territorial consumer cooperatives.19

Fourth, the scope of corporate law became increasingly narrower during the course of the nineteenth century, as the field progressively specialized in the rights and duties of managers and shareholders-investors. Concerns about monopoly – which were initially addressed by corporate statutes and charter provisions – became increasingly extraneous to this area of law.20 Early corporate charters and statutes contained several mechanisms that regulated monopoly pricing and dissuaded anticompetitive combinations – of which regressive voting is but an unappreciated instance.21 Over time,

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20 See HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW 1836-1937 243 (1991) (noting that by the early twentieth century antitrust policy was already recognized as entirely separate from state corporate law, so that compliance with corporate laws was not longer a defense against claims of anticompetitive conduct).
21 Hovenkamp has highlighted what turned out to be powerful antitrust provisions of early corporate charters, which frequently prevented corporations from operating out-of-state, from holding shares in other corporations, and from engaging in activities not expressly contemplated by the charter. Id. at 63. These restrictions, in turn, led many firms to adopt the trust form in order to obtain greater organizational
however, the regulation of monopoly (natural or otherwise) came to be the object of specialized areas of law – namely, antitrust and utility regulation. And governmental regulation of access and pricing in some monopolistic service industries arguably provided a more effective long-term check on anticompetitive practices than did charter-based corporate voting restrictions.  

The explanation we offer for nineteenth-century voting restrictions is strongly at odds with the investor protection theory. When a firm is a monopoly, there is a strong conflict of interest between the firm’s investors and the firm’s customers. The investors benefit most by having the firm charge monopoly prices, while the customers are best served by having the firm charge competitive prices – or, in fact, even prices that do no more than cover marginal cost, so that the firm effectively provides no return at all to the shareholders’ investment. Consequently, if the firm is controlled by shareholders who are also major customers of the firm, the shareholders may prefer to keep the firm’s prices low, and get the return on their investment in the form of low prices rather than high dividends. But this policy will not be attractive to shareholders who are not also customers of the firm. From the perspective of an investor in the corporation, the customer-shareholders of the firm are tunneling out its (potential) profits through their other transactions with the company.

It is a familiar notion that the twentieth century brought the separation of ownership and control in large U.S. business corporations. Less familiar, but surely as fundamental, was the prior separation of ownership and consumption that characterized the evolution of corporations in the nineteenth century.

The remainder of this essay explores the potential of the consumer protection theory of regressive voting by examining more closely the economic properties of different voting schemes and the available data on shareholder voting rights in nineteenth-century corporations. Part II describes the schemes of shareholder voting rights adopted by U.S. corporations in the late eighteenth and early nineteenth centuries. We break down our analysis by industry and show that voting restrictions appeared with far greater frequency in firms that had market power and were owned by their principal customers. Part III examines the potential of the consumer protection account to explain

flexibility – hence the term antitrust. Id. at 64. Similarly, most other forms of regulation in the nineteenth century, including pricing schemes for public utilities, also took place via corporate charters. Id. at 126. In fact, before the Supreme Court decision in *Munn v. Illinois*, 94 U.S. 113 (1877), it was not even clear that the state had constitutional authority to regulate unincorporated entities.

22 This is not to deny that voting restrictions might have served other functions as well. In particular, there is evidence that they were employed to maintain a balance of control and profit-sharing in firms that have several dominant shareholders. Musacchio, *Laws versus Contracts*, supra note 14, at 466, mentions the example of a Brazilian brewery company that was dominated by a few families that, owing to voting caps, “had to broker deals to share power.” However, it is not at all obvious that small shareholders in the firm would benefit from such an arrangement. Rather, by stabilizing competition among the leading blockholders for control of the firm, the voting restrictions may permit coordination among those blockholders in allocating corporate opportunities among themselves, including lucrative employment with the firm, to the greater disadvantage of the firm’s small shareholders. The same function is today typically served not by charter provisions but by shareholder agreements, and the increased willingness of the courts to enforce shareholder agreements in the twentieth century is perhaps important in explaining the abandonment of charter provisions of this character.
the foreign experience with regressive voting in early business corporations. In particular, we analyze the voting rules adopted by some of the world’s pioneer joint-stock companies, such as the Dutch East India Company and the English East India Company, as well as the voting schemes observed in England, Brazil, and continental Europe in the nineteenth century. In Part IV, we suggest that the consumer protection account sheds light on another feature of early corporation law for which conventional explanations seem unsatisfying: the doctrine of ultra vires. Part V then explores the reasons for the progressive abandonment of regressive voting schemes in the latter part of the nineteenth century. Part VI concludes.

II. Corporate Ownership and Voting Rights in Early U.S. History

We begin by examining the ownership structure and voting patterns of U.S. business corporations in the late eighteenth and early nineteenth century. For ease of exposition, we divide our analysis by industry sector, focusing first on corporations promoting physical infrastructure projects, second on financial firms, and finally on manufacturing corporations.

A. Physical infrastructure

Today, much of society’s basic physical infrastructure, and particularly major elements of transportation networks such as roads and bridges, are financed – and commonly owned and operated – by one or another level of government. In the early decades of the American republic, however, the situation was quite different. Municipal corporations in the American colonies, like their English counterparts of the seventeenth and eighteenth centuries, were generally dominated by local tradesmen, and served largely to establish and protect the monopolistic guild-like powers of the various trades. Municipalities sometimes constructed and operated facilities such as market halls and wharves, though apparently in large part for the sake of reinforcing the market power of the various trades and of the municipalities themselves, for which the facilities provided a source of income through user charges.

The American Revolution brought substantial democratization to local government, but this did not result in broad expansion of local (or state or national) governmental provision of physical infrastructure. Not only was the historical precedent for much activity of this sort lacking, but so was the popular will. Strong suspicion of government and resistance to taxes – particularly conspicuous in the Jacksonian era – were accompanied by fierce regional rivalries that blocked agreement on governmental development projects.

24 See, e.g., id. at 28.
25 Id. at 64-78.
26 See the discussions of specific types of infrastructure that follow.
State governments of the early nineteenth century were, however, prepared to give corporate charters to groups of citizens who wished to finance and manage publicly beneficial improvement projects on their own. The result was widespread resort to private organization and financing. And the internal governance structures given these corporations reflected their role as private producers of public goods.

(i) Turnpikes

Turnpikes provide a paradigmatic example of the use of voting restrictions in firms that were principally owned by their customers. In the late eighteenth and early nineteenth century, turnpikes were almost invariably undertaken by business corporations.\(^28\) Turnpikes were in fact one of the most common forms of business corporation throughout this period. Roughly two-thirds of all corporate charters granted in the late eighteenth century concerned turnpike companies, which remained the leading form of business corporation in the East Coast through the early nineteenth century.\(^29\) Turnpikes made up one-third of all New York incorporations between 1800 and 1830.\(^30\)

Regressive voting schemes were particularly prevalent in turnpikes. Joseph Davis notes that voting caps were “well-nigh universal” in eighteenth-century turnpike companies.\(^31\) Other surveys of voting patterns in nineteenth-century business corporations find that turnpikes displayed the highest incidence of voting restrictions across all industries. In his study of early New York corporations, Eric Hilt finds that a striking 98% of turnpike charters included voting restrictions and only 1% of them specified a one-share-one-vote scheme.\(^32\) Hilt estimates that turnpikes had a significantly lower level of voting concentration than corporations in other industries (a score of 0.23 in his index, compared to the next lowest score of 0.70 for bridge companies).\(^33\) Similarly, Cadman reports that, even though the “vast majority” of early New Jersey corporations granted one vote per share, approximately 30% of turnpikes adopted either voting caps or a graduated voting scale.\(^34\) Dodd states that only in Massachusetts did turnpikes overwhelmingly follow a one-share-one-vote rule.\(^35\)

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\(^{28}\) George Rogers Taylor, The Transportation Revolution 1815-1860 25 (1951) (noting that “[t]he corporate form of organization appears to have been used for the turnpikes practically without exception”).


\(^{31}\) Joseph Stancliffe Davis, Essays in the Earlier History of American Corporations 323 (1917)

\(^{32}\) Hilt, supra note 13, at 6. Hilt’s sample reflects the prevalence of turnpike companies in New York, as they make 304 of the total sample of 812 business corporations. New York’s general incorporation law for turnpikes of 1807 provided for one vote per share up to 10 shares, and one vote per 5 shares beyond that. Act of March 13, 1807, ch. 38, N.Y. Laws 104.

\(^{33}\) Id.

\(^{34}\) John W. Cadman, Jr., The Corporation in New Jersey: Business and Politics 308 1792-1875 (1949). Only 15% of New Jersey firms in the period analyzed displayed restricted voting schemes, of which just over 30% were turnpikes. Id. at 206-207 and 309.

\(^{35}\) Edwin Merrick Dodd, American Business Corporations Until 1860 (With Special Reference to Massachusetts) 243 (1954). The only turnpike corporation in Alex Dreier’s survey of Connecticut
To confirm and extend these statistics, and others we report below, we undertook our own analysis of a large database – assembled and generously made available to us by economic historians Richard Sylla and Robert Wright – that contains the voting rules of nearly all (more than 22,000) business corporations that obtained a legislative charter in any of the states of the United States between 1790 and 1860. A more extensive description of that database, as well as tables with statistics we have derived from it, appear in the Appendix. To simplify interpretation, we focus only on corporations formed in the original 13 states. Moreover, we exclude from our analysis the states of Massachusetts and South Carolina, for which there are indications that the original data contain systematic omissions or miscoding. This leaves us with a sample of 6,387 corporations. We will refer to our work with this sample as our “multistate analysis.”

As shown in the last two columns of Table 1, our multistate analysis reveals that 65% of corporations undertaking turnpikes or plank roads (which we combine under the heading of “roads” in the tables) had regressive voting regimes over the period 1790-1860. Confirmation that this percentage is significantly higher than those for manufacturing is provided in Table 2, which contains the results of a regression analysis showing that, controlling for state and decade of incorporation, turnpikes and roads were significantly more likely to have a regressive voting rule than were manufacturing corporations over the same period.

Consistent with the consumer protection account, turnpikes were the industry in which the interests of shareholders in the firm’s output (the road), rather than in the firm’s profits, were most conspicuous. Turnpike stockholders were commonly merchants and landowners who were located along the path of the turnpike and would benefit from its presence. As put by Ronald Seavoy, “[t]urnpikes were popular investments, not necessarily because they were expected to be profitable, but because they improved access to markets, raised local land values, and lowered the costs of goods that had to be teamed in. Shares were of low par value and were widely held.”

In fact, turnpikes rarely paid dividends to their investors, and were not expected to. Contemporary references to the lack of profitability of turnpikes were abundant and did not seem to cause uproar among shareholders. Purchasing a share resembled a corporate charters specified one vote per share. Alex Dreier, Shareholder Voting Rules in nineteenth century American Corporations: Law, Economics and Ideology (1995) (unpublished manuscript, on file with the authors).

36 The dataset has been used as well in earlier work by [Richard Sylla and] Robert Wright: [ ].
37 TAYLOR, supra note 28, at 25.
38 SEAVOY, supra note 29, at 41. See also JOSEPH AUSTIN DURRENBERGER, TURNPIKES: A STUDY OF THE TOLL ROAD MOVEMENT IN THE MIDDLE ATLANTIC STATES AND MARYLAND 104 (1931) (analyzing numerous shareholder lists and concluding that “subscribers were usually more interested in the possible benefits the new lines of communication would bring than in the profitableness of their investment”). Klein & Majewski, supra note 30, at 469 (“[l]andowners, merchants, and farmers struggled to finance turnpikes, not so much in hopes of company dividends but in hopes of improved transportation, stimulated commerce, and higher land values”).
39 See also Essex Turnpike Corp. v. Collins, 8 Mass. 292, 297 (1811) (“[i]t is well known that in this country enterprises of this description have not been productive of profit to those who have engaged in them; nor is this generally a primary object of consideration with the subscribers.”).
voluntary payment of taxes toward a public good. Social pressure to contribute to this community improvement was an inducement to subscriptions, and the unlikely prospect of a financial return on the stock might have served as a form of selective incentive. But the most effective marketing tool in attracting shareholders was the recurring emphasis on the expected financial benefits that the road would bestow upon them as local merchants and landowners.

That the principal interests of turnpike shareholders lay in the firm’s output, not in its profits, was apparent from the turnpike litigation in the early nineteenth century. Indeed, some courts went as far as to allow shareholders to renego on their subscription commitments if a subsequent alteration of the turnpike’s route made the road less useful to them as prospective users. In Middlesex Turnpike v. Locke, a shareholder successfully defended an action for payment of assessments made after his subscription precisely because a later act of the legislature had altered the planned course of the turnpike road. Defendant’s counsel successfully argued that his client “never consented to become a proprietor in the turnpike, as it was in fact located and made. He was induced to subscribe originally, on account of the particular convenience to him of the turnpike as originally directed. He would perceive no such convenience in the other route. He would have never subscribed to aid the latter.” The court agreed and let the shareholder off the hook.

Even the courts that refused to invalidate subscription obligations due to later changes of route understood well the nature of the interests of turnpike shareholders in the enterprise. In Irvin v. Turnpike, the aggrieved shareholder contended that “it was not at all contemplated that the profits of the road would compensate the individuals for their money subscribed; it was the facilities and benefits which would result to their property: and it was upon this consideration that Irvin entered into the engagement to pay.” The court agreed that “the indirect benefit supposed to be received by the owner”

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41 Id. at 803 (describing the mechanisms of social pressure as a driver of turnpike investments).
42 Id. See also Essex Turnpike Corp. v. Collins, supra note 39 (“the benefit contemplated to accrue individually to the subscribers from this new direction of the turnpike formed another valuable consideration (...) [The subscribers] are well aware that the community is benefited by them, and they agree to take a share of the burden”); and the excerpt from a newspaper article encouraging subscriptions for the New Paltz Turnpike, cited by Klein & Majewski, supra note 30, at 20 (arguing that the enterprise “can only be done by the stock being distributed very generally among the inhabitants of the village-each finding a motive to take a little, not from an expectation of its being productive (though it no doubt would pay something), but from an expectation that the investment would be returned with treble interest, in the addition which would be made to business and the value of property”).
43 8 Mass. 268 (1811).
44 Id. at 271.
45 Id. at 272 (the court found that “the defendant may truly say, Non haec in foedera veni” [this was not what I promised to do]).
46 2 Pen. & W. 466 (1831).
was a “very powerful incitement” to turnpike subscriptions, but it refused to equate “the motive for entering into the contract, with the consideration of it.”

In this context, regressive voting helped ensure that nobody – and, in particular, somebody who was not a major user of the turnpike – would accumulate enough shares to give him or her both the interest and the authority to set the tolls at a price much higher than marginal cost, much less to monopoly pricing levels. It was evidently understood that economic development would advance most rapidly and most advantageously toward all adjacent merchants and landowners, if tolls on the turnpikes were kept low. Toll prices were kept very low indeed (almost to the point of undermining the firms’ viability) and underwent little change under the period. It is telling that, despite the well-known lack of profitability, petitions to the legislature for toll increases seemed to be very rare.

(ii) Bridges

Voting restrictions were present in bridge companies incorporated in some states but not in others. Hilt finds that 42% of all bridge companies chartered in New York through 1825 adopted a regressive voting scheme. Voting restrictions also appeared in some early bridge companies in Massachusetts and in one-third of bridge company charters in New Jersey. Conversely, bridge corporations chartered in Connecticut only rarely adopted regressive voting. In our own multistate analysis, 38% of bridge corporations formed between 1790 and 1860 had regressive voting.

Two of the most important nineteenth-century cases involving business corporations concerned bridge companies: the landmark Supreme Court decision in

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47 Id. at 4 (“[t]hat an expectation of benefit from a rise in the value of property near the route, has been a powerful spring, in putting these incorporated bodies in motion, is not to be denied. Yet (…) the legislature has never encouraged it so far as to recognize it as a condition of the contract of subscription”).
48 To be sure, toll prices were typically set by corporate charters and were subject to legislative scrutiny. Nevertheless, charter amendments were common, hence leaving open the possibility that a dominant shareholder with a financial interest in the firm would lobby the legislature for toll price increases. See Wright & Sylla, supra note 13, at 9 (describing the high frequency of charter amendments in the nineteenth century).
49 Klein & Majewski, supra note 30, at 499 (“[t]o what extent companies even petitioned for [toll] increases we do not know, but it appears to have been little”). Interestingly, the typical toll pricing structure seemed to privilege productive over leisurely transportation; by far the most expensive tolls rates applied to “pleasure carriages” (as opposed to the transportation commercial and farm products). Id. at 484. Interestingly, English turnpikes in the same period were commonly constructed by nonprofit corporations rather than business corporations, with adjacent landowners and small investors purchasing bonds issued by the nonprofit corporation. Those bonds paid a reasonable rate of interest, and tolls were kept high enough to pay the interest. Thus, English turnpikes were effectively profit-making ventures in nonprofit form, while the U.S. turnpikes were essentially nonprofit ventures in profit-making form. See, e.g., on turnpike trusts in England, William Albert, The Turnpike Trusts, in TRANSPORT IN THE INDUSTRIAL REVOLUTION (Derek H. Aldcroft & Michael J. Freeman eds., 1983); Dan Bogart, Did Turnpike Trusts Increase Transportation Investment in Eighteenth-Century England?, 65 J. ECON. HIST. 439 (2005).
50 Hilt, supra note 13, at 658.
51 DODD, supra note 35, at 241; CADMAN, supra note 34, at 309.
52 Dreier, supra note 35, at 22 (showing that only one out of 19 bridge companies chartered in Connecticut between 1789 and 1836 adopted a voting cap.)
Charles River Bridge,\textsuperscript{53} which held that a corporate charter does not imply a grant of monopoly privileges, and Taylor v. Griswold,\textsuperscript{54} the most cited case for the proposition that one-member, one-vote was the common law rule on shareholder voting rights in business corporations.\textsuperscript{55} These influential decisions notwithstanding, bridge corporations have received far less scholarly attention than their counterparts in other industries.

This dearth of historical studies translates into less information on the ownership patterns of early bridges and the driving forces behind their incorporation. Like turnpikes, bridges commonly have an important degree of monopoly power, which would naturally be expected to encourage consumer ownership. In describing the incorporation of Charles River Bridge, the first such company to be chartered in Massachusetts, Joseph Davis observes that “expectations of improvements in local business and in land values played a large part in the promotion besides the prospect of revenue from tolls.”\textsuperscript{56} However, by the time the Charles River Bridge case was decided (more than fifty years after the establishment of the company), the Supreme Court consistently refers to the interests of its shareholders as those of investors.\textsuperscript{57}

As suggested by Table 1 in the Appendix, although many early bridges had restrictive voting rules and were presumably promoted by consumer interests, investor-owned firms ultimately came to dominate the landscape. One reason may be that early bridge charters, such as the one for Charles River Bridge, provide for elaborate regulatory and pricing schemes to protect consumers, including a mandate for universal service to all paying customers, hence reducing the risk of investor ownership.\textsuperscript{58} Moreover, unlike turnpikes and canals, many toll bridge corporations turned out to be highly profitable ventures, thus attracting investors who were not necessarily interested in the company’s services.\textsuperscript{59}

In Taylor v. Griswold, the question before the New Jersey Supreme Court was whether a bridge corporation could adopt bylaws permitting voting by proxy and providing for a one-share-one-vote rule in shareholder meetings when the company’s charter was silent on the issue. The court ruled in the negative, concluding that only the corporation’s charter, not the bylaws, could permit departures from the common law rule of one vote per member. In doing so, the court emphasized the “public nature” of corporations operating turnpikes, bridges and railroads, as opposed to corporations it

\textsuperscript{53} 36 U.S. 420 (1837).
\textsuperscript{54} 14 N.J.L. 222 (1834).
\textsuperscript{55} But see Ratner, \textit{supra} note 9, at 9 (arguing that “there is no indication that a common law rule of one vote for each member of a business corporation ever existed” and highlighting that the Taylor court failed to cite any precedent on this issue).
\textsuperscript{56} DAVIS, \textit{supra} note 31, at 187. The charter of Charles River Bridge itself was silent as to shareholder voting rights, but subsequent Massachusetts bridges incorporated usually adopted voting caps.
\textsuperscript{57} Charles River Bridge v. Warren Bridge, \textit{supra} note 18, at 470 (acknowledging that the chartering of Warren Bridge “has ruined the property of subsequent innocent stockholders [of Charles River Bridge], who have made their investments at a high price”).
\textsuperscript{58} See HOVENKAMP, \textit{supra} note 20, at 126 (noting that bridge charters specified the rates that the corporation could charge from different types of customers and mandated universal service to all paying customers).
\textsuperscript{59} See TAYLOR, \textit{supra} note 28, at 29, and DAVIS, \textit{supra} note 31, at 186, on the profitability of bridge corporations.
deemed to be “purely private,” such as banks and insurance companies. Colleen Dunlavy pointed to the argument that “[e]very corporator, every individual member of a body politic, whether public or private, is, prima facie, entitled to equal rights” as paradigmatic of a different “social conception of the corporation.”

Nonetheless, a closer reading of the Taylor opinion suggests that the adoption of regressive voting schemes in the nineteenth century was at least partially motivated by economic considerations. The New Jersey court’s decision, in particular, explicitly hints at a connection between voting restrictions and the interests of the consuming public in face of a monopolistic firm. As put by Chief Justice Hornblower, “the apparent tendency, of the by-law in question [adopting a one-share-one-vote rule], is to encourage speculation and monopoly, to lessen the rights of the smaller stockholders, depreciate the value of their shares, and throw the whole property and government of the company, into the hands of a few capitalists; and it may be, to the utter neglect or disregard of the public convenience and interest. I do not say, that such was the design, or that such has been the effect; but only, that the natural or probable tendency of the by-law in question, is to produce such a result.”

The court argues that because bridges “partake more of a public nature… the public have a more direct and immediate interest in their management,” an objective that would be arguably best achieved by a one-member-one-vote rule – a voting scheme that gives primacy to the interests of consumers and the public vis-à-vis those of providers of capital.

(iii) Canals

The incidence of voting restrictions in canal corporations varied across time and place. Early canal charters in Massachusetts frequently provided for voting caps. However, regressive voting schemes were present in only a small number of New Jersey canals, and were entirely absent from the corporate charters of the four canals incorporated in Connecticut through 1856. Our own multistate analysis indicates that 43% of canal corporations formed between 1790 and 1860 had restrictive voting, with a peak of 66% having restrictive voting in the 1790s.

The impetus behind the creation of the first canals in the United States was essentially the same as that for turnpikes. Local merchants and landowners whose business would benefit from improved means of transportation pooled resources and

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60 Taylor v. Griswold, supra note 54, at 7.
61 Id. at 9.
62 Dunlavy, Social Conceptions, supra note 10, at 1372.
63 Id. at 11.
64 Id. at 7. The Revisors of the Civil Code of Virginia expressly discussed the link between regressive voting rules and consumers interests. See note 224 infra and accompanying text. See also Ratner, supra note 9 (proposing the adoption of a one-shareholder, one-vote rule in order to implement a stakeholder-oriented model of corporate governance).
65 Dodd, supra note 35, at 41. Some of these proposed canals, however, never came into being.
66 Cadman, supra note 34, at 24; Dreier, supra note 35, at 25.
incorporated some of the early canals.\textsuperscript{67} Other eighteenth century canals, however, attracted foreign investments from the beginning.\textsuperscript{68}

The Middlesex Canal, one of the few early canals to be successfully constructed and operated (though unprofitable), provides an example of this type of locally owned and financed enterprise. Its founders were merchants, professional men, and landholders of Medford, the locality which, as the natural terminus of the canal, stood to benefit most from the new enterprise.\textsuperscript{69} Christopher Roberts attributes the significant stability of the canal’s shareholder base in its early years to “the function of coöperating owners uniting to establish a public utility.”\textsuperscript{70} The Middlesex Canal’s original charter of 1793 contained an elaborate graduated voting scale, a scheme which was streamlined by a charter amendment two years later granting voting by shares subject to a limit of 25 votes per shareholder.\textsuperscript{71} In the Delaware and Raritan canal, a regressive voting scheme was apparently instituted as a defensive mechanism against foreign – i.e., out-of-state – control of the enterprise, again presumably to protect shareholders as customers at the expense of their interest as investors.\textsuperscript{72}

Ultimately, U.S. canals came to develop as government rather than private (either investor-owned or consumer-owned) enterprises, for various reasons.\textsuperscript{73} First, U.S. demographic patterns cut against private ownership of canals by investors.\textsuperscript{74} The most densely populated and commercially active areas in the United States were located either next to natural waterways or in the proximities of big East Coast centers that were accessible by roads, thus rendering canals uncompetitive.\textsuperscript{75} Second, private ownership by customers was impeded by the need for large amounts of capital, and by the heterogeneous group of merchants served by a long canal. Third, the high fixed costs and low variable cost of a canal required that, for efficiency, prices be set lower than the average cost, which required a substantial subsidy that was best injected through

\textsuperscript{67} CHANDLER, supra note 17, at 35 (“[t]he first canal lines were organized by merchants who needed the facilities to transport their goods. But they quickly came to be owned and operated by specialists”).

\textsuperscript{68} DAVIS, supra note 31, at 167-9 (noting that Dutch capital contributed to the “the Proprietors of the Locks and Canals on Connecticut River,” chartered by Massachusetts in 1792, and London Capital financed most of the construction of a canal on the Connecticut River at Bellow’s Falls in Vermont, also chartered in 1792).

\textsuperscript{69} CHRISTOPHER ROBERTS, THE MIDDLESEX CANAL 1793-1860 28 (1938) (reporting that the leading citizens of Medford “were interested both directly as landowners and more indirectly as men of business attracted by the prospect of general prosperity”).

\textsuperscript{70} Id. at 45.

\textsuperscript{71} Id. at 41. For the original charter, see An Act to Incorporate James Sullivan Esquire, and others, by the name and style of the Proprietors of the Middlesex Canal (June 22, 1793) (providing that “[t]from one hundred to three hundred dollars, inclusive, there shall be allowed one vote; from three hundred and one, to fix hundred dollars, inclusive, shall be allowed one vote more; and for every thousand, above one thousand, shall be allowed one vote more, provided no one proprietor shall have more than twenty votes”).

\textsuperscript{72} See HORACE CRANMER, THE NEW JERSEY CANALS: STATE POLICY AND PRIVATE ENTERPRISE, 1820-1832 (1978). Cranmer argues that the adoption of a regressive voting rule in the Delaware and Raritan (granting one vote per share up to ten shares, and one vote per every five shares thereafter) was designed to prevent the corporation from falling under the control of New York of Pennsylvania. Id. at 35 and 144.

\textsuperscript{73} DAVIS, supra note 31, at 185 (concluding, with respect to eighteenth and early nineteenth-century canals, that “the corporate form, while necessary here, proved unequal to the task”).

\textsuperscript{74} See Part III infra for a discussion of the U.K. experience with canal companies.

\textsuperscript{75} DAVID R. MEYER, THE ROOTS OF AMERICAN INDUSTRIALIZATION 28 (2003).
government ownership. Prior to the Erie Canal, only three of the existing canals in the country covered more than two miles; at 28 miles in length, the Middlesex Canal was the longest of them, but struggled financially. In constructing and financing the trailblazing Erie Canal without the intermediation of the corporate form, the state government of New York inaugurated a new era of direct state involvement in canal development. Those public projects, in turn, would soon be threatened by the rise of railroads.

(iv) Railroads

Railroads came to dominate long-distance transportation in the nineteenth century, but they appeared later than the turnpikes and canals that they eventually replaced. While turnpikes and canals had been chartered since the eighteenth century, the first railroad corporations date from the late 1820s. As was the case with many canals, some railroad corporations received substantial government backing, but most of the early New England railroads formed in the 1830s were wholly private enterprises.

Voting restrictions were common in the early stages of private railroad development. Massachusetts railroads established in the 1830s typically capped the voting power of large shareholders. A Massachusetts railroad statute of 1836 regressive the voting rights of individual shareholders to one-tenth of the number of outstanding shares. Likewise, five out of the first ten railroads incorporated in Connecticut followed the latter rule.

Similarly to turnpikes and canals, the formation of early railroad corporations was commonly animated by the prospect of indirect benefits stemming from improved means of communication. Domestic and foreign finance capital, which became important financing sources in later decades, did not play a major role in funding early railroad construction. As highlighted by Thelma Kistler, the first railroad promoters generally framed their appeals for subscriptions in terms of “incidental benefits” rather than profitability. Shareholders agreed to subscribe for the stock of the Western Railroad despite “a certainty of no direct profits.” Likewise, calls for contributions from residents along the route of the Amherst and Belchertown road stressed that subscriptions were not meant to be “an investment” for “financial return,” but rather to “secure the benefits for himself and the community.”

77 HANDLER, supra note 17, at 24 (describing the insufficiency of private corporations to finance canal development). For a study on the role of the government in canal development, see CARTER GOODRICH, GOVERNMENT PROMOTION OF AMERICAN CANALS AND RAILROADS, 1800-1890 (1960).
79 DODD, supra note 35, at 25. All of the first Massachusetts railroads chartered in 1830 capped the number of votes per shareholder, even if one of them placed the rather lenient cap of one-fourth of the total number of shares. Id.
80 Mass. Rev. Stat., ch. 39, § 50 (1836). (providing that “each member shall not be entitled to any vote for any shares beyond one tenth part of the number of shares of the stock of such corporation”).
81 Dreier, supra note 35, at 27.
82 Id. at 9 (1932) (finding virtually no evidence of the use of foreign and banking capital in the first decades of railroad promotion); TAYLOR, supra note 28, at 99.
However, regressive voting gradually fell into disuse as the industry matured in its first decades. Voting restrictions were present in ten New Jersey railroads incorporated through 1836, but vanished from the corporate charters of firms created thereafter.\textsuperscript{84} All Connecticut railroads chartered after 1841 granted one vote per share.\textsuperscript{85} New York’s general incorporation law for railroads of 1850 also specified a one-share-one-vote rule in director elections.\textsuperscript{86} In our multistate analysis, the percentage of railroad charters with regressive voting dropped precipitously from 48% of those chartered in the 1820s to 6% of those chartered in the 1850s. Consistently with these figures, Colleen Dunlavy shows that already in the 1840s support for regressive voting was rapidly losing traction even in railroad corporations that initially limited the voting rights of large shareholders.\textsuperscript{87}

We suggest that changes in voting rules parallel major transformations in the financing and ownership structure of railroad companies. Late nineteenth-century railroads came to be seen as the paradigm of the modern, large-scale business corporation requiring massive amounts of capital, specialized management, and dispersed ownership. Railroad securities ultimately became the darlings of Wall Street and the object of the most high profile corporate scandals and control contests in the nineteenth century.\textsuperscript{88} But this shouldn’t obscure the fact that many of the earliest U.S. railroads closely resembled the type of cooperative enterprise that characterized other early transportation companies.

The geographical distribution of early railroad shareholdings corroborates the import of ancillary benefits as an inducement to stock subscriptions. The first railroad corporations in New England were an eminently local business, covering an average distance of 36 miles as late as 1850.\textsuperscript{89} As much as 95% of Western Railroad shareholders (holding 96.6% of its stock) resided along the route of the road. Most shareholders of the New London were also adjacent residents.\textsuperscript{90} All in all, the vast majority of early railroad promoters and shareholders were local merchants, manufacturers, or landowners who expected to benefit from the railroad’s operations.\textsuperscript{91} The interests of shareholders-consumers help explain the use of voting restrictions in early railroad companies. A key driver behind the first railroad incorporations, in

\textsuperscript{84} CADMAN, supra note 34, at 309.
\textsuperscript{85} Id. at 28.
\textsuperscript{86} Even after the enactment of general incorporation laws for railroads, however, corporate promoters continued to seek special charters for additional privileges. See COLLEEN A. DUNLAVY, POLITICS AND INDUSTRIALIZATION: EARLY RAILROADS IN THE UNITED STATES AND PRUSSIA 70 (1994).
\textsuperscript{87} Dunlavy, Social Conceptions, supra note 10, at 1383 (describing developments at the Western Railroad). See also Colleen A. Dunlavy, Corporate Democracy: Stockholder Voting Rights in Nineteenth-Century American and Prussian Railroad Corporations 47, in INSTITUTIONS IN THE TRANSPORT AND COMMUNICATIONS INDUSTRIES (Lena Andersson-Skog & Olle Krantz eds, 1999) (noting that by the mid nineteenth-century “graduated voting schemes – even a simple cap on total votes – seem generally to have fallen out of favor, except possibly in Massachusetts”).
\textsuperscript{88} WINTHROP M. DANIELS, AMERICAN RAILROADS: FOUR PHASES OF THEIR HISTORY 26 (1932).
\textsuperscript{89} DANIELS, supra note 88, at 4.
\textsuperscript{90} KISTLER, supra note 83, at 84.
\textsuperscript{91} TAYLOR, supra note 28, at 97 (“[a]s with the turnpike companies, many of the early railroads secured most of their private capital from merchants, small manufacturers, farmers, and professional men living along the proposed route of the new railroad”).
particular, was “the desire to deflect trade from a rival commercial town.”

In this light, voting restrictions helped assure that the corporation would not easily come under the control of capitalists having interests antagonistic to those of the railroad and its beneficiaries – a consideration that seems to have carried real weight at the time.

The experience of the Western Railroad, one of the first Massachusetts railroad companies, is illustrative of this concern. In 1834, when the Western faced great difficulty in obtaining the requisite financing for construction, a group of New York capitalists offered to subscribe to the company’s entire capital in exchange for control of the business. Despite the firm’s urgent need for funds, its representatives rebuffed the offer, pointing to the risk that the railroad would be “so managed as to defeat the purpose of its incorporators.”

The voting restrictions specified in Western’s initial charter, which capped the voting rights of individual shareholders at one-tenth of the total shares, arguably fulfilled a similar function.

By contrast, the little Mohawk and Hudson Railroad chartered by the New York legislature in 1826 was one of the few early railroads to be entirely investor owned. The Mohawk, which sought to connect the cities of Albany and Schenectady, was the first U.S. railroad designed to draw passenger traffic. Unlike its contemporary counterparts, it was not a local enterprise; Albany and Schenectady residents played virtually no part in the creation of the railroad, which was primarily sponsored by New York City capitalists. In 1830, only two months after the beginning of construction, it became the first railroad to be traded on the New York Stock Exchange. Consistent with its investor ownership, the Mohawk adopted a one-share-one-vote rule from the outset.

The development of the railroad industry brought about changes in its financing and size. Once the first railroads were successfully constructed and turned out to be lucrative ventures, railroad promoters began to emphasize potential profit as well as indirect benefits when seeking new subscriptions. The structure of early railroads as

92 DANIELS, supra note 88, at 4.
93 KISTLER, supra note 83, at 84. See also TAYLOR, supra note 28, at 99 (noting that “New York competition was so feared that when badly needed funds for the Western Railroad were offered by New York capitalists, they were refused”). Two years later, the Western succeeded in obtaining public financial support; the new subscriptions by the Commonwealth of Massachusetts made it a “one-third partner” in the enterprise and entitled it to appoint three of its nine directors. See SALSbury, supra note 78, at 143; Dunlavy, Social Conceptions, supra note 10, at 1376.
94 To be sure, not all merchant-backed railroads adopted voting restrictions. Merchants seeking to regain the trade that was being diverted through the Erie Canal promoted the creation of the Baltimore & Ohio Railroad, chartered in 1827. This corporation, however, enjoyed substantial governmental support from its inception, with the state of Maryland and the city of Baltimore subscribing for one half of its total capital. See EDWARD HUNGERFORD, THE STORY OF THE BALTIMORE & OHIO RAILROAD 1827-1927 28 (1828). Perhaps because of its concentrated government ownership and the infeasibility of a takeover, its charter adopted a one-share-one-vote rule.
97 Id. at 26; DANIELS, supra note 88, at 99.
98 An Act to incorporate the Mohawk and Hudson Rail Road Company (passed April 17, 1826), Laws of New York, 49th session, Chap. 253 (1826).
99 KISTLER, supra note supra note 83, at 84.
“local ventures designed to serve local purposes” no longer seemed practical after 1847, and railroad expansion to more distant areas of the country became a priority.  

As the scale of railroad operations expanded, so did their financing sources. As noted by Winthrop Daniels, in the infancy of the industry “[t]he primary interest of most investors lay in the indirect benefits to be gained, though as the period advanced, purchase for investment or speculation by financiers in the eastern cities and abroad began to be important.” Railroads resorted to the issuance of bonds beginning in the 1850s; meanwhile, railroad securities were becoming popular in eastern financial centers, and were increasingly held by speculators or magnates seeking control of the enterprise. By 1905, it appeared clear that “Wall Street is built on railway securities.”

As the industry developed, and railroad ownership and control shifted away from local beneficiaries to investors, public dissatisfaction mounted over the railroads’ monopolistic pricing practices. Arthur Hadley’s classic study on railroad history viewed the separation between owners and customers as the source of discontent against railroad monopoly. “Serious conflicts of interests concerning a turnpike or bridge were almost impossible,” he argued, “because those who owned them and those who used them were to a large extent the same, or, at any rate, came in personal contact;” by contrast, “one set of men own a railroad and another set of men use it.”

Still, as late as 1878, the New York Times advocated a voting rights solution for what it saw as “the great power that has grown up in the hands of great corporations, and especially those that control the principal lines of internal communication.” The editorial defended the adoption of a one-shareholder-one-vote rule to “enforce a policy of management which would have due regard for the interests of all,” as opposed to the prevailing system of voting by shares, which arguably concentrated excessive power in the hands of magnates to the detriment of “[t]he laborers in their employ, small sharers in the property which they manage, and even their public from which they draw their patronage and their resources.” But subsequent remedies to abuses in railroad pricing

100 Id. at 33-35.
101 DANIELS, supra note 88, at 101-102. See also TAYLOR, supra note 28, at 100 (“until the end of the second decade of railroad construction only a small part of railroad capital came from financial districts of the eastern cities”).
103 ARTHUR T. HADLEY, RAILROAD TRANSPORTATION: ITS HISTORY AND ITS LAWS 21 (1896).
104 The Contest against Corporations, N.Y. TIMES, Aug. 14, 1878. Dunlavy, Social Conceptions, supra note 10, at 1384, reads this editorial as articulating “with unusual force a social conception of the corporation that drew explicitly upon norms of civic governance and roundly condemned the rise of plutocracy in corporate governance.” It seems, however, that the article’s author was particularly concerned with abuse of the railroads’ monopoly (arguing that “[f]or many years railroad managers have been able to exert an enormous influence upon the markets by their control of the internal carrying trade; they have played fast and loose with rates and charges, have crushed opposition and rivalry, have distributed almost at will the foreign commerce of the country, by giving direction, according to agreements among themselves, to the transportation of merchandise, and have used their power with little regard for anything but an increase of their own power and wealth”).
did not follow the lines of this type of governance reform – which would in any case have been a poor means of addressing monopoly once railroad shares were no longer in the hands of consumers. Rather, reforms took the arguably more effective forms of rate regulation and antitrust law.\textsuperscript{105}

**B. Financial infrastructure**

(i) **Banks**

Voting restrictions were also common in early U.S. banking firms. Merrick Dodd finds that voting caps were a “uniform practice” in Massachusetts banks in the early nineteenth century.\textsuperscript{106} According to Dreier’s study of nineteenth-century Connecticut charters, banking corporations accounted for the highest incidence of voting restrictions across all industries, with precisely 50% of such firms specifying a graduated voting scale or, more often, an absolute cap on the number of votes per shareholder.\textsuperscript{107} Similarly, nearly one half of early New Jersey banks adopted a graduated voting scale.\textsuperscript{108} Voting restrictions were comparatively less frequent among New York banks. Hilt finds that 26% of New York banks in his sample adopted regressive voting, while 63% followed a one-share-one-vote rule.\textsuperscript{109} Our multistate analysis, in turn, shows 53% of banks adopting regressive voting between 1790 and 1860, with a peak of 82% in the active decade from 1810 to 1820.

Like other early business corporations, the impetus for the creation of the first banks often came from parties who were more interested in the bank’s services than in its profits.\textsuperscript{110} In the words of Robert Morris, the Superintendent of Finance who promoted the creation of the first chartered bank in the U.S., the Bank of North America, would later remark that the bank’s profit rate “would never be sufficient inducement to hold

\textsuperscript{105} The Interstate Commerce Commission was created by the Interstate Commerce Act of 1887 to regulate railroad rates. Moreover, the U.S. Supreme Court initially applied the Shearman Act to railroad industry, which was later expressly exempted from the scope of antitrust laws by Congress. \textit{See} JAMES ELY, RAILROADS AND AMERICAN LAW 100-1 (2001).

\textsuperscript{106} Edwin Merrick Dodd, American Business Corporations until 1860 (With Special Reference to Massachusetts) 215 (1954).

\textsuperscript{107} Dreier, \textit{supra} note 35, at 24. Dreier’s study also reveals that caps on share ownership were also widespread among early Connecticut banks.

\textsuperscript{108} CADMAN, \textit{supra} note 34, at 308 (noting that this proportion included “nearly every bank charter passed before 1850”).

\textsuperscript{109} Hilt, \textit{supra} note 13, at 13. In the period covered by Hilt (all incorporations through 1825), the chartering process in New York was particularly corrupt, with politicians expecting financial and political benefits in consideration for banking charters. A backlash against these corrupt practices led to the adoption of Free Banking in New York in 1838. \textit{See} Howard Bodenhorn, \textit{Bank Chartering and Political Corruption in Antebellum New York: Free Banking as Reform, in Corruption and Reform} (Edward Glaeser & Claudia Goldin eds., 2006).

\textsuperscript{110} \textit{See}, e.g., SEAVOY, \textit{supra} note 29, at 53 (“[m]erchants organized the first state banks because they wanted to use the credit the banks created”); Dodd, \textit{supra} note 35, at 76 (“[t]he eagerness to organize new banks was in many cases due more to the desire of prospective borrowers to create a bank from which they could obtain credit than to desire of prospective investors to profit by means of dividends on bank shares”).
stock, if there were no other consideration”\textsuperscript{111} and that the vast majority of its shares “belong to citizens of Philadelphia, and principally to the commercial men, whose greatest inducement to continue stockholders, is to support an institution which affords them accommodation and convenience, by means of discounts.”\textsuperscript{112}

Local merchants were simultaneously the principal owners and the principal customers of most banks in the late eighteenth and early nineteenth century. In the words of a contemporary observer, “those who are not capitalists, but who are borrowers” were the main promoters of early Massachusetts banks.\textsuperscript{113} In their work on the history of New York’s Citibank, Harold Cleveland and Thomas Huertas noted that “like nearly all banks of the day,” the bank established in 1812 “was intended to be a kind of credit union for its merchants-owners.”\textsuperscript{114}

These banks typically financed the purchase and sale of merchandise at wholesale, and steered away from serving other types of potential customers.\textsuperscript{115} In particular, banks provided much-needed liquidity for these merchants, who often had to advance credit at both ends of a given sale transaction.\textsuperscript{116} For example, merchants would pay sellers of merchandise with notes of obligation rather than with piles of coin. The sellers could then take those notes to the local bank to “discount” them – which is to say, exchange the company’s notes for short-term credit in the bank, with the bank taking a small fee (discount) for the transaction. The bank might itself give sellers notes of obligation – banknotes – issued by the bank, which these sellers, in turn, could hand over to other merchants as payment for consumption goods. Unlike modern commercial banks, which take deposits from the general public, early banks lent heavily out of their own capital stock.

Competition appears to have been limited in late eighteenth century and early nineteenth century banking. Dreier reports, for example, that,\textsuperscript{117}

\begin{itemize}
  \item \textsuperscript{111} DEBATES AND PROCEEDINGS OF THE GENERAL ASSEMBLY OF PENNSYLVANIA, ON THE MEMORIALS PRAYING A REPEAL OR SUSPENSION OF THE LAW ANNULING THE CHARTER OF THE BANK 44 (Mathew Carey ed., 1786).
  \item \textsuperscript{112} Id. at 95. For a detailed description of the commercial motives behind the later opposition to the Bank of North America, see Joseph H. Sommer, The Birth of the American Business Corporation: Of Banks, Corporate Governance and Social Responsibility, 49 BUFFALO L. REV. 1011, 1034 et seq. (2001).
  \item \textsuperscript{113} HENRY WILLIAMS, REMARKS ON BANKS AND BANKING: AND THE SKELETON OF A PROJECT FOR A NATIONAL BANK BY A CITIZEN OF BOSTON 17 (1840) (noting that investor contributions made up only a modest proportion of the bank’s total capital).
  \item \textsuperscript{114} HAROLD VAN B. CLEVELAND & THOMAS F. HUERTAS, CITIBANK 1812-1970 8 (1985). See also Sommer, supra note 112, at 1028 (describing the early U.S. banks as “considered merchants’ utilities, chartered perhaps as public corporations, but operated as private credit clubs”).
  \item \textsuperscript{115} DODD, supra note 35, at 214. See also BRAY HAMMOND, BANKS AND POLITICS IN AMERICA: FROM THE REVOLUTION TO THE CIVIL WAR 75 (1957) (noting that “the first American bankers were merchants seeking to advance their own interests by an improved means of providing the credit they needed,” and “they lent as bankers the way they had lent as merchants”).
  \item \textsuperscript{116} Naomi R. Lamoreaux, The Structure of Banking in Antebellum Southern New England: Some Social and Economic Implications, 13 BUS. & ECON. HIST. 171 (1984) (“when these merchants borrowed money from the banks they controlled they were to a great extent merely withdrawing their own funds”).
  \item \textsuperscript{117} Dreier, supra note 35, at 49 n. 119.
\end{itemize}
judging by the names of the banks and insurance companies chartered by special act in Connecticut between 1789 and 1856, which usually reflected where they were located, it was rare to find two banks, or two insurance companies insuring against the same risks, in the same town.

This initial shortage of bank charters was reinforced by state limitations on interstate and intrastate branching and by the legal restrictions on unincorporated banking in many states. While these legal restraints on bank competition were evidently in large part the product of ideology and political influence, early banks may also have enjoyed some monopoly power as a result of simple economies of scale. For example, prior to the establishment of a national currency in the 1860s, there were presumably important economies of scale in the issue of private banknotes.

The combination of a limited supply of bank charters and price regulation via usury laws led banks to favor insiders in allocating funds. Merchants unaffiliated with banking institutions had difficulty obtaining credit. Hence there was a good reason for local merchants, who needed the bank to discount their notes, to control the bank (and, before they did that, to pitch in together to finance its creation). That is, in this scenario, “[e]ach borrowing interest wanted a bank of its own.”

Moreover, banks of the time were highly risky enterprises, subject to a significant moral hazard in their operations (by leveraging themselves too highly), and failed at a rapid rate. If their customers collectively owned the bank, they had an incentive to manage it conservatively so it would be less likely to fail (and especially to fail while owing them money). This is the same reason why consumer savings banks were exclusively nonprofit and mutual firms before 1845, only slowly becoming investor-owned after that as states began to regulate their reserves.

Voting restrictions in consumer-owned banks helped prevent large shareholders from appropriating the banks’ credit to themselves to the detriment of other merchant owners. Yet the impetus for the adoption of voting restrictions in banks did not always come from the firm’s shareholders; it was sometimes externally imposed. The Bank of Massachusetts of 1784, one of the very first banks established in the United States, illustrates this point. Its charter mentioned the interests of merchants-consumers among the main justifications for the Bank’s creation. Many of the Bank’s initial shareholders

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118 See, e.g., Richard Sylla, Early American Banking: The Significance of the Corporate Form, 14 BUS. & ECON. HIST. 105, 111 (1985) (noting that “[u]nincorporated enterprises, glorified in most fields, were actually crusaded against in banking”). For a political economy account of branching restrictions, see Ronald Gilson, Henry Hansmann & Mariana Pargendler, Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S. and the EU, 63 STAN. L. REV. 475, 519 et seq. (2011).


120 HAMMOND, supra note 115, at 147.

121 See HANSMANN, supra note 7.

122 The petition of William Phillips and five others for a charter, dated January 1784, argued that “as the Consideration received for such Loans [to the Community] will never exceed the Interest established by
were prospective customers, but its principal founder and stockholder, William Phillips, publicly displayed himself as a capitalist and a lender, not borrower, of the bank. The Bank’s initial charter provided for a one-share-one-vote rule.

When elected president of the Massachusetts Bank in 1786, Phillips forced its shareholder-borrowers to sell their shares and withdraw from the corporation, in a move which was arguably designed to steer the bank away from the type of debtor cooperative that was prevalent at the time. He also imposed limits on the amounts any shareholder or person could borrow, a rule which was however later abandoned. Yet the Bank’s monopoly profits, combined with a perception of insider favoritism and arbitrary discount refusals, continued to trigger resentment among disgruntled borrowers.

In order to appease critics and ensure “a more secure administration of the affairs of the Massachusetts bank,” the state legislature eventually amended the bank’s corporate charter over its objections. Among the charter amendments, which ranged from prudential regulations to limitations on the bank’s scope of activity, the legislature imposed a cap of ten votes per shareholder – a rule that would persist as the norm for Massachusetts banks for nearly half a century.

In 1790, two years before this incident, Alexander Hamilton had famously defended the adoption of a regressive voting scheme in the First Bank of the United States – a rule that he viewed as a “prudent mean” between the more extreme alternatives of one vote per member and one vote per share. In his words, “[a] vote for each share renders a combination between a few principal stockholders, to monopolize the power and benefits of the bank, too easy,” while “[a]n equal vote to each stockholder, however great or small his interest in the institution, allows not that degree of weight to large

Law the enormous advantages made by the griping Usurer from the Necessities of those want to borrow Money will be immediately checked & in great Measure Destroyed.”

123 N.S.B. GRAS, THE MASSACHUSETTS FIRST NATIONAL BANK OF BOSTON 1784-1934 54 (1937) (noting that Philips “borrowed only small sums from the Bank and indeed seems generally to have stood before the community as a lender or stockholder rather than as borrower”).
124 An Act to Establish a Bank in this State & to Incorporate the Subscribers thereto, Feb. 7, 1784 (“the number of votes to be determined by the number of shares each voter holds or represents”).
125 GRAS, supra note 123, at 64 (noting that, through the stock repurchase, the Massachusetts Bank “seemed to be about to step down the primrose path of early banks in New England… owned by stockholders who were more interested in borrowing from the Bank than in loaning to it, more concerned with becoming fixed debtors than permanent creditors”).
127 Id. at 13 (“the suspicion began to take root, both inside and outside the state legislature, that a handful of wealthy individuals had gained control of the bank and were using it for their own private purposes”).
129 The act (1) fixed a minimum denomination of $5 on notes issued; (2) made directors personally liable for payments of notes when loans exceeded twice the specie deposited in the bank; (3) required directors to make semiannual statements of the amount of capital, debts, deposits, circulation, and cash on hand; (4) “forbade dealings in merchandise or bank stock on penalty of forfeiture of double the value;” (5) limited each stockholder to 10 votes. DAVIS, supra note 31, at 9.
stockholders which it is reasonable they should have, and which, perhaps, their security and that of the bank require.”

Hamilton’s statements do not sufficiently clarify his motives for advocating the adoption of voting restrictions in the Bank of the United States. But read in light of contemporary controversies and Hamilton’s overall concerns and objectives for the Bank, it seems more consistent with the consumer protection account of voting restrictions than with investor protection. The Bank of North America of 1781 – the backdrop against which Hamilton formulates his proposals – had been arguably “‘all but crippled’ during the 1790s because a few powerful borrowers had monopolized its funds.”

Throughout his “Report on a National Bank,” Hamilton sought to reconcile the interests of investors and those of the general public. He seemed particularly concerned with mitigating profit-maximizing behavior by the Bank’s shareholders to the detriment of consumers, as well as with preventing favoritism in lending decisions. He defended, for instance, the constitution of a bank with a large capital, because shareholders, fearing a decrease in profits, might resist subsequent capital increases that are beneficial to the Bank’s security and to its customers. “Banks are among the best expedients for lowering the rate of interest in a country,” he argued, “but to have this effect, their capitals must be completely equal to all the demands of business, and such as will tend to remove the idea, that the accommodations they afford are in any degree favors – an idea very apt to accompany the parsimonious dispensation of contracted funds. In this, as in every other case, the plenty of commodity ought to beget a moderation of the price.”

He also proposed a mandatory rotation of directors, a rule that he deemed to reduce “the danger of combination among the directors, to make the institution subservient to party views, or to the accommodation, preferably, of any particular set of men.”

Ownership and control of banks by their merchant customers – and voting restrictions designed to reinforce that control – presumably served not just to constrain

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130 Alexander Hamilton, Report on a National Bank, communicated to the House of Representatives, Dec. 14, 1790. The voting rule ultimately adopted provided as follows: “For one share, and not more than two shares, one vote; for every two shares above two, and not exceeding ten, one vote; for every four shares above ten, and not exceeding thirty, one vote; for every six shares above thirty, and not exceeding sixty, one vote; for every eight shares above sixty, and not exceeding one hundred, one vote; and for every ten shares above one hundred, one vote; but no person, co partnership, or body politic, shall be entitled to a greater number than thirty votes.”

131 See Sommer, supra note 112, at 1042 (“[a]lthough this rationale [described in Hamilton’s Report] can be read as providing for community control of the merchants, it reads more logically as providing mercantile control of the directors. In theory, regressive voting would ensure that the respectable merchants would collectively dominate the bank, but would keep individual merchants (or factions) from oppressing the rest.”)


133 Hamilton, supra note 130, at 67 (also arguing that “[p]ublic utility is more truly the object of public banks than private profits. And it is the business of Government to constitute them on such principles, that, while the latter will result in a sufficient degree to afford competent motives to engage in them, the former be not made subservient to it”).

134 Id.

135 Id., at 68.
exploitation of monopoly power, but also to inhibit the banks from assuming an inefficient amount of risk, the costs of which would fall upon the banks’ customers. Clearly this was the reason for the dominance of mutual and nonprofit firms among savings banks – which in the nineteenth century were a distinct class of institutions from the commercial banks we are concerned with here – prior to the advent of effective governmental regulation of reserves beginning in the late 1840s.136 While the threat to customers of inefficient risk-taking was surely much higher in savings banks than in commercial banks, merchants whose notes were discounted by commercial banks clearly had a strong interest in the continuing creditworthiness of the banknotes or other credits issued by the banks in exchange.

Indeed, viewed in this latter respect, consumer ownership of commercial banks also helps explain other common charter provisions beyond shareholder voting rules. It was common for early bank charters to specifically prevent banks from engaging in trade or dealing in merchandise.137 Such provisions seem more likely to have been intended as consumer protection than as investor protection. In particular, they plausibly served to limit the riskiness of the banks, and perhaps also prevented the banks from competing with their local merchant-owners.

The early nineteenth century commercial banks gradually transitioned from consumer ownership to investor ownership.138 What accounted for this transition? Increased competition seems a likely answer, as localities came to have more than a single bank and, beginning in the 1860s, bank entrepreneurs had the alternative of a federal charter as well as a state charter (though the widespread limitations on both interstate and intrastate branch banking continued to limit effective competition139). Expanding state and federal regulation presumably also reduced the riskiness of banks, and was perhaps important as well in providing some assurance to merchants that their local bank would not discriminate against them in favor of their competitors.

(ii) Insurance

Voting restrictions also appeared among early property and casualty insurance companies.140 Maximum vote provisions were common, although not universal, in late eighteenth and early nineteenth century stock insurance companies in Pennsylvania and

136 HANSMANN, supra note 7, at 246-64.
137 See, e.g., DAVIS, DAVIS, supra note 31 (describing a charter amendment prohibiting the Massachusetts Bank from dealing in merchandise).
138 For a description of this process, see LAMOREAUX, supra note 126. Lamoreaux focuses on an intermediate stage of the process, in which the banks remained under the partial ownership and control of their merchant customers, and argues that those customers provided reputational reassurance to prospective non-customer investors. (“[i]nvestors knew that when they bought stock in a bank they were actually investing in the diversified enterprises of that institution’s directors.” Id. at 5.). We do not engage the latter issue here.
140 DAVIS, supra note 31, at 246 (“[r]egressive voting, or else one vote per share up to a maximum of ten, thirty, or fifty, was the rule” in eighteenth-century insurance corporations”).
Approximately 28% of stock insurance corporations chartered in Connecticut through 1856 adopted regressive voting schemes. By contrast, the overwhelming majority of New York and New Jersey insurance companies granted voting rights in direct proportion to share ownership. Our multistate analysis shows 38% of insurance companies chartered between 1790 and 1860 adopting regressive voting.

A significant number of the early insurance corporations were, both in name and substance, mutual insurance companies. These firms were owned by their customers – the insured – and typically adopted one vote per member or another form of stringent voting restrictions. Early mutual insurance companies were particularly common in the fire insurance business. The economies of scale in building an insurance pool gave many of these companies substantial monopoly power, and created a strong incentive for collective ownership by their customers.

While many consumer-owned insurance companies were organized formally as mutuals, a number of insurance companies formed as joint stock corporations were also effectively mutuals, serving principally to insure their shareholders. In this sense, the history of insurance companies is essentially akin to, and closely related with, that of banks. As described by Alfred Chandler, in the context of marine insurance, “[b]y pooling resources in an incorporated insurance company, resident merchants, importers, exporters and a growing number of specialized shipping enterprises were able to get cheaper insurance rates;” as a result, “[n]early all these companies handled only the business of local shippers and ship owners.” The local element of early insurance firms was made explicit in their charter provisions; state citizenship – or, in some cases, town residency – requirements for directors were common.

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141 James Mease, The Picture of Philadelphia 108 et seq. (1811); Dodd, supra note 35, at 225. See also Ratner, supra note 9, at 8 (citing an 1832 Massachusetts statute on insurance companies capping the number of votes at 20 per shareholder).
142 Dreier, supra note 35, at 22-23.
143 Hilt, supra note 13, at 658; Cadman, supra note 34, at 308-9.
144 The first U.S. insurance company was, famously, the Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, a mutual firm founded with the assistance of Benjamin Franklin in 1752. F.C. Oviatt, Historical Study of Fire Insurance in the United States 157, in Annals of the America Academy of Political and Social Science (1905).
145 Hansmann, supra note 7, at 278. However, while the mutual form of organization mitigated potential conflicts between investors and consumers, it also gave rise to disputes among heterogeneous consumers themselves. For instance, a decision by the Contributionship board to stop insuring houses surrounded by trees (for they arguably hindered fire-fighting efforts) caused much discontent among some of its members, who ultimately created a new mutual insurance company to provide such coverage upon payment of an additional premium – the Mutual Assurance Company, whose symbol, fittingly, was a green tree. See Oviatt, supra note 74. In Currie's Administrator v. Mutual Assurance Society, 4 Hen. & M. 315 (1809), a member sued over an amendment to the charter of a mutual insurance corporation increasing the premium to be charged from residents in the town vis-à-vis those of the country. The court held that the amendment had been approved by a majority of the corporation and was therefore valid.
146 Davis, supra note 31, at 246 (stressing the close relationship between banks and insurance firms, as “the merchant class demanded both services and naturally tended to control both types of institutions”).
148 Davis, supra note 31, at 324. Prohibitions on interlocking directorates were also widespread.
Take, for example, the Insurance Company of North America, the first U.S. stock insurance company, which was chartered in Philadelphia in 1784. Historians attribute the decision to transform what was initially a failing Tontine association into a marine insurance company to N. Nesbitt, one of its founders and its future president who, as virtually all leading merchants at the time, had significant experience both as a policyholder and underwriter of marine insurance. As was then standard, the company came to insure the ventures of many of its shareholders and directors – a situation expressly contemplated and permitted by the corporation’s charter, provided that insiders did not receive special privileges. However, not all prospective customers were able to become shareholders in the company. In fact, the Philadelphia legislature granted a charter to another marine insurance company, the Insurance Company of North America, just four days after chartering its predecessor, with the justification that “a number of the ship owners and traders of Philadelphia, from local circumstance, have not been able to obtain shares in [the Insurance Company of North America].” Both insurance companies adopted a graduated voting scheme, subject to an absolute cap on the number of votes per shareholder.

Leading merchants were also instrumental in establishing the first stock insurance corporation in Connecticut, the Hartford Fire Insurance Company, in 1810. According to P. Henry Woodward, “a sense of ever-present peril, a desire to avert the worst effects of calamity from the immediate sufferer by distributing the loss through the community, and a willingness to contribute fairly to the common fund brought the company into existence;” even though its subscribers certainly intended to make a profit, “money-making was a secondary consideration.” Nevertheless, its shareholders and directors turned out not to be avid purchasers of insurance policies, and the company initially struggled for lack of a clientele. The corporation’s charter granted voting rights in

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149 See THOMAS H. MONTGOMERY, A HISTORY OF THE INSURANCE COMPANY OF NORTH AMERICA 11 (1885); JAMES MARQUIS, BIOGRAPHY OF A BUSINESS, 1792-1942: INSURANCE COMPANY OF NORTH AMERICA 16 (1976) (noting that Philadelphia merchants of the time previously “banded together to insure one another’s shipping ventures”).
150 MARQUIS, supra note 149, at 36; An Act to Incorporate the Subscribers to the Insurance Company of North America (Apr. 14, 1794), Section VII, art. 9th, Laws of Pennsylvania, Chapter MDCCXL [hereinafter “Act to Incorporate the Insurance Company of North America”], article ninth (“[a]ny member of the Corporation may nevertheless become assured thereby by any vessel, goods, wares, merchandise, or lives, in the same manner, and with the same effect, as if such member had no interest in the Corporation”).
151 MONTGOMERY, supra note 149, at 43 (quoting the report of the legislative Committee on the companies’ charter applications).
152 Act to Incorporate the Insurance Company of North America, Section VII, art. 1st (granting one vote per share up to 50 shares, one vote for every 10 shares above 50, subject to a cap of 100 votes per shareholder, in his own right or as a proxy); An Act to Incorporate the Insurance Company of the State of Pennsylvania, Laws of Pennsylvania, Chapter MDCCXLVII (Apr. 18, 1794), Section IX, art. 1st (providing one vote for the first share, one vote for every two shares up to 10, and one vote for every 4 shares up to 30, subject to a maximum of 24 votes per shareholder).
154 DANIEL HAWTHORNE, THE HARTFORD OF HARTFORD, AN INSURANCE COMPANY‘S PART IN A CENTURY AND A HALF OF AMERICAN HISTORY 34 (1960) (noting that “some of the Directors were very slow about taking out policies and a good many of the stockholders apparently never did”).
The inspiration for the establishment of another fire insurance company in Hartford came from merchants who were previously customers of the Hartford Fire Insurance Company. Interestingly, their main motivation for creating a competing business was allegedly not the firm’s monopoly prices, but rather its slack customer service. The story goes that the office of Walter Mitchell, the secretary and sole salesman of the Hartford Fire Insurance Company, had a highly inconvenient location, erratic hours of operation, and no regard for agreed-upon appointments. A disgruntled group of merchants then “pooled their discontent in a general protest” and incorporated the Aetna Insurance Company in 1819. Although originally a local endeavor, economies of scale soon led the Aetna to expand to other localities and procure outside business through agents. The company’s original charter capped voting rights at 50 per shareholder, a rule that was however abandoned in favor of voting by shares in 1877.

The decline in voting restrictions among stock insurance companies over the course of the nineteenth century can probably be attributed in part to increasing competition in property and liability insurance – competition that, in turn, was the consequence of economic growth, improved communications (and hence a wider potential scope for a given company’s market), and improved information concerning risks. A more important reason for the disappearance of voting restrictions, however, is probably the increasing formal divide between investor-owned and policyholder-owned insurance companies. After the disappearance of special legislative chartering, policyholder-owned insurance companies were no longer formed as joint-stock companies with voting restrictions, but rather as mutual companies with ownership formally tied to purchase of insurance rather than to investment of capital. Even today, roughly a quarter of all property and liability insurance in the United States is written by mutual companies, but those companies are true mutuals rather than jury-rigged joint stock companies.

C. Manufacturing

In sharp contrast to the types of firms discussed above, one vote per share was from the outset the dominant voting rule in U.S. manufacturing corporations. Only one out of 135 manufacturing corporations chartered by special act in Connecticut through 1856 adopted voting restrictions. Similarly, regressive voting schemes were present in

155 Id.
156 HENRY ROSS GALL & WILLIAM GEORGE JORDAN, ONE HUNDRED YEARS OF FIRE INSURANCE: BEING A HISTORY OF THE AETNA INSURANCE COMPANY 28 (1919) (detailing that “[t]he trip out to Wethersfield along a clayey road, sometimes swamped by rains or rutted by drought, was an exasperating journey at the best (...) Merchants or business men who wanted insurance did not relish the “Gone for the day” sign that greeted their eyes so often on the door of his office”).
157 Id. at 46 (“[i]t was realized at the very beginning that the local field, shared as it was with another company, would be small, and that it would be essential to stimulate outside business through carefully selected agents”).
158 Id. at 231 and 236.
159 HANSMANN, supra note 7, at 265.
only 2% of the manufacturing corporations chartered in New York through 1825 and 3% of such firms incorporated in New Jersey up to 1867.\footnote{160} New York’s path-breaking general incorporation act for manufacturing firms of 1811 provided a one-share-one-vote rule – a pattern that prevailed in most such statutes subsequently enacted by other states.\footnote{161}

Our multistate analysis shows 31% of manufacturing firms chartered between 1790 and 1860 as having regressive voting, but this proportion is, almost certainly, misleadingly high. Manufacturing firms, in contrast to other types of firms, appear to have been formed under the period’s new free incorporation statutes in substantial numbers from an early stage.\footnote{162} Indeed, the pioneering New York corporation statute of 1811 was limited to manufacturing firms. Consequently, manufacturing firms are probably underrepresented in these data, which exclude corporations chartered under free incorporation statutes. Moreover, there is good reason to believe that the omitted manufacturing corporations had a substantially higher ratio of one-share-one-vote rules than did the specially chartered manufacturing corporations included in the data. One reason is that the early statutes providing for free incorporation, such as the New York statute of 1811, were not only limited to manufacturing firms but also mandated a rule of one-share-one-vote.\footnote{163} Thus our multistate analysis presumably understates the disparities between the voting rules adopted by manufacturing corporations and those adopted by corporations in other industries. Nonetheless, the regression reported in Table 2 shows that the frequency of regressive voting was significantly smaller in manufacturing corporations than in corporations organized to provide banking, bridges, canals, insurance, or roads.

The trend towards voting by shares in manufacturing firms was already apparent upon the incorporation of the pioneering Society for Establishing Useful Manufactures (S.U.M.) in New Jersey in 1791. The S.U.M. was a privately owned, but state-sponsored, corporation to foster the development of manufacturing in the United States. Even though ultimately chartered and headquartered in New Jersey, most subscribers were New York capitalists and speculators. Unlike other contemporary corporations, which specified the object of the firm with considerable precision, the purposes clause of the S.U.M charter was exceedingly broad, providing that the corporation was to carry on “the

\footnote{160} Hilt, supra note 13, at 658; CADMAN, supra note 34, at 206-7 and 309.


\footnote{162} See Henry N. Butler, Nineteenth-Century Jurisdictional Competition in the Granting of Corporate Privileges, 14 J. LEGAL STUD. 129, 163 (1985) (“Between 1848 and 1871, only 143 business corporations were created under Wisconsin general incorporation laws while 1,130 were created by special acts – a ratio of almost eight to one. Thus, in Wisconsin as in New York, the constitutionally mandated, dual system did not significantly alter the legislators’ behavior toward special charters. In general, it appears that the constitutionally mandated, dual system failed to have a negative impact on the market for special corporate charters.” [note omitted]).

\footnote{163} See id. ("[F]or the years 1840-45, there were sixty-nine manufacturing company incorporations under the [New York] Act of 1811; during that time there were only nine by special act.").
Business of Manufactures in the State” and to employ its capital stock in “Manufacturing or making all such Commodities or Articles as shall not be prohibited by Law.” The S.U.M. charter granted one vote per share to private shareholders, while limiting the voting rights of the U.S. and state governments to 100 votes each if they were to become shareholders in the firm. Interestingly, Alexander Hamilton, who vigorously defended the adoption of voting restrictions in the First Bank of the United States, was one of the chief promoters of the S.U.M.164

While many of the early corporations previously examined – such as bank, insurance, and transportation companies – were customer-owned local monopolies, shareholders of manufacturing corporations were almost always investors, not consumers. In contrast to the public utilities of the time, most manufacturing firms that required enough capital to employ the corporate form – which produced mostly textiles and, in smaller numbers, glass and metal165 – were likely to be part of a reasonably broad market and thus face substantial competition. Moreover, the consumers of manufacturing firms were generally so dispersed, and purchased their products so sporadically, that they could not be efficiently organized to become owners of the enterprise. In this respect, they contrasted with the users of turnpikes, banks, and insurance companies, who would have continuously transacted with those service providers at a fairly constant rate of expenditure. Finally, as Donald Smythe observes, manufacturing firms required more active and innovative management than the early public utilities, and were therefore best served by active owners who faced and reacted to strong financial incentives, as compared to the broad cross-section of customers who presumably shared ownership of the monopolistic service industries.166

III. Voting Restrictions in Comparative Perspective

Early U.S. corporations were not unique in resorting to voting rules that limited the number of votes that large shareholders could cast. Similar schemes were present among the closest antecedents of the modern business corporation, dating back to the Dutch and English East India Companies, as well as in a number of other jurisdictions in the nineteenth century. This section examines the characteristics and the rationale for the adoption of regressive voting in these contexts by looking first at a few paradigmatic joint-stock companies formed in the seventeenth and eighteenth centuries, and then at firms incorporated in England, Brazil, and continental Europe in the nineteenth century. Although the evidence of consumer ownership in these cases is mixed, voting restrictions still appear more plausibly a response to monopoly power than a mechanism to protect the financial interests of small investors.

164 For a very thorough review of the establishment and early development of the S.U.M., see DAVIS, supra note 31, at 349 et seq.
166 Smythe, supra note 14, at 1419.
A. The First Business Corporations

Early U.S. corporations were not unique in resorting to voting rules that limited the number of votes that large shareholders could cast. Similar schemes were present among the earliest antecedents of the modern business corporation, dating back to the iconic Dutch and English East India Companies. This section examines the role of regressive voting in the latter two firms, and then proceeds to examine the historical development of firms incorporated in England, Brazil, and continental Europe.

(i) Dutch East India Company

The pioneer Dutch East India Company – also known as the VOC, its Dutch acronym for *Vereenigde Oost-Indische Compagnie* – is widely recognized the first publicly-traded business corporation. The company was chartered in 1602 as the product of a merger, clearly designed to eliminate competition, of six existing trading companies, each of which previously operated as a form of *commenda* or limited partnership established for single voyages. In exchange for a grant by the state of a monopoly on the trade routes between the Cape of Good Hope and the Straits of Magellan, the VOC was also to fulfill public functions such as assisting in wars of independence against Spain.

The VOC charter restricted the voting rights of large shareholders, though hardly in a way that benefited minority investors. The company had a two-tier shareholding structure composed, on the one hand, of governors or *bewindhebbers*, who were the active merchants in charge of the prior trading companies and had hereditary status, and, on the other hand, of the outside investor class of *participanten*. *Bewindhebbers* had one vote each and only they could be elected to the VOC governing body, the “Seventeen Directors.” *Participanten*, by contrast, lacked voting and information rights altogether. Although the VOC’s initial charter gave shareholders the right to withdraw their capital contributions after the first 10 years, a subsequent charter amendment orchestrated by *bewindhebbers* and the state eliminated this right, effectively locking in outside investors against their will.

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169 Ella Gepken-Jager, *Vereenigde Oost-Indische Compagnie (VOC): The Dutch East India Company 52, in VOC 1602-2002: 400 YEARS OF COMPANY LAW* (Ella Gepken-Jager et al. eds., 2005). The Seventeen Directors were governor representatives of each of the VOC’s six chambers, which were remnants of the early trading companies existing before the merger. The division of activities and votes among the chambers was done in a manner such that no single chamber would come to dominate the others, even though the chamber of Amsterdam had invested the most capital. See Femme S. Gaastra, *The Dutch East India Company: Expansion and Decline* 21 (2003).

The VOC boasted from the outset most of the key elements of the corporate form as we know it today — legal personality, limited liability, delegated management, and transferable shares — as well as partial investor ownership. Nevertheless, the company also was partly owned and entirely controlled by the merchant traders in charge of the partnerships that it replaced, thus effectively functioning as a consumers’ cooperative. As described by a Dutch scholar, similarly to the early companies, “the governors [of the VOC] were simultaneously the suppliers of the goods sent to Asia and the main buyers of the spices and other goods that the ships returned with.” Until 1623 the governors had a right to prior purchase on the goods shipped by the company, which they then resold at a profit. From the perspective of the outside investors, the merchant governors were essentially self-dealing by charging themselves low prices for the merchandise to the detriment of the firm’s profitability. Despite the charter’s mandate, dividends were not distributed until 1610 and 1612, and then were paid out only in kind – in mace, pepper, and nutmeg – at a time in which the market price for these commodities was particularly low due to excess supply.

In this context, the rule of one vote per governor ensured that no single merchant would be able to appropriate the benefits of the firm’s monopoly to himself at the expense of other merchants. The famous episodes involving Isaac Le Maire are illustrative of this concern. Initially the largest single shareholder in the VOC and a bewindhebber sitting on the board of governors, Le Maire apparently attempted to divert the firm’s profits to himself by undertaking 14 expeditions under his own accounts instead of those of the company. Since his large shareholdings were not accompanied by greater voting power, Le Maire was soon ousted by other governors in 1605 on charges of embezzlement, and was forced to sign an agreement not to compete with the VOC.

Having retained stock in the company following this incident, in 1609 Le Maire would become the author of what is celebrated as “the first recorded expression of investor advocacy” in history. Le Maire protested in a petition to the VOC board about “how badly the company’s assets are being managed, and how every day needless and unnecessary expenses are being made, of great interest and to the detriment of shareholders.” Shareholders, he added, were “less than happy with the authoritarian

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172 Ella Gepken-Jager, supra note 169, at 44.
173 Klaus J. Hopt & Patrick C. Leyens, Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy 284, in VOC 1602-2002: 400 YEARS OF COMPANY LAW (Ella Gepken-Jager et al. eds., 2005) (noting that “the governors’ right to prior purchase turned out to be unfortunate, leading to an early form of what today we call self-dealing).
174 GAASTRA, supra note 169, at 23-4.
175 HENK DEN HEIJER, DE VOC EN DE BEURS 16 (2002).
177 Id. at 45.
178 SHAREHOLDER RIGHTS AT 400: COMMEMORATING ISAAC LE MAIRE AND THE FIRST RECORDED EXPRESSION OF INVESTOR ADVOCACY (Paul Frentrop et al. eds., 2009).
179 Id. at 7.
management and the use of the company’s resources by the directors, who act as if they stand above even the Honourable Gentlemen Estates General, who do everything without consulting anyone, and who flout the company’s charter by taking 2 per cent commission on all prizes, whereas they are allowed only 1 percent, which they ought and should not do.”

In addition to his written complaint, Le Maire launched a bear raid against the company, which ultimately resulted in the enactment of a ban on naked short selling. But Le Maire’s main source of discontent was not the lack of dividend payments by the company, but rather the extended scope of its monopoly, which legally (though not practically) prevented him from launching competing ventures. In fact, Le Maire “subordinated his criticism on the point [the company’s corporate governance] to his main concern, that the VOC’s monopoly should be restricted and not, as the board wanted, extended. Big merchants such as he and De Moucheron were keen to get the scope of the intercontinental trade widened and chafed at the unproductive VOC monopoly.”

Over time, however, the protests of outside investors were heard. The VOC’s charter of 1623 simultaneously curbed self-dealing by the merchant governors and increased the rights of large investors. The new charter eliminated the governors’ right of prior purchase, only permitting bewindhebbers to purchase goods from the company if they had fixed prices or were bought in public auctions. It also modified the system of governor compensation by providing for a joint remuneration of 1% of net returns in lieu of the prior scheme that was also based on the value of the equipping of ships. At the same time, the charter granted voting and supervisory rights to the major shareholders. Major participanten became eligible for a newly-created Committee of Nine, an early form of supervisory board, and had a say in the appointment of governors, but small shareholders remained thoroughly disenfranchised.

In short, the early VOC was essentially a monopolistic traders’ cooperative – a cartel – whose early restricted voting rules were clearly designed not to protect small outside shareholders, but on the contrary to protect the firm’s trader-members from the control of either outside investors or prominent insiders like Le Maire.

(ii) English East India Company

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180 Id.
182 In fact, since 1607 Le Maire entered negotiations with the French King, Henry IV, to establish a French East India Company, a project that was later joined by Henry Hudson. See SHAREHOLDER RIGHTS AT 400, supra note 178, at 14.
183 GELDERBLOM ET AL., supra note 181.
185 J. Matthijs de Jongh, Shareholder Activism at the Dutch East India Company in 1622, in THE ORIGINS OF SHAREHOLDER ADVOCACY (Jonathan Koppell ed., 2010).
186 Gepken-Jager, supra note 169, at 57-8; Hopt & Leyens, supra note 173, at 284.
The English East India Company (EIC) was chartered in 1600, two years before the VOC. Its early organization roughly mirrored that of the VOC, though its contours were less clearly drawn.

The charter “granted by Queen Elizabeth to the Governor and Company of Merchants of London trading into the East Indies” conferred a monopoly of the trading routes through the Strait of Magellan and the Cape of Good Hope. The company was at first essentially an association of merchants, having inherited some of the character of the preceding guild-like “regulated companies.” In particular, it followed the practice of regulated companies by initially adopting the rule of one vote per member. The merchants promoting the new enterprise felt that their resources alone were insufficient to fund such long-distance trading, thus creating the need to obtain outside financing. Consequently, unlike a conventional regulated company, which was formed by a tight group of merchants engaged in a particular type of trade, the EIC welcomed non-merchant outside investors as members and had transferable shares.

As in the VOC, mixed membership at times generated conflict. Thus, as with the VOC, merchants often favored dividend distributions in commodities so as to make an additional profit upon resale, while non-merchant investors had difficulty disposing of the commodities and preferred payments in cash. The non-merchant members initially obtained some protection from an option to subscribe or not for single voyages, after each of which the company distributed back both profits and principal. The resulting repeat-play dynamics discouraged insiders from abusing outside investors. But the EIC’s continuous need to attract subscriptions meant that the rule of one vote per member would not be long lasting. Indeed, it was soon abandoned in favor of more proportional voting rules that gave greater voice to investors. But it was large investors, not small investors, who received consideration. According to Ron Harris, in 1609 the company began granting one vote for every £500 invested – a rule that was maintained by the

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187 CHARTERS RELATING TO THE EAST INDIA COMPANY FROM 1600 TO 1761 1-2 (John Shaw Ed., 1887).
188 For a discussion of the differences between regulated and joint-stock companies, see WILLIAM ROBERT SCOTT, 1 THE CONSTITUTION AND FINANCE OF ENGLISH, SCOTTISH AND IRISH JOINT-STOCK COMPANIES TO 1720 443-4 (1912).
189 Harris, supra note Error! Bookmark not defined., at 26.
190 K. N. CHAUDHURI, THE ENGLISH EAST INDIA COMPANY: THE STUDY OF AN EARLY JOINT-STOCK COMPANY, 1600-1640 26 (1965); Samuel Williston, History of the Law of Business Corporations before 1800, 2 HARV. L. REV. 105, 109 (1888) (quoting the defense of the Company in the Privy Council to the effect that “noblemen, gentlemen, shopkeepers, widows, orphans, and all other subjects may be traders, and employ their capital in a joint stock”).
191 SCOTT, supra note 188, vol. II, at 110. In a particular controversy in 1629 following a proposed dividend distribution in calicoes, the company eventually decided for a distribution in money “in order to give contentment to the gentry.” Id.
192 Of the company’s 12 voyages between 1601 and 1612, only one had a total loss and almost all others returned a profit of well over 100%. Id. at 49 (based on data from Chaudhuri).
193 E. L. J. Coornaert, European Economic Institutions and the New World: The Chartered Companies, in The Economy of Expanding Europe in the Sixteenth and Seventeenth Centuries 259, in 4 THE CAMBRIDGE ECONOMIC HISTORY OF EUROPE (E. E. Rich & C. H. Wilson eds., 1967) (“[i]n the English East India Company each member’s voting right was in proportion to his investment”). Nevertheless, voting restrictions were many years later reinstated in the form of a graduated voting scale following political opposition to the company. SCOTT, supra note 188, at __.
company’s charter of 1661\textsuperscript{194} – and the EIC also came to impose large shareholdings as a qualification requirement for directors and governors.\textsuperscript{195}

B. The United Kingdom

As noted by Brian Cheffins, “capped voting arrangements have a long historical pedigree in Britain.”\textsuperscript{196} Following the early experiments with the rule of one vote per member in the seventeenth century, such as in the first years of the English East India Company, voting caps and graduated voting scales became a common feature of joint-stock companies in the U.K. in the eighteenth century. Overall, the pattern of shareholder voting rights observed in England in the late eighteenth and early nineteenth century is largely similar to that of the United States and seems to support the consumer protection account of voting restrictions.

Regressive voting schemes were particularly common among firms providing essential infrastructure services to their merchant-owners but rarer among investor-owned firms. Voting restrictions appeared with significant frequency in firms in charge of canal building, insurance, and gas lighting, for instance. A historian of gas lighting in the U.K. remarked that “many millowners also recognized that by pooling resources the community could both share the cost of construction and at the same time take advantage of economies of scale in production and distribution to reduce the price.”\textsuperscript{197} Although gas lighting companies rarely paid dividends, this was hardly the object of discontent among shareholders, who seemed more than happy to receive a return on their investment in the form of lower gas prices.\textsuperscript{198}

As investor-owned firms gradually became dominant, the use of voting restrictions also receded. Throughout the nineteenth century, Table A of the Companies Act provided for a graduated voting scale as a default rule, but most companies opted out of this standard in drafting their charters.\textsuperscript{199} By the early twentieth century, voting restrictions were thoroughly out of date, and the Companies Act of 1906 finally modified the default rule under Table A in favor of a one-share-one-vote standard.\textsuperscript{200}

\textsuperscript{194} Harris, supra note Error! Bookmark not defined., at 29 (also stating that, “in practice, most of those who passed this threshold [£500 under the 1609 charter] had one vote, or at most two”).
\textsuperscript{195} SCOTT, supra note 188, at 452 (noting that the qualification requirements in the EIC came to be of £1000 for directors and £4000 for governors).
\textsuperscript{196} BRIAN R. CHEFFINS, CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED 32 (2008). Indeed, voting restrictions were present even among the first joint-stock trading companies in England, such as the East India Company. See W. SCOTT, THE CONSTITUTION AND FINANCE OF ENGLISH, SCOTTISH AND IRISH JOINT-STOCK COMPANIES TO 1720 (1912).
\textsuperscript{197} Id. at 85.
\textsuperscript{198} Id. at 90.
\textsuperscript{199} SIDNEY STANLEY DAWSON, THE ACCOUNTANT’S COMPENDIUM 421 (1898) (noting that the “scale” system [provided by Table A]… is not generally adopted, the articles of association generally conferring one vote for every share held”).
\textsuperscript{200} CHEFFINS, supra note 196, at 33; Dunlavy, Social Conceptions, supra note 10, at 1360.
C. Brazil

Voting caps were also pervasive among Brazilian corporations in the late nineteenth and early twentieth centuries. In his study of firm governance and capital market development in Brazil during this period, Aldo Musacchio interprets the inclusion of maximum voting rules in company charters as a contractual device that protected small investors in a legal environment that afforded insufficient levels of shareholder rights. In his view, “[b]y-laws that established the voting rights of shareholders were critical to encouraging the participation of small investors in equity ownership.”

In another study, however, we provide new data on early Brazilian corporations that cast doubt on the view of voting restrictions as a contractual response to a lack of investor protection. By examining the voting rules specified in the charters of virtually every firm incorporated in Brazil between 1850 and 1882, the period between the enactment of Código Comercial and Brazil’s first general incorporation law, we found that a striking 90% of the firms adopted regressive voting rules. Only 5.2% granted voting rights in direct proportion to equity ownership in the firm, while 4.7% of the charters were silent as to shareholder voting.

Our findings challenge the investor protection theory and, in particular, the assumption that these voting restrictions were contractual in character. First, the vast majority of charters required a minimum stock holding for a shareholder to be allowed to vote (usually five or ten shares), and a significant number of them also imposed a much higher holding requirement as a condition for eligibility as a director. This seems inconsistent with the objective of empowering and protecting small investors. Second, voting restrictions were often not a reflection of the parties’ preferences, but rather the product of government imposition. The Council of State, the body in charge of reviewing charter petitions, often imposed or strengthened voting caps as a condition for approval. In fact, as soon as entrepreneurs had a real choice with respect to voting rules following the advent of Brazil’s first general incorporation statute in 1882, the incidence of voting restrictions declined sharply. Finally, and relatedly, corporations were abandoning voting restrictions precisely as Brazil’s capital market expanded, which goes against the view that voting restrictions were a critical element of investor protection enabling firms to obtain outside financing.

Nevertheless, the evidence is also not entirely supportive of the consumer protection account of voting restrictions. On the one hand, a surprisingly large number of Brazilian corporations at the time were either expressly labeled as mutual companies or

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201 Musacchio, Laws versus Contracts, supra note 14, at 461.
203 Id.
204 Id. Based on our sample of 70 companies incorporated in São Paulo between 1882 and 1890, the proportion of firms adopting proportional voting schemes rose from nearly 5% to over 41% in the eight years since the availability of general incorporation without the need for prior governmental approval. Id. According to Musacchio’s sample of business corporations operating in Brazil in 1909, the proportion of companies employing voting restrictions was even smaller, at 26% of the total. Musacchio, supra note 13, at 99.
otherwise had their principal customers as shareholders. It was common for insurance companies to underwrite the risks of merchants who were simultaneously shareholders of the firm. Similarly, a number of early railroads in São Paulo were promoted and financed by coffee planters seeking lower transportation costs. On the other hand, the charters of investor-owned firms at the time also contained voting restrictions, even if only as a result of governmental imposition and often circumvented in practice.205

The difficulty is that the government’s motives in mandating regressive voting schemes are dubious and potentially compatible with competing theories about the economic function of voting restrictions. Although we cannot rule out the state’s concern about minority shareholder protection as an explanation, the market’s reaction leading to the decline and eventual disappearance of voting restrictions since the advent of general incorporation seems inconsistent with the investor protection account.

D. France

Shareholder voting restrictions were also common in nineteenth-century continental Europe, although the precise treatment of voting rules varied widely in different jurisdictions. In the later part of the century, Belgium mandated voting caps, Italy provided a graduated voting scale as a default rule, and France left the choice of a voting scheme entirely up to the corporation’s charter.206 Before proceeding to examine the structure of shareholder rights in France in the early nineteenth century, one caveat is necessary. Owing to the difficulty in obtaining a corporate charter, most French entrepreneurs seeking to raise capital from the general public resorted to tradable limited partnerships as a substitute for incorporation. As a result, business corporations account for only a small proportion of large enterprise in France during this period and are therefore unlikely to be representative of the general business environment in the country.207

The experience of France in the nineteenth century was mostly comparable to that of Brazil, which in this respect followed French law closely.208 Until 1867, incorporations in France required the prior approval by the Conseil d’Etat which, like its Brazilian

205 See Pargendler & Hansmann, supra note 202, for a more detailed discussion.
206 RENÉ PIRET, L’ÉVOLUTION DE LA LÉGISLATION BELGE SUR LES SOCIÉTÉS ANONYMES 54 (1946) (noting that, according to the 1873 statute, no shareholder could vote more than one-fifth of issued shares or two-fifths of shares voting in a given meeting, a system that persisted well into the twentieth century); CESARE VIVANTE, TRATTATO DI DIRITTO COMMERCIALE, v. 2, at 223 (1903) (describing art. 157 of the Italian Code, which provided as a default rule a graduated voting scale granting one vote per share up to five shares, one vote per five shares up to 100 shares, and one vote per 25 shares beyond that); Dunlavy, supra note 10.
207 See Timothy Guinnane et al., Putting the Corporation in Its Place, 8 ENTERPRISE & SOC’Y 708 (2007) (describing the use of tradable limited partnerships as a surrogate for incorporations in France); Ch. Coquelin, Des sociétés commerciales en France et en Angleterre, REVUE DES DEUX MONDES 408, 416 (1843) (arguing that due to difficulties in obtaining governmental authorization, sociétés anonymes were a “rarity” and only of secondary importance to France).
208 Brazil’s nineteenth-century organizational law did, however, deviate from French law in other important respects. Tradable limited partnerships were conspicuously absent from the Brazilian Civil Code and were expressly outlawed by a government decree in 1854. See Mariana Pargendler, Politics in the Origins: The Making of Corporate Law in Nineteenth-Century Brazil, 60 AM. J. COMP. L. 805 (2012).
counterpart, often conditioned the grant of a corporate charter on the adoption of tight voting caps – of four, five, or even fewer votes per shareholder.\textsuperscript{209} It was not until the 1850s that the Conseil d’Etat began to allow for more flexible caps of 10 or 20 votes per shareholder.\textsuperscript{210}

The French practice of mandating voting caps across the board, irrespective of firm industry or ownership structure, raises difficult questions of interpretation. One possibility is that voting restrictions are a legacy of a time in which most business corporations were essentially consumer cooperatives. Another hypothesis is that voting restrictions might also have served to prevent concentrations of power that were independent of the state, or more generally as an anti-takeover device to prevent the state’s preferred owners and managers from being displaced. Finally, the Conseil might have imposed voting restrictions with the purpose of protecting minority investors. But the plausibility of this latter interpretation is partly offset by the Conseil d’Etat’s suspicion of wide shareholder participation in annual meetings, which, in its view, “could hinder the proper administration of the company.”\textsuperscript{211} As a result, the Conseil not only included strict voting caps but also consistently disenfranchised small shareholders by imposing minimum stock ownership requirements for attending and casting votes in shareholder meetings.\textsuperscript{212}

In decline since the 1850s, France’s system of mandatory voting caps came to an end with the adoption of the general incorporation statute of 1867, which granted significant leeway to shareholders in specifying a voting rule of their choosing in the corporation’s charter. As in other jurisdictions, the rule of one-share, one-vote quickly became the scheme of choice of shareholders of investor-owned firms by the end of the nineteenth century.

IV. Ultra Vires as Consumer Protection

The recognition that a great number of early business corporations were owned by consumers rather than investors can shed light on other historical aspects of corporate law beyond shareholder voting rights. Another prominent feature of nineteenth century corporation law that later fell into desuetude was a strong doctrine of “ultra vires” (literally, “beyond the powers”), which essentially prohibited corporate managers from deviating from the particular set of activities (or “purposes”) set forth in the corporation’s charter. Nineteenth-century business corporations typically listed in their charters a relatively narrow and specific set of corporate purposes. Corporate acts falling outside the scope of the specified purposes were subject to particularly stringent remedies, which

\textsuperscript{209} Anne Lefebvre-Teillard, \textit{La Société Anonyme au XIXe Siècle} 370 (1985).
\textsuperscript{210} \textit{Id.} at 371.
\textsuperscript{211} \textit{Id.} at 129 (quoting the Conseil d’Etat).
\textsuperscript{212} For instance, the Conseil d’Etat raised from 20 to 40 the number of shares required for a vote in the Société Générale Algerienne. Charles E. Freedeman, \textit{Joint-Stock Enterprise in France} 1807-1867 128 (1979).
ranged from shareholder and state lawsuits against corporate managers to the voidance of ultra vires contracts by the corporation or its counterparty.\(^{213}\)

Since the late nineteenth century, this restrictive approach to corporate purposes has been progressively abandoned in both law and practice.\(^{214}\) Two conventional explanations have been offered for the rise and fall of the ultra vires doctrine. The first is that a narrow definition and construal of corporate powers made sense at a time in which incorporation conferred special privileges, a rationale that however faded with the decline of the franchise view of the corporation and the spread of general incorporation statutes. The second is that the ultra vires doctrine served as a form of investor protection, assuring investors that their capital contributions to the firm would only be used in industries or activities in whose profitability they had some faith.\(^{215}\) The abandonment of the doctrine in more recent times is then explained on the grounds that it was ultimately ineffective, or produced too much opportunistic litigation, or hampered corporate management in times of ever-increasing rates of technical change, or was rendered unnecessary by the increasing liquidity of securities markets and the easy exit this permitted for shareholders unhappy with a corporation’s change of activities.

We suggest that purpose restrictions might have served an additional important function in those early corporations – such as turnpikes, banks, and insurance companies – that were in essence consumer cooperatives. In consumer-owned firms, the nature and specifics of the business that the corporation engages in matters a great deal from a shareholder’s perspective. The early turnpike cases in which shareholders refused to pay for their subscriptions after a change in the proposed location of the road provide an illustrative example of this concern.\(^{216}\) A strong ultra vires doctrine not only assured firm members that their contributions would be channeled to the desired services, but also reduced the potential for using rents from the monopoly activity to cross-subsidize another activity that had a different distribution of benefits across the firm’s shareholders – a problem that haunts cooperatives up to this day.\(^{217}\) Moreover, the binding character of the proposed lines of business helped assure early shareholder-merchants that their corporate subscriptions would not be used to fund potential competitors.

\(^{213}\) Interestingly, the old doctrine to the effect that ultra vires contracts are void was not part of the ancient English common law, but rather a U.S. legal development. See Arthur W. Machen, A Treatise on the Modern Law of Corporations 826 (1908) (“If ultra vires contracts of royal-charter corporations were binding at common law, the universal and apparently spontaneous growth in America of the doctrine that ultra vires contracts of all kinds of corporations are void is very difficult to explain”).


\(^{215}\) Nevertheless, courts enforced charter limitations even when the ultra vires activities were likely to be profitable. Greenfield, supra note 214, at 1375.

\(^{216}\) See note 43 supra and accompanying text.

\(^{217}\) See Abhijit Banerjee et al., Inequality, Control Rights, and Rent Seeking: Sugar Cooperatives in Maharashtra, 109 J. Pol. ECON. 138 (2001) (finding evidence that controlling members of sugar cooperatives in India engage in rent-seeking by directing the firm to enter into ancillary activities that provide disproportionate benefits to themselves).
As product market competition increased the prevalence of purely investor-owned firms, this early function of the ultra vires doctrine lost its raison d’être for most business corporations. If what a shareholder expects from the firm is not a specific product or service, but a profit – the fungible good par excellence – the precise purposes and activities specified in a corporate charter should be comparatively less important. Indeed, flexibility in switching lines of business in response to changing market conditions and technological advances is critical to maintaining profitability.

Consequently, ultra vires was gradually abandoned as investor-owned firms came to dominate the corporate landscape. Consistent with this interpretation, (i) the ultra vires doctrine first started to lose its force as applied to manufacturing firms, which were overwhelmingly investor owned,218 and (ii) ultra vires has only subsisted (although in increasingly weakened form) in firms where the corporate purpose is not profit, such as nonprofit corporations in general and charities in particular.219

V. The Decline of Voting Restrictions

Throughout this paper, we have sought to demonstrate the link between shareholder voting restrictions and consumer ownership of monopolistic corporations in the late eighteenth and early nineteenth century. Just as in the twentieth century, regressive voting schemes historically functioned as takeover defenses, albeit of a different kind. Unlike their modern counterparts, voting restrictions in early business corporations served not to shield corporate management and employees from a hostile acquisition, but rather to protect consumers by preventing the corporation from falling under the control of either a profit-maximizing investor or of a single merchant who would favor his own business over other local merchants in setting output allocation and pricing policies.

One of the main benefits of the one-share-one-vote rule from an economic perspective is that it gives large shareholders an incentive to monitor and influence management. But creating incentives for shareholder monitoring was arguably less important in the cooperative enterprises of the nineteenth century than in the average listed corporation today. Because early shareholders transacted with the firm on a regular basis in their role as consumers, they were in a better position to observe mismanagement than were small and dispersed investors. Moreover, early turnpikes, banks, and insurance companies were fundamentally local enterprises, and geographic proximity to the firm’s headquarters and operations further facilitated monitoring.

218 HOVENKAMP, supra note 20, at 60 (noting that courts first relaxed the application of the ultra vires doctrine with respect to manufacturing corporations).
219 Linda Sugin, Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity, 76 FORDHAM L. REV. 893 (2007) (“[w]hile the ultra vires doctrine is nearly dead in the jurisprudence of for-profit corporations, it is potentially powerful in nonprofit enforcement”); James J. Fishman, Improving Charitable Accountability, 62 Md. L. REV. 218 (2008), (“[t]he duty of obedience mandates that the board refrain from transactions and activities that are ultra vires, that is, beyond the corporation's powers and purposes as expressed in its certificate of incorporation”).
The consumer protection account predicts that the disappearance of voting restrictions would follow a shift from consumer to investor ownership of business corporations. We suggest that the nineteenth century witnessed precisely such a shift, for several reasons. First, increases in market competition and improvements in governmental regulation came to provide sufficient protection to consumers to render customer ownership of the firm unnecessary in a greater number of industries. Second, by the late nineteenth century general physical infrastructure such as roads, canals, bridges, port facilities, and even railroads were commonly financed and frequently owned and operated by government at one or another level. Third, in the areas where severe market failure continued to favor customer ownership of the enterprise, but the benefits of the enterprise’s services were insufficiently widespread to justify governmental provision, consumer-controlled firms increasingly faced the option of organizing, not as jury-rigged business corporations, but under new general statutes that provided explicitly for the formation of cooperative or mutual corporations.

The suggestion that increased market competition was responsible for the decline of voting restrictions is not entirely novel. Colleen Dunlavy attributes what she sees as the premature abandonment of the democratic conception of the corporation in the United States to the early intensification of competition for capital in the United States compared to Europe. David Ratner, in turn, has speculated that, with the rise of general incorporation statutes and the demise of the franchise view of the corporation, “the external control afforded by competition supplanted the internal control provided by voting restrictions.”

We argue, in contrast, that the competition that helped foster a change in voting patterns did not take place in capital markets, but rather in product and service markets. Moreover, it was not competition in itself, but the decline of customer ownership made possible by competitive markets and governmental activity, that ultimately led to the abandonment of regressive voting rules. Greater competition, in turn, was due both to technological advances, such as the transportation improvements that the first consumer-owned companies helped to bring about, and to legal developments culminating in the proliferation of general incorporation laws, the enactment of the Sherman Act, and the rise of the regulatory state to police monopoly power in the second half of the nineteenth century. And expanded government ownership came with the increased legitimacy and greater organizational effectiveness of the public sector through the course of the nineteenth century.

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220 Apart from improvements in competition and regulation, the natural development of certain industries also contributed to a shift from consumer toward investor ownership. In the infancy of certain industries such as turnpikes, bridges and railroads were not expected to be profitable – and were therefore likely to attract owners seeking ancillary benefits from the firm’s existence who could therefore live with a lower, or even negative, direct financial return on their investment in the firm. Some of these early companies, however, turned out to be profitable ventures and came to attract significant investor interest, which would ultimately lead to a change in voting rules.


222 Ratner, supra note 9, at 46.
The notion that voting restrictions favored the interests of consumers at the expense of investors was well understood at the time. This point is clear from the 1846 Report of the Revisors of the Civil Code of Virginia, a rare piece of evidence of legislative intent on the reasons for abandoning regressive voting schemes. This work noted that the financial interests of the state government as a shareholder in many public improvement corporations counseled in favor of the one-share-one-vote rule. The Revisors showed concern that excessively stringent voting restrictions were allowing shareholder-consumers to exercise disproportionate influence over corporate management so as to favor low prices to the detriment of profitability. According to the Report, “[t]he private stockholder who has a large amount invested will be apt, when he gives his vote, to consider the effect of that vote upon his investment, and go for such a course as seems best calculated to make his stock productive;” by contrast, “the man who has but one or two shares will often be either indifferent as to the measures that are adopted, or be less alive to the interest of a stockholder looking for dividends, than to the interest of one using the work, that the tolls be low.”

Although the expansion of competition, regulation, and governmental services decreased the need for consumer ownership in some industries, continuing market and contract failures led to a proliferation of mutual and cooperative enterprise in other areas, such as insurance and agricultural marketing. Nevertheless, while early business corporations included many cooperatives in disguise, from the mid-nineteenth century onward cooperatives began to be recognized as a distinctive form of organization and to be expressly labeled as such. Scholars typically view the establishment of the Rochdale Society of Equitable Pioneers, an English consumer cooperative, in 1844 as marking the birth of the cooperative movement and the first enunciation of cooperative principles, including the rule of one member, one vote. The first U.S. cooperative statute was enacted in Massachusetts in 1866, and several other states followed suit before the end of the nineteenth century in order to protect agricultural interests against

223 Report of the Revisors of the Civil Code of Virginia made to the General Assembly at December session 1846 335 (1847).
224 Id. (emphasis added) (also stating that “there is too much reason to apprehend, that owing to the largeness of the vote of those having either a small interest in the stock, or a preponderating interest of some other kind, considerations foreign to the interest of the stockholders, as such, have too often operated in Virginia and conduced to the bad success which has attended so many of our works of internal improvement”). The Report ultimately proposed the adoption of a more flexible graduated voting scale that gave far greater voice to large shareholders.
225 CHARLES T. AUTRY & ROLAND F. HALL, THE LAW OF COOPERATIVES (2009) (noting that prior to the enactment of cooperative statutes, cooperative organizations were formed as business corporations). The lack of a separate organizational form for cooperatives for most of the nineteenth century and beyond was also apparent outside of the U.S. Rob McQueen argues that pressures for an organizational form granting limited liability to worker cooperatives played an important role in the enactment of the English Companies Act in 1856. ROB McQUEEN, A SOCIAL HISTORY OF COMPANY LAW, GREAT BRITAIN AND AUSTRALIAN Colonies 1854-1920 63 (2009). Similarly, the first cooperative statutes in Brazil date back to the twentieth century; before then companies fulfilling serving cooperative functions were organized as regular business organizations, often taking the form of sociedade anônimas under existing corporations laws. See, e.g., WALDIRIO BULGARELLI, AS SOCIEDADES COOPERATIVAS E SUA DISCIPLINA JURÍDICA 65 (2000).
226 For discussion of the functions of the one-member-one-vote rule in cooperatives, and the deviations from it, see HANSMANN, supra note 7, at 13.
monopoly. Similarly, other jurisdictions around the world did not have distinct cooperative statutes until the late nineteenth or early twentieth centuries, with the result that consumer-owned firms were until then often organized as business corporations.

VI. Conclusion

Shareholders in business corporations around the world today are generally investors whose primary, and typically only, interest in the firm is to obtain a financial return. The need to protect outside investors against abuse by insiders – either managers or controlling shareholders – largely dominates corporate law and policy.

Before the late nineteenth century, however, a significant fraction of shareholders in business corporations were not primarily interested in obtaining a financial return but rather in having access to the firm’s services at reasonable cost. Accordingly, some peculiar features of early corporate law and practice – including, in particular, regressive voting schemes -- served not to protect the shareholders as investors but to protect them as consumers.

By the late nineteenth century, governmental provision of infrastructure had expanded, while legal rules addressing antitrust concerns, utility regulation, and cooperative corporations had been gradually spun off from the law of business corporations. This evolution permitted business corporations, and the corporate law that governs them, to focus on the agency problems within investor-owned firms – between controlling and noncontrolling shareholders, and between managers and the shareholders as a group – for which the rule of one share, one vote is generally most efficient. Legal and economic scholarship today focuses heavily on those agency problems, and on the evolution of the separation between ownership and control that has aggravated them. If we look back to the nineteenth century, however, we see another important – though frequently overlooked – turning point in the history of the business corporation: namely, the separation between ownership and consumption. Ignoring that earlier phase in the development of the business corporation can result in an anachronistic misinterpretation of the unusual voting structures that were so widely employed in the past, but that have now largely disappeared.

227 Id. at 14-15.
229 John Armour, Henry Hansmann & Reinier Kraakman, What is Corporate Law?, in THE ANATOMY OF CORPORATE LAW (Reinier Kraakman et al. eds., 2009) (citing legal personality, limited liability, delegated management, transferable shares, and investor ownership as the basic elements shared by business corporations worldwide).
Appendix

Patterns of Regressive Voting Across Industries, States, and Decades

The results reported in Tables 1 and 2 below are derived from the Sylla/Wright data set. That data set includes corporations with legislatively granted charters, but excludes corporations that formed under statutes – such as the New York statute of 1811 for manufacturing firms – that provided for incorporation as of right without special legislative action. For most industries, legislatively granted charters were evidently dominant until the middle of the nineteenth century even in the presence of incorporation statutes. For this reason, the pattern of corporate voting rules reflected in the Sylla/Wright data set presumably offers a reasonably accurate picture of the relative prevalence of regressive voting to be found among firms in different industries, states, and decades. That is evidently not true for manufacturing firms, however, as discussed in the text. Thus, the results in the tables below presumably understate the disparities between the voting rules adopted by manufacturing corporations and those adopted by corporations in other industries.

The full data set includes 22,419 observations. The voting rule for each of these corporations was coded as “one-share-one-vote,” “one-person-one-vote,” “prudent mean” (which includes all capped and graduated voting rules), or “not specified.” We aggregated the firms with one-person-one-vote and prudent mean rules into a single category of “regressive” voting, permitting us to code each firm with a binary variable indicating whether the firm had restrictive voting or one-share-one-vote.

The voting rule is specified for less than half the corporations in the sample, perhaps because the voting rule was included in the corporate bylaws rather than in the charter, or because the voting rule was established by a separate statute not located by the coder of the data. For the analyses reported here we eliminated all firms for which the voting rule was missing, though this of course leaves questions about systematic bias in the sample that remains. We were left with a sample of 10,996 firms. We then eliminated all firms chartered in states other than the original thirteen, firms operating in industries (usually small) other than those reported in the tables below, and all firms incorporated in either Massachusetts or South Carolina (because of irregularities that suggested systematic miscoding or missing data). We also eliminated all observations for the decade of the 1860s, which were quite limited. We were finally left with a sample of 6,387 corporations, which we used for the analyses reported here.

The Sylla/Wright data set contains no information on the ownership of the firms involved other than the names of the original incorporators. As a consequence, it does not permit us to explore directly the relationship between firms’ voting rules and the number and nature of their shareholders.
Table 1 below offers a simple breakdown of the frequency of regressive voting rules among firms by industry and decade. Table 2 presents a regression analysis in which the dependent variable is an indicator variable taking the value of 1 if the firm has a restrictive voting rule and 0 if the voting rule is one-share-one-vote. The omitted variables in that regression are manufacturing (industry), Georgia (state), and 1850s (decade). Therefore, each regression coefficient in Table 2 reflects the difference between (1) the probability that a corporation in the given industry, state, and decade will have a restrictive voting rule and (2) the probability that a regressive voting rule will be found in a corporation engaged in manufacturing in Georgia in the 1850s.
Table 1: Percentage of Regressive Voting Charters by Industry and Decade

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Total observations are reported in parentheses.
# Table 2. Logistic Regression.

**Dependent Variable:** Percentage of Firms with Regressive Voting.

Omitted Variables: Manufacturing, Georgia, 1850s.

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Standard errors in parentheses: *** p<0.01, ** p<0.05, * p<0.1

Number of observations: 6,387