BEYOND TRUST:
WHY AMERICAN CLASSICAL JURISTS AND ECONOMISTS COULD NOT LOVE THE CORPORATION

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Given the unconditional favor that scholars imbued with classical ideas should bestow on any manifestation of business freedom and entrepreneurial spirit, it was not a given that classical jurists and economists would join the ranks of those who in the late 19th century complained about the corporatization of the American economy. The usual explanation is that they did so out of doctrinal and practical concerns for the effect of the associated rise of monopolies and trusts. A complementary account exists, however, offered by law historians and based on the doctrinal controversies about the true nature of corporations triggered by the famous *Santa Clara* decision (1886) of the US Supreme Court. The paper casts new light on the latter account by uncovering those aspects of classical economics that made it impossible for its supporters – economists and jurists alike – to unreservedly support the corporate form before and beyond the trust problem.

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Introduction

American people's relationship with the corporation has always been of a love-hate kind. Through history the corporation has been simultaneously praised as "an engine of economic growth and a bulwark of democratic prosperity" and denounced as "a source of corruption and driver of inequality […] a site of coercion, monopoly, and the agglomeration of excessive social, economic, and political power" (Lamoreaux & Novak 2017, 2). Both the "love" and the "hate" thus rested on an assortment of reasons, such as sheer business size and scale economies, faith in technical and managerial progress, fear of monopoly power or of interference with democratic processes. Prominently in this mix, also featured the corporate form as such.

Yet, it might be expected that at least a well-specified group of late 19th-century American scholars could have mainly embraced the "love" part of the relationship. I refer to the classical economists and to those jurists who endorsed the leading principles of classical economics. Who else than the champions of individualism and laissez faire could cherish the corporation? How could these scholars fail to appreciate its virtues as the most effective instrument for maximizing the benefits of free entrepreneurship? True, the corporate form – grounded as it was on state charters – was tantamount to law-granted privilege, conducive to undesirable monopoly. Those reservations, however, should have vanished by the end of the century, after free incorporation rules had eased the granting of corporate charters. Grounded no more on blatant legal privilege, monopoly did remain a matter of concern for those economists and jurists who feared the negative effects of anticompetitive behavior and sheer business size on American prosperity and democracy. Yet, such concerns depended on issues like scale economies, market power and trade restraints, not necessarily associated with the corporate form per se. While those issues are dealt with by the vast literature on the early years of American antitrust law, the point of this paper is that another reason existed before and beyond the trust problem explaining why not even the most committed laissez-faire scholars of classical penchant could unreservedly love the corporate form. The reason was, in a nutshell, the latter's governance structure.

The essay illustrates the difficult relationship between classical economics and the corporations during the so-called Gilded Age (ca. 1870-1900), highlighting a complementary explanation to the standard, monopoly-based one. Sections 2 and 3 show how famous classical economists and classical jurists had mixed feelings about the corporate form. The central part of the essay explains why classical scholars should love the corporation. I start in §4 with the landmark *Santa Clara* decision by the US Supreme Court, which allegedly endorsed a laissez faire approach to corporations, and then sketch in §5 the main legal theories of the Gilded Age about the true nature of the corporation. Legal debates ended with the triumph of the so-called "classical corporation" model, whose virtues are examined in §6. The next two sections question this idyllic picture by explaining why supporters of classical economics had troubles in getting along with essential features of that model, such as limited liability (§7) and shareholders' rights (§8), regardless of any other concern they might also have about market power and business size. The Conclusion summarizes the argument and underlines the inability of classical scholars to grasp the main economic rationale for incorporation. Before all that, the next § explains what I mean by "classical economics" and offers non-legal scholars some coordinates to properly frame the American debates on the corporation within the more general historiography on the law and economics of the Gilded Age.

§1. Being classical and being a corporation during the Gilded Age

The term "classical economics" is used in the following pages to synthesize the views of the majority of American economists in the last decades of the 19th century. Historians of economics have demonstrated that the two approaches that eventually came to dominate the discipline in that country – marginalism and historicism/institutionalism – were at the time still minoritarian, although quickly spreading among the younger scholars. It was not by chance that the economists who endorsed those approaches came to be known as the New School. [1] The disciplinary struggles accompanying the birth of the American Economic Association in 1885 further testify the founders' willingness to break with the traditional, classical mainstream.

As to the latter's content, it is equally an established fact that the most popular economics textbooks of the time[2] were in the classical laissez-faire tradition. Within this approach, Smithian views prevailed, though not in the sense of a comprehensive reading of Adam Smith,[3] but of a simplified, minimalist rendition, built around basic notions such as natural liberty, free trade, and government's limited role. At the same time, the main textbooks writers of the day rejected the alternative version of classical economics, based on the Malthusian doctrine of population, the Ricardian theory of rent, and Bentham's utilitarianism. Even when, at the end of the period, a synthesis began to emerge between classical ideas and the historical and marginal utility schools, the most authoritative syntheses were still conservative, often consisting in the simple super-imposition of marginal utility upon the basic classical framework.

Outside universities the picture did not change. Traditional views still had a strong hold on the minds of Gilded Age Americans – indeed, in 1876 the three most popular names among writers on economic affairs were still those of Adam Smith, John Stuart Mill, and Arthur Latham Perry.[4] The case of the American Social Science Association (ASSA) is even more emblematic. Founded in 1865, it was an association of American social reformers and researchers that lasted until 1909 and reflected the union of scientific aspirations in the realm of the social sciences with that generation's reformist impulse prompted by the massive socio-economic transformations of the time. Even within the ASSA, though, classical economic principles prevailed – as embodied by the likes of Perry, "the American Cobden" David A. Wells, and Spencerian economist William G. Sumner. This in obeyance to the association's goal, namely, "the diffusion of sound principles on questions of Economy, Trade, and Finance […] for the purpose of obtaining by discussion the real elements of Truth".[5]

Hence, the catchphrase "classical economics" used in the paper to summarize the mainstream economic views of the era. And given that those very views laid the intellectual foundations for the private economic empires that were built in the last quarter of the 19th century, the question arises as to why so many of their supporters were at the same time hostile to the legal form those same empires adopted – the corporation.

The evolution of corporate law is also one of the usual punch lines of those who denounce the jurisprudential attitude of the time. The pejorative term *Lochner* era is often used to indicate the period of American constitutional law when the Supreme Court allegedly endorsed a laissez faire, pro-business attitude that led to the

[1] The New Schoolers were a group of Progressive scholars who repudiated classical economics, opposed laissez faire and advocated social reforms. See Yonay 1998, Chs.2-3; Bernstein 2001, Ch.1. For an encyclopedic overview of the different trends of the economics profession in post-Civil War America, Dorfman 1949 remains the compulsory reference.
[2] Books like Reverend Francis Wayland's *Elements of Political Economy* (1st ed. 1837), Amasa Walker's *The Science of Wealth* (1st ed. 1866), and Arthur Latham Perry's *Principles of Political Economy* (1st ed. 1873), all of which went through several editions and were influential well into the Gilded Age.
[3] On the partial, idiosyncratic reception of Adam Smith by American scholars, see Liu 2022.
[4] See Dorfman 1949, 80-1.
[5] See Meardon 2008.

invalidation of several economic regulations enacted by democratically elected legislators.[6] As far as corporations are concerned, a specific case allegedly substantiates such accusation. The Supreme Court is said to have been subservient to the interests of Corporate America, its deference being epitomized by the *Santa Clara* decision of 1886. Many interpreters then and now read that ruling as expressing a new theory of "corporate personality" that enhanced the power and opportunities of American big business.[7] The ensuing corporatization of the US economy was triggered, so the standard story goes, by this jurisprudential go ahead. *Santa Clara* thus foreran within the specific realm of corporate law what two decades later *Lochner* would do under the more general rubrics of freedom of contract and substantive due process.

Law historians have recently questioned this reading. Corporations were already common in the US well before the Gilded Age, the latter being more an era of consolidation in which many existing corporations merged into larger conglomerates. Moreover, *Santa Clara* neither entailed the personification of US corporations nor was intended to benefit big business. The decision, together with others in the pre-*Lochner* years, represented the Court's attempt to reach a difficult compromise. Starting from the 1870s, American judges and jurists came to understand that a middle ground had to be found in corporate law between different needs: protecting individual property rights, as established by the Fourteenth Amendment of the US Constitution; fostering economic development through proper legal design of those very property rights; accounting for the transformation of the US economy, with the rise of big business and the emergence of unprecedented technological and financial innovations; and the federalist urge to preserve some control over corporations in the hands of the states. Thus, *Santa Clara* was something other than a "thematic" *Lochner*.

The complex relationship among laissez faire ideology, concrete business interests, constitutional jurisprudence and the corporate law of the Gilded Age raises interesting questions also for historians of economic thought. Let us accept the premise that the legal doctrines of the *Lochner* era, including doctrines of the corporation, have been informed by economic theory.[8] Is it then correct to argue, as Progressive scholars did,[9] that the same kind of economics that allegedly drove the *Lochner* Court – namely, classical laissez faire – also inspired the jurisprudential support for the corporatization of the American economy? Or would the opposite be closer to truth, namely, that the corporate form could not be easily accommodated within the system of thought of classical political economy – this being a key reason the above-mentioned compromise in late 19th-century corporate law was so hard to achieve?

My narrative is complementary to the revisionist literature on *Santa Clara* in that I argue that the conventional story is wrong not only about the unproven subordination of the *Santa Clara* Court to powerful business interests, but also with respect to the allegedly perfect overlap between the main principles of classical economics

[6] Stretching from the mid-1880s to the mid-1930s, the era is named after *Lochner v New York* (198 US 45, 1905), a case where the Supreme Court stroke down a New York state statute regulating bakers' working hours. On the economics of the *Lochner* era, see Siegel 1984; Benedict 1985; Hovenkamp 1988a; Ely 2009; Giocoli 2017.
[7] *Santa Clara County v. Southern Pacific Railroad*, 118 U.S. 394 (1886). See e.g. Beard 1914, 57; Graham 1943, 853; Sklar 1988, 49; Schwartz 1993, 169-70.
[8] One need be no Justice Oliver Wendell Holmes (who famously chastised the undue influence of economics on the *Lochner* majority) to acknowledge that economic ideas – whether expressly stated or only implicitly held – do contribute to shape a judge's mind, especially when economic values are at stake.
[9] For classic statements of this view, see e.g. Beard (1914, Ch.3) or Twiss (1942, 60-62). This reading has been so widespread that even the entry on the *Santa Clara* decision in the online *Merriam-Webster Dictionary* still endorses it!

and the prevailing view of the corporation as a mere expression of the partners' freedom of contract. While the latter freedom lay at the foundation of the classical edifice, it might seriously undermine that same edifice when exercised in corporate form. Many American economists and jurists of classical formation knew this danger all too well, so much so that their attitude towards corporations was seldom straightforward. Indeed, they turned out to be rather critical of, when not openly contrary to, the corporatization of the economy.

§2. Some classical economists disliked corporations…

American economists of the 19th century have never been especially enamored with corporations. Already before the Civil War, and with rising tones in the following decades, they complained about a way of organizing business they deemed at odds with their general vision of a well-functioning economic system. The judgement was shared by scholars of different inclinations – classical, progressive or proto-neoclassical. Each saw in the corporation an anti-competitive threat, at the minimum, and a blatant privilege, at the worst. So critical an attitude was understandable in the case of those scholars who challenged the authority of classical ideas, like the above-mentioned New Schoolers. Much less so in the case of the economists who, from the mid-19th century till the dawn of the Progressive Era (ca. 1900), still paid allegiance to their classical heritage.

Doubts about the corporation date back to the origin of classical economics. As explained above, monopoly per se was neither the only, nor the most important issue. Governance held centerstage. In a section added to the third edition (1784) of the *Wealth of Nations*, no less than Adam Smith jettisoned the joint stock company for reasons other than their monopolistic power.[10] "These companies", he wrote, "have in the long-run proved, universally, either burdensome or useless, and have either mismanaged or confined the trade" (*Wealth of Nations*, V.1.94). Practical and theoretical reasons fueled his skepticism. Smith highlighted the weak and distorted incentives that marred the management of corporations − what would modernly be called the separation between ownership and control. On the one side, "proprietors" had little incentive to actively control the corporation: "the greater part of those proprietors seldom pretend to understand any thing of the business of the company; and […] give themselves no trouble about it, but receive contentedly such half yearly or yearly dividend, as the directors think proper to make to them" (V.1.107); on the other, managers had even less motives to take care of the owners' business: "The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own" (ibid.)

Smith's overly pessimistic view of the corporation was a rare subject of disagreement with his main American epigone, Francis Wayland (1796-1865). The author of the most popular economics textbook before the Civil War, Wayland supported free banking and, therefore, used his *Elements of Political Economy* to defend the corporate form from the widespread idea that, being mere "creatures of the legislature" (see below §3), corporations in general, and banking corporations in particular, could − indeed, should − be strictly regulated. An idea that, he lamented, stemmed from "a very general disposition […] to interfere with the rights of capital" (Wayland 1837,

[10] See Anderson & Tollison 1982, and, above all, Fleckner 2016, which we follow here.

320). Readers of Wayland's textbook were thus instructed to view the corporation as a natural way of running a business, one whose true origin did not lie in legislative will. "Legislation never confers any right whatever", he wrote, "it only confirms those rights which previously existed". Thus, "[a]n act of incorporation, has no other effect, *per se*, than to place a society under the same protection as individuals, and subject it to the same responsibilities as individuals; that is, to place it under the common and universal laws of the land" (ibid., 315-6). Wayland urged to stop fearing corporations, at least as long as legislators refrained from granting them monopoly privileges and let competitive forces work freely (ibid., 319-20).

Attacks against the "money capitalists" who hid behind the corporate form became a cliché of antebellum politics. Like most members of the new Republican party, another prominent classical economist, Amasa Walker (1799-1875), followed this pattern. In an 1853 speech at the Massachusetts Constitutional Convention, Walker denounced "this system of corporations", which he decried as "nothing more nor less than a moneyed feudalism" (quoted by Foner 1970, 22). His concerns about the power of capital concentration and the loss of economic independence gratified the Republicans' "free labor" constituency of small farmers and craftsmen. "Corporations change the relation of man to wealth", he lamented. "[W]hen the management of property is put into the hands of corporations, the many delegate the power of managing it to the few. […] Hence, the agent of a factory, or a corporation of any kind, has absolute control over all persons connected with that corporation".

The Civil War did not modify Walker's views. In his influential textbook he warned against the excessive concentration of capital, arguing that efficiency gains on the production side were sooner or later overcome by managerial slackness. In a passage that, with the benefit of hindsight, looks hardly prescient, he even praised the return of "the older wisdom of the country" in favor of "smaller establishments, which secure full, interested personal supervision of labor", away from the belief, which to his view American people had held for too long, "that corporations were the most efficient agents of production" (Walker 1872, 79).

On a similar note was Aaron Lucius Chapin (1817-1892), ironically the author of the last, amply revised edition of Wayland's textbook. Again, the problem was the governance of corporations, more than their size or anti-competitive behavior. Chapin warned 1878 readers against the "mighty power" concentrated in the hands of corporate managers, which could be used against the interest of the corporations and the public. Gilded Age railways had now replaced Jacksonian banks as the epitome of corporate evils: railroad promoters could deceive suppliers of funds, bribe legislators or involve their corporations into excessively risky businesses. A remedy was called for, but Chapin – faithful to the classical imprint of Wayland's book – refused direct legislative intervention and trusted the vigilance guaranteed by public conscience, if properly instructed in the eternal truths of classical economics (Wayland & Chapin 1878, 387-390).

The author of another widely used textbook and perhaps the most prominent representative of American late classicism in economics, Arthur Latham Perry (1830-1905) also complained about the corporate form, which he viewed as a catalyst of capitalists' greed. A follower of Frédéric Bastiat's doctrine of "economic harmonies", Perry identified the greatest evil caused by corporations precisely in the damages they caused to the beneficial harmony of interests an economic system ruled by classical principles would otherwise guarantee. The special privilege accorded to capital by state rulers via the corporate charters could indeed thwart those "broad benefits designed by a wise Providence" that free market exchanges would generate (Perry 1891, 236). Even worse, by allowing capitalists to earn "artificial profits", corporate privilege ignited the discontent of labor that would then start "knocking at [the Legislature's] doors", asking as well for "artificial wages" (Perry 1888, 247-8).

Even a committed convert to classical laissez-faire like David A. Wells (1828-1898), while deeming the rise of corporations inevitable to meet the necessities of mass production, could not avoid stressing their negative effects. Again, the harm was not just to competition, but also – as a consequence of the corporations' organization and governance – to "the individualism or independence of the producer in manufacturing", as well as to "the pride which the workman formerly took in his work" (Wells 1889, 93).

After the Civil War, free incorporation had been exalted by many as the ideal instrument to further market democracy. Reality ushered in quickly, shattering utopia. In the late 1880s, in the midst of the impressive rise of Corporate America, another economist, this time of marked anti-classical penchant, had a clear grasp of the theoretical and socio-political challenges raised by the advent of big business. In a celebrated 1887 pamphlet, New Schooler Henry Carter Adams (1851-1921) blamed corporations for the rising economic concentration that was destroying competitive opportunities in the marketplace. Fostered by a naïve commitment to classical laissez-faire, "the tyranny of corporations", as he called it, "was as grievous as any tyranny ever established by government agency" (Adams 1887, 13). With the sole exception of businesses characterized by massive scale economies – which could well become corporations, but only if managed "in the interest of the public" – the corporate form should therefore be avoided altogether (ibid., 64).

However, even an arch enemy of trusts and monopolies like Adams knew that the troubles with corporations did not end with market power and size. The separation of ownership and control caused problems of their own kind. "The responsibility and care for the detailed management of great concerns must of necessity be assigned to superintendents and agents", he wrote (ibid., 61). It was impossible, however, to conclude that such "superintendents and agents" – i.e., the managers – would always run a private business more efficiently than a government-owned one, this being generally true only when "the men who do the [managing] work are personally interested in what they do" (ibid.). The comparative efficiency of private corporations vis-à-vis public ownership thus depended on the specific rules governing the appointment of managers – on their governance structure, in short.[11]

Long after the Gilded Age had ended, classical views were still present at the highest echelons of the economics profession in America. First published in 1911, Frank Taussig (1859-1940)'s *Principles of Economics* – a textbook that shaped generations of Harvard students – was exemplary in this respect. Among several classical features, the volume also contained a balanced account of the pros and cons of the corporatization of the American economy. The advantages were those any classical author of the previous century would extol: the corporation enhanced the potential of private property and free markets by allowing more large-scale operations, greater investment fluidity and better risk spreading. Among the drawbacks, Taussig mentioned the "vast deal of unproductive effort in the way of stock gambling", an activity for which, he wrote, it was not "easy to say whether the social gain on the whole outweighs the social loss". Moreover, he remarked that "the sense of association for common ends has

[11] These problems were at centerstage of the analysis of another New Schooler, Jeremiah Jenks (1856-1929). A renowned expert of the trusts, Jenks believed that the troubles with corporations stemmed by and large from the latter's inadequate "methods of organization and management" (Jenks 1900, Ch.VI).

virtually disappeared" among the shareholders of the modern corporation: "Each looks out for himself; deserts the venture in case of expected loss as a rat deserts a sinking ship". Despite its common acceptance in the modern world, a classical author like Taussig could not refrain from censoring such behavior as "among the phases of individualism that bring a shock to a nice moral sense" (Taussig 1921 [1911], 86-7). He acknowledged the rise of "a sort of abstract or distilled property […] exempt from the vicissitudes of industry". This new "leisure class, based not on feudal privilege, but on savings, investment, and productive enterprise", was formed by those shareholders who could happily live out of the steady returns of their financial investments in the corporations. The corporate form had created a new genre of investor who was a far cry, Taussig complained, from the brave and inventive entrepreneur whose business virtues classical economists had celebrated (ibid., 90).

These examples should suffice to make the point. For the good part of the 19th century American economists strived to reconcile the corporate form of doing business with the fundamental principles of classical economics. The reconciliation was ever more difficult when, in the last quarter of the century, the universal truths of classical economics were apparently invalidated by the new industrial reality of big business, massive capital investments and widespread monopoly. While it is common knowledge that, against such evidence, most American economists remained faithful to classical doctrines, much less appreciated is that they themselves did not refrain from criticizing the corporations. Even more significantly, the cliché of the insulation the corporations *qua* monopolists enjoyed from competitive pressures did not exhaust their discontent. From (Smith and) Walker to Chapin, from Perry to Taussig, they all identified in its peculiar governance structure a – possibly, *the* – reason why they could not unreservedly love the corporation, despite plenty of classical reasons for cherishing it.

§3. … and so did some classical jurists

The difficult relationship between classical economics and the corporate form is further exemplified by the case of the two legal scholars who during the Gilded Age were the closest to the ideas of Adam Smith and his heirs. Both Thomas McIntyre Cooley (1824-1898) and Christopher Gustavus Tiedeman (1857-1903) epitomize the marriage between classical political economy and classical legal thought.[12] These jurists extolled the virtues of private property, defended freedom of contract, and circumscribed the scope of government intervention in the economy. More generally, they were both decisive for inspiring a generation of judges and Justices who affirmed the constitutional salience of classical laissez faire during the so-called *Lochner* era. Still, neither Cooley nor Tiedeman were enthusiastic about the corporate form.

A former Jacksonian and a life-long believer in the equal rights dogma, Cooley conceived of monopoly as a special privilege granted by the law. This view matched the classical economists' notion of monopoly as a non-persistent deviation from competitive conditions, absent government interference. Let market forces be free to eliminate any supra-competitive price, Adam Smith had taught, and the possible source of permanent monopoly

[12] I use the expression "classical legal thought" not as just another name for "legal formalism", but in the broader sense of Hovenkamp 1991 and Horwitz 1992 as a system of legal thinking informed by classical liberal values and classical political economy.

could only be state-granted privilege. Yet, the role of corporate charters in promoting economic development was impossible to deny. Even Cooley acknowledged that “special privileges are sometimes defensible, and sometimes a grant of them may be supported on grounds of necessity” (Cooley 1878, 260). How to reconcile this avowal with his Jacksonian anti-privilege imprint, on the one side, and his Smithian commitment to absolute business freedom, on the other?

For the answer, Cooley looked beyond the traditional legitimization of corporate monopolies under the Contract Clause of the Constitution[13] and sought for a criterion allowing a case-by-case screening of state-granted privileges (ibid., 261). Could the power to grant a corporate charter be subsumed under the broader regulatory power of the states – that very *police power* on which Cooley himself was the acclaimed authority?[14]

Cooley recognized that, when left to the free play of market forces, some businesses might generate abuses, or inconveniences, for the whole society. If outright prohibition was not an option, then the only solution was to put such businesses “in the hands of one or of a few persons, who shall first take out a state license under stringent conditions, and afterwards be subjected to a supervision which could not be extended if the business were open to every one” (ibid., 264). Even the corporate form, with its attached privileges, could thus be subsumed under the police power of the states.

Cooley’s next step was to link the corporation to the standard nuisance doctrine of the common law and to the early analysis of externalities put forward by classical economists like Adam Smith and, above all, John Stuart Mill. The issue was where to draw the boundary between legitimate and illegitimate government interferences upon the individual freedom to cause nuisance – i.e., generate negative externalities – and thus affect someone else’s equivalent freedom. Mill had suggested that each intervention be separately assessed via utilitarian principles.[15] This solution, however, could not suit a classical jurist who, like Cooley, was still imbued with categorical thinking, i.e., the practice of formulating so-called judgments in kind. In the police power realm, the practice meant that those called to apply the law could only classify, once and for all, each regulation as either belonging to the (closed) category of legitimate interventions or not. Case-by-case solutions à la Mill were instances of the opposite approach – so-called judgements of degree – which classical jurists rejected, and which would blossom only much later in American law. So, where to draw the line of lawful economic regulation?

Cooley viewed the corporation as an alternative, pragmatic solution. Control over the externalities generated by many economic activities could be expressly delegated to private businesses, the corporations, under those strict government instructions and supervision that only the chartered terms of incorporation could allow. This confirmed that the rationale for corporate privileges could well be found in a broader reading of the police power. With this ingenious way-out, Cooley somehow reconciled his classical hostility to privilege with the reality of the new American economy. Yet, compressing corporate law within the constraints of police power jurisprudence was hardly an ideal solution. Moreover, the solution took it for granted that corporations owed their existence to government’s will. As we show below, this notion was about to be legally superseded.

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[13] The Clause entailed the prohibition for states to modify or disavow the terms of corporate charters.
[14] Cooley’s *Treatise on the Constitutional Limitations Which Rest Upon the Legislative Power of the States of the American Union* (1st ed. 1868) was a must-read for any contemporary jurist dealing with police power, i.e., with the power of the states to protect the health, safety, morals, and general welfare of society.
[15] See e.g. Mill 1909, V.11.

Tiedeman's credentials as a supporter of classical political economy were also impeccable. Suffices to mention here his *Treatise on the Limitations of Police Power in the United States* (1886), a book that made the most of classical laissez faire vis-à-vis government interference with the economy. This famously included designating the Latin maxim *sic utere tuo ut alienum non laedas* as the sole, narrow foundation of police power.[16] Liberty itself was defined in terms of that maxim: individuals should enjoy complete freedom of action under the only proviso that they did not harm others or interfere with their equal freedom (Tiedeman 1886, 4). Tiedeman's classical imprint was thus manifest.

Still, even so undisputed a champion of classical principles did not hesitate to attack corporations.[17] In the second, largely revised edition of his *Treatise*, Tiedeman lamented that the increasing concentration of economic power, if "left unchecked, either by economic conditions or law", would become "a menace to the liberty of the individual, and to the stability of the American States as popular governments" (Tiedeman 1900, 383). He believed that market democracy could only be saved by making it extremely difficult, if not wholly impossible, for private partners to incorporate. "The grant of charters of incorporation", Tiedeman wrote, "only serves to intensify the natural power which the capitalist in his individual capacity possesses over the noncapitalist, by the mere possession of the capital. I advocate, as a return to a uniform recognition of the constitutional guaranty of equality before the law, *the repeal of the statutes* which provide for the creation of private corporations" (ibid., 609-10, emphasis added). An even more drastic proposal came in his last article, which called for the outright *nationalization* of all big businesses, such as banks, communications, or railroads, which by their nature could not be operated other than in corporate form (Tiedeman 1903).

How could such a radical program stem from a champion of classical laissez faire? Did he renege on classical political economy? Not at all. Tiedeman's later ideas should be read as a coherent, if extreme, intellectual evolution in the wake of the late 19th-century industrial landscape. Radical as they might seem, his proposals did represent a legitimate conclusion drawn from that classical paradigm. Tiedeman simply deemed the corporate form incompatible with classical competition. The fear of large-scale entities – whatever their nature, public or private − overwhelming smaller ones while curtailing competition, led him to focus, alternatively and with identical emphasis, on two dangers: arbitrary regulatory measures undertaken by government, on the one side, and the destruction of competition by massive agglomerations of economic power such as trusts or corporations, on the other.[18]

The examples of Cooley and Tiedeman illustrate the difficulty of reconciling the classical framework with the corporate boom of the Gilded Age. Indeed, the trouble did not reside in the two jurists' somehow idiosyncratic views. Nor in the economists' inability to adapt their theoretical schemes to the changing reality of American business. The difficulty ran deeper and involved no less than the corporate notion itself. A glance at the prevailing legal explanations of the nature of corporations proves the point.

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[16] Cf. Mill 1909, V.11, and Spencer 1851, 103.
[17] See Horwitz 1985, 205-6.
[18] See Halper 1990.

§4. A matter of personality

The *Santa Clara* decision seems unambiguous. The controversy was whether the equal protection clause of the Fourteenth Amendment barred California from taxing corporate property (railroad property, in the specific case) differently from personal property. The Supreme Court famously held that a corporation was a person under the Fourteenth Amendment, and thus entitled to its protection – or so the standard story goes. Actually, that issue was not even discussed by the Justices.

"The court does not wish to hear argument on the question whether the provision in the Fourteenth Amendment to the Constitution, which forbids a State to deny to any person within its jurisdiction the equal protection of the laws, applies to these corporations. We are all of opinion that it does" (*Santa Clara*, at 396). This statement appears at the beginning of the reported version of the decision, before the formal opinion by Justice John Harlan. Put on paper by the Court reporter, the phrase is credited to Chief Justice Morrison Waite, who allegedly pronounced it at the start of the oral argument, but no comparable words about corporations and the Amendment exist in the opinion. Indeed, the Court based its decision solely on California tax law, ducking the constitutional side of the controversy.

Many scholars, then and now, read in Waite's words the Court's willingness to raise a powerful shield against government interference with corporate rights – first and foremost, property rights. "This quiet change sculpted a constitutional safeguard of the rights of newly freed slaves into a potent instrument for use against state taxation and regulation", a modern interpreter comments.[19] The enhanced protection in turn facilitated the rise of the corporate form, which became the dominant way of doing business in late 19th-century America. According to this narrative, the Court that handed down *Santa Clara* deserves a place side-by-side the *Lochner* Court as the most valuable – and, for many, most despicable – sponsor of business interests.

The conventional narrative is questionable. The *Santa Clara* Court never intended to revolutionize corporate law, nor affirm a pro-business bias. The Justices reasoned pragmatically and merely selected "the shortest and most practical route" to achieve "constitutional protection of shareholder property rights equivalent to the protection given to unincorporated firms or persons" (Hovenkamp 1988b, 1645). If anything, by characterizing corporations as businesses like any others and by emphasizing shareholders' property rights, the 1886 decision reconnected to a different approach to corporate nature, orthogonal to the idea of the corporation as an autonomous entity. Indeed, by the mid-1880s, the so-called partnership theory of the corporation was well on its way to replace the traditional grant, or concession, theory.

Special incorporation charters were traditionally conferred by state legislatures as a privilege for the pursuit of public purposes, usually following a (not necessarily transparent) negotiation between private interests and state officials. According to the grant theory, the business corporation was therefore an *artificial entity*, created by the state, the powers of which were strictly limited by its charter of incorporation. This characterization of corporations had been enshrined in constitutional law by Chief Justice Marshall's dictum in *Dartmouth College*: "Being the mere *creature of law*, [a corporation] possesses only those properties which the charter of its creation

[19] See Keller 1997, 64. Also see Friedman 1973, 455, and the references in footnote 7.

confers upon it, either expressly, or as incidental to its very existence".[20] This was also the understanding of corporations feeding the above-mentioned skepticism of classical economists and jurists.

Andrew Jackson's political platform in the 1830s denounced special charters as a vehicle of privilege, corruption, and, worst of all, monopoly. However, rather than attacking the corporation as a matter of principle, the Jacksonian solution was to *democratize* the institution (Hovenkamp 1988b, 1634). The elimination of privilege and a free access to all legal formats were deemed necessary for achieving the Jacksonian goal of diffusing liberty and democracy in the economic sphere. The rise of general incorporation acts, which allowed firms to incorporate without seeking a special charter from the state, but "simply by filling out a set of forms, meeting a statutory requirement, and paying a fee" (Lamoreaux 2006, 151), thus rested on the premise that the corporation should no longer be a "prerogative of the Crown", requiring special permission and dedication to public use. This would ensure equal access to market newcomers – against the special charter system, which favored the well-established and well-connected.

The movement for general incorporation acts gained momentum before the Civil War. For example, in the case of manufacturing, eleven states had enacted general incorporation statutes by 1850, and twenty-four by 1860 (Hilt 2017, 58). Still, general incorporation only triumphed after the war, when it catered to the Republicans' "free labor" ideology of social mobility and equal economic opportunities, and with the decisive push of state constitutional amendments, which made general incorporation mandatory while prohibiting legislatures from issuing special charters.[21] The universal availability of the corporate form undermined the grant theory and incorporation came to be regarded as a normal way of doing business, though with some privileges still attached (see below, §§7-8).

As noted above, the utopia of free incorporation soon made way to the dire reality of big business, which, in turn, led to the skepticism and fears of the likes of Perry, Wells, Cooley or Tiedeman. Yet, it was not just a matter of coping with reality. The problems raised by the erosion of the grant theory were also, if not predominantly, theoretical. Legal theorists struggled to re-conceptualize the corporation as something different than a "creature of the law" and, at the same time, explain the nature of the privileges still enjoyed by corporations. While a new consensus never materialized, by the time of *Santa Clara* fundamental changes had already taken place in corporate law theory. What matters to us, none of these changes dovetailed with classical political economy.

§5. A partnership or an entity?

The crux of the matter was whether the corporation was a mere aggregate of individuals, like a partnership, or an "entity", separate from the individuals forming it.[22] Free incorporation meant that corporations could be treated

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[20] *Dartmouth College v. Woodward*, 17 U.S. 518 (1819), at 636, emphasis added.
[21] That it took so long for free incorporation to prevail is itself telling of the concerns that still surrounded the corporate form *per se*. Indeed, "most early general incorporation laws were full of regulations that imposed strict limits on what corporations could do" (Lamoreaux & Novak 2017, 3).
[22] See Horwitz 1985, 182-5.

as a kind of partnership, subject to the age-old rules of partnership law. Yet, some of the special attributes of the corporation – first and foremost, the privilege of limited liability – could not be encompassed by partnership law. Inevitably, two images of the corporation arose.

In the first, the so-called *partnership theory*, the corporation was depicted as a purely private creature, an offspring of free contractual activity among shareholders, no different in nature from any other kind of partnership. If the corporation was nothing more, and nothing less, than a manifestation of its shareholders' contractual freedom, then corporate law itself was part of private contract law, whose individualistic character matched the core principles of classical economics. As treatise writer Victor Morawetz put it, "the rights and duties of an incorporated association", particularly as related to property, were "in reality the rights and duties of the persons who compose it, and not of an imaginary being" (Morawetz 1882, 2). In short, the corporation was at the same time a fiction and a contract.

This view easily reconnects with *Santa Clara*. The Supreme Court would render its reasons explicit a couple of years later: "Such corporations are merely associations of individuals united for a special purpose, and permitted to do business under a particular name, and have a succession of members without dissolution".[23] Clearly, the Justices did not mean – as many interpreters claim – to impute full personhood, and the attached array of constitutional rights (including property rights and freedom of contract), to corporations. The gist of their decisions lay in declaring that the Fourteenth Amendment protected the property rights of individual shareholders, rather than of some abstract corporate entity. *This* was a breakthrough in constitutional law. The substantive protection of property guaranteed by the Amendment replaced the Contract Clause as corporations' constitutional shield.[24] The same protection, that is to say, which will be at centerstage of *Lochner* and its progeny and, above all, which classical economists had always considered the legal keystone of a free market economy.

The second approach developed by American jurists after the demise of the grant theory was the *entity theory*. Once more, the corporation was conceptualized as a private institution and a normal mode of business organization. However, it was no longer viewed as a fiction, a merely contractual expression of the partners' will. Not only did the corporation exist prior to the law, so that it was not an artificial creature, but it was a real, or natural, entity.[25]

Contrary again to the conventional narrative, this was *not* what the *Santa Clara* Court argued. The entity view of the corporation was at the time still a decade away from being affirmed in the literature, let alone in constitutional jurisprudence. As remarked by David Gindis (2020), the causal arrow should be reversed. It is true that by legitimizing the corporation as a private institution like any other partnership *Santa Clara* helped the surge of big business, but it was this very surge that eventually led to the demise of the partnership theory in favor of the entity theory. Depicting the corporation as a mere contract among individuals became untenable exactly when it was most forcefully predicated by legal scholars. The unprecedented growth of corporate size and concentration in the American economy of the Gilded Age and early Progressive Era made it implausible to deny the reality of corporate organizations as something distinct from the mere aggregate of their shareholders.

[23] *Pembina Consolidated Slyer Mining & Milling Co. v. Pennsylvania*, 125 U.S. 181 (1888), at 189.
[24] See Hovenkamp 1988b, 1601-604.
[25] I use "real" and "natural" interchangeably. In fact, entity theorists disagreed on the true nature of the corporate entity: was the corporation a real person or just an entity distinct from the sum of its members? For an overview, see Gindis 2009.

Several scholars at the turn of the century pursued this route and depicted the corporation as a natural entity, where "natural" meant that its existence was "prior to and separate from the state" (Horwitz 1985, 217-8). Entity theorists thus completed what supporters of the partnership theory had begun. Like the latter, they represented the corporation as independent from the state – a truly private entity. But, against the partnership view, which was still embedded within classical individualist boundaries, in the new characterization groups were considered as real as individuals, so much so that the corporation was separate and distinct from its shareholders too. "A corporation exists as an objectively real entity", Baltimore jurist Arthur Webster Machen proclaimed. "[It] is an entity – not imaginary or fictitious, but real, not artificial but natural". "All that the law can do", he added, "is to recognize, or refuse to recognize, the existence of this entity" (Machen 1911, 260-62).

The entity theory testified to a detachment from the strict individualism of classical scholars, jurists and economists alike, and a major step in the direction of crediting collective bodies with rights of their own – a cornerstone of modern legal thought. A major philosophical breakthrough thus lay ahead. While the language of individualism and natural rights also came in handy for early proponents of the entity theory, in that it allowed the portrayal of the corporation as just another right-bearing "person", whose existence was also natural, i.e., independent of the law, the new approach struck directly at a pillar of classical liberalism, namely, the absolute primacy of the individual and her rights. Admitting that collectives could enjoy rights of their own was a revolutionary idea, with momentous consequences. No surprise, then, that the controversy between supporters of the two conceptions of the corporation flared up in the law journals and learned treatises of the time.

Economic reality eventually dwarfed doctrinal debates. Acknowledging corporate personhood became a matter of fact vis-à-vis an unstoppable socio-economic trend. Accordingly, even depicting the corporation as a natural entity, rather than as a partnership that nonetheless enjoyed constitutional personhood, turned from a high-brow philosophical issue into a pragmatic way of coping with reality. The entity theory, a Harvard Progressive scholar summed up, "looks upon a corporation […] as a normal business unit, and its legal personality as no more than a convenient mechanism of commerce and industry" (Henderson 1918, 3). The recognition and protection of group interests, like those of a corporation, was a practical necessity of modern life that in no way implied special privileges. The corporation, Henderson declared, is "no more than a convenient technical device […] to achieve the practical results desired, of unity of action, continuity of policy [and] limited liability" (ibid., 167). Debates on the "true nature" of corporations, or on who or what a "real person" is, moved into the background. Center stage was now taken by the economic essence of the corporation as an ordinary, yet highly efficient, way of doing business. A classical economic essence – apparently so.

§6. The classical corporation

Anchoring the constitutional protection of the corporate form to the Fourteenth Amendment was also a turning point in the troubled relationship between classical economics and the corporation. If the latter was just a kind of partnership, an expression of constitutionally protected freedom of contract, and an opportunity for financial democracy, most of the problems denounced by classical economists à la Walker and Perry or by classical jurist à la Cooley would vanish. The corporation was no more the offspring of privilege or tantamount to state-granted monopoly. Now it nicely fit the theoretical framework of classical economics.

The equivalence before the law between the property rights of a shareholder and those of an individual businessman or a partner in an unincorporated firm conformed to the idea that the corporation was just an effective device for raising capital and doing business. Well before Henderson or other turn-of-the-century legal scholars, this very idea lay at the core of the classical theory of the corporation, itself a corollary of the basic principles of classical economics.

Law historian Herbert Hovenkamp reconstructed long ago the 19th-century rise of what he calls the *classical model* of the corporation.[26] The model rested on two premises: first, that the corporate form was merely one way of organizing a business, rather than a special privilege granted by the state; second, that the corporation's peculiar advantage over other organizational forms was its superior ability to raise and concentrate capital, an ability the law should encourage or, at least, not hamper. Business law should thus limit itself to guaranteeing to corporations the same rights as any other business, while allowing corporate managers maximum leeway to exploit any advantage inherent to the corporate form. The underlying belief was of pure classical yarn, namely, that free competition, not legislators, should, and would, determine which particular way of organizing an enterprise (in modern jargon, which governance structure) would prevail in the marketplace. Hence Hovenkamp's use of the term "classical" – to emphasize the perfect overlap of this model of the corporation with the mainstays of classical economics.

By making business corporations constitutionally equal to ordinary enterprises, the *Santa Clara* Court gave corporations the same freedom from government interference that liberty of contract and substantive due process provided to unincorporated businesses. The corporate status became irrelevant: only how a business was run should matter, not its legal form. The free play of competitive forces should have the final word in determining winners and losers in the marketplace. No doubt, Smith and the other classical economists would applaud.[27] Adding that the partnership theory fit nicely with the classical economists' philosophy of contractual freedom, methodological individualism, hostility to monopoly, and faith in the allocative efficiency of free markets, one could thus infer that the troubled relationship between classical economics and the corporation was not so troubled, after all. Or, at least, not anymore once legal and jurisprudential innovations had stripped the corporate form of its previous foundations in state-granted privilege.

Unfortunately, so optimistic a conclusion would still leave some loose ends. While Hovenkamp is right in claiming that the partnership theory was the backbone of the classical corporation, the fact remains that the same theory still entailed a few inconsistencies with the key principles of classical economics. First and foremost, limited liability.

[26] See Hovenkamp 1988b; 1991, Chs.1-6.
[27] For what the words "Smith and the other classical economists" mean in this context, see §1.

§7. The litmus test: limited liability

It is customary to identify limited liability as the key advantage that made the corporation so popular as an organizational form in the second half of the 19th century. Limited liability means that shareholders are not accountable for debts or other claims against the corporation beyond the extent of their investment in shares: personal assets that have not been committed to corporate business are protected from corporate creditors. Hence, limited liability acts as an effective risk-smoothing device.

Limited liability was a key ingredient of the classical corporation and, therefore, also of its allegedly perfect fit with classical economics. In the classical perspective, the smooth flow of capital towards its most efficient uses is the sign of a properly working economic system, conducive to widespread prosperity. The corporate form in general, and limited liability in particular, were expressly designed to facilitate such a flow.[28] Once again, the match-up between theoretical requirements and legal provisions seems flawless.

Unfortunately, reconciling limited liability with the classical model is no easy task. Even neglecting the historical circumstance that limited liability is a relatively recent idea, the invention of which was actually inessential for the development of the corporate form,[29] a dilemma arises. Both the partnership theory of the corporation and classical economics were premised on the naturalness of the rights enjoyed by corporate members. Yet, by its very existence the corporation seemed to contradict the natural law foundations of property and contractual rights. A chartered corporation was a clear instance of the social, rather than natural origin of rights. The incongruity was blatant for supporters of the partnership theory.

According to the latter, corporations should be entitled to no privileges with respect to other forms of private contractual agreements. How to explain then that limited liability could only be enjoyed by corporations, but not by individuals? If the corporation really was the product of the shareholders' natural right to freedom of contract, how could it end up with a privilege, such as limited liability, which did not belong to the shareholders in the first place? Wasn't this *very* artificial? Even worse. Reducing liability for those investing in corporations was a sort of indirect subsidy that clashed with the central tenet of classical economics that individuals should bear the full cost of their economic decisions. Wasn't this a manifestation of those hideous privileges economists and jurists of classical inspiration should loathe?[30]

An argument in favor of limited liability only existed when the corporation was conceived of as an artificial entity, distinct from its shareholders and with privileges the legislature could discretionally mold. But this was precisely what the partnership theory had denied and, above all, the reason for the classical economists' dislike of the corporate form. A conceptual trade-off thus existed between the legislative grant of corporate privileges, like limited liability, and the claim that corporations were the offspring of natural rights, entitled to their same constitutional protection. Under the partnership theory, the latter claim had led courts to emphasize the shareholders' individual rights (albeit hidden behind the handy formula of the corporation as a "legal person"), but limited liability wouldn't fit the picture.

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[28] The sixth chapter of Taussig's textbook (see §2) especially stressed this feature.
[29] See Hansmann & Kraakman 2000a, 814-6; Blair 2003, 437-41.
[30] Even a pro-corporation author like Wayland (1841, 283-4) had to recognize that.

A closer look at classical economics may smooth the trade-off. In his 1988 essay on the classical corporation, Hovenkamp explains how the informal analysis of (what are today called) market failures made by some classical economists foreran the modern rationale for limited liability as a device to solve one such failure in the capital market.[31] Corporate enterprises are typically risky businesses, where small investors, uninterested in following the company's daily affairs, delegate to managers control over assets and liabilities. Risk aversion and asymmetric information would make it difficult for entrepreneurs to persuade this kind of investors to put their capital into corporations, unless an effective risk-sharing and risk-reducing device exists to lure them in. Limited liability is the answer. By fixing the maximum amount a shareholder may lose, it spreads the risk from investors to creditors. Far from being an undue privilege, the rule thus represents an essential ingredient of the corporate form's success.

Limited liability for companies not enjoying a special charter became lawful in Britain with the 1855 Limited Liability Act. Classical champion John Stuart Mill welcomed the Act on the basis of the risk-spreading rationale. As he asked in the 1857 edition of his *Principles of Political Economy*: "If a number of persons chose to associate for carrying on any operation of commerce or industry, agreeing among themselves and announcing to those with whom they deal that the members of the association do not undertake to be responsible beyond the amount of the subscribed capital; is there any reason that the law should raise objections to this proceeding, and should impose on them the unlimited responsibility which they disclaim? For whose sake?" (Mill 1909, V.9.6). Surely, not for the sake of third parties who entered into business relations with the company: "nobody is obliged to deal with the association", Mill observed in pure classical tone, "still less is any one obliged to give it unlimited credit. The class of persons with whom such associations have dealings are in general perfectly capable of taking care of themselves, and there seems no reason that the law should be more careful of their interests than they will themselves be" (ibid.).

Mill was also aware of the advantage of limited liability in broadening access to shareholder property. In the 1865 edition he credited "the legalization of joint-stock associations with limited liability" for having expanded the profit-earning class with respect to that of the interest-earners (ibid., III.23.3). Even the objection that limited liability represented a public subsidy to shareholders, with no countervailing chartered duty, found an answer in his *Principles*.[32] The potential wealth transfer caused by limited liability did not partake of the same nature of those privileges that so much concerned, say, Walker or Cooley. The subsidy's burden fell on neither taxpayers nor consumers, but only on corporate creditors; but these, Mill remarked (ibid., V.9.6), were aware of limited liability and so could take this information into account when deciding whether, and under what conditions, to lend their money to, or enter into any other business relation with, the corporation. Far from being a privilege granted by government to the special class of corporate owners, limited liability appeared again as a mere technical device, solving a well-specified market failure in a way that was wholly consistent with the classical dogma of economic agents having to bear the full consequences of their choices.

It may thus be concluded that the above-mentioned trade-off between privilege and naturalness was not so severe. If the ability to encompass the vital principle of limited liability is the litmus test to validate the matching

[31] See Hovenkamp 1988b, 1656-7.
[32] Hovenkamp (1988b, 1657) accounts for both the objection and the answer, without however tracing them back to Mill.

between the corporate form and the classical model, a (narrow) pass is due. The most sophisticated version of classical economic analysis, widely available by the 1860s and indeed quite popular in the US,[33] somehow guaranteed that limited liability did not really clash with the classical economists' worldview, nor with the classical model of the corporation.

§8. Beyond limited liability: other partnership problems

Even explaining limited liability did not fully reconcile the classical corporation with the principles of classical economics. Other friction points existed, like the rights of minority shareholders, the lawfulness for corporations to own shares in other corporations, or the unanimity rules.[34]

Despite the proclaimed defense of individual rights, the partnership view adversely affected the rights of corporate minorities.[35] A state-granted charter could dictate the governance of a corporation, including provisions to protect minority shareholders (e.g., by qualifying the one-vote-per-share rule or by demanding super-majorities for relevant corporate decisions). General incorporation laws allowed greater freedom to devise charter rules bestowing full governance rights on simple majorities.[36] As Chapin and Taussig remarked, shareholders in control of the corporation could thus easily expropriate minorities. It was not just a matter of respecting classical individual rights. The possibility of being de facto expropriated by the majority had also the tangible effect of wiping off any benefit small shareholders might potentially get from the assumed higher tradability of corporate shares.

What made the minority shareholders' situation truly dismal was their inability, under the common law of partnership that now also ruled corporations, to take abusive majorities to court. Recognizing the corporation as a legal person whose property rights were vested in itself did not help. If the injured party of the majority's misbehavior was the corporation, rather than the single shareholder, then the proper legal remedy would be for the corporation itself to seek redress in court – an unlikely event given that the legal action had to be voted by the majority. Even seeking redress on matters of fairness in a court of equity was no easy task for battered minorities. While the law recognized corporate officers as trustees of the corporation and, as such, compelled to correct behavior, a consistent jurisprudence required minorities to prove that the officers' alleged wrongdoing was a matter of fraud, and not just of different judgment. Under the so-called "business judgment rule", courts sanctioned the managers' right to choose the corporate policies and, conversely, implied the shareholders' trust

[33] As noted above (§2), Mill and his *Principles* were still household names during the Gilded Age.

[34] The list is by no means exhaustive. The lack of full information concerning the corporation and its affairs was a thorny issue too for believers in the smooth functioning of capital markets. As a referee rightly pointed out, the issue also affected Mill's own solution to the limited liability conundrum. From Mill onward, until well into the 20th century, economists of all theoretical and political inclinations, in Britain, the US and elsewhere, would call for the establishment and enforcement of publicity duties as a fundamental task of corporate law. On the British version of such call, see Giocoli 2013.

[35] Lamoreaux & Rosenthal 2006 provide evidence of the abuses suffered by minority shareholders of turn-of-the-century corporations.

[36] In the early years of general incorporation laws some states still imposed relatively strict regulations (see above footnote 21). But since the 1880s states began to compete in offering the most favorable incorporation rules: see Yablon 2007.

in the propriety of managerial acts – a trust each shareholder implicitly expressed when freely entering the partnership contract.

The possibility for corporations to own shares of other corporations was one of the most controversial, and complicated, legal problem of the Gilded Age. It involved questions of corporate and constitutional law, of federal versus state powers, of the common law vis-à-vis state and, since 1890, federal antitrust law. Reasons of space make it impossible to even scratch the surface of the issue.[37] Suffices to note, however, that when New Jersey legalized the holding company in 1889, permitting corporations to purchase the shares of other corporations, the classical model of the corporation suffered another blow, in that the provision allowed an additional layer to be interposed between individual responsibility and economic activity. How could the property rights of the individual businessman championed by classical economics still be considered equivalent to those of a corporate shareholder if the latter could itself be a corporation? Apparently, the corporation was something more than, as the classical model affirmed, a mere technical device to better raise and organize capital.

Finally, consider the judicially imposed requirement of shareholders' unanimity for fundamental corporate changes. A pillar of the 1880s partnership theory, and a principle fully in line with the classical individualist creed, even this doctrine could hardly be reconciled with a reality of large enterprises where corporate managers, rather than shareholders, had become the real decision-makers. Such reality, as American economists had noticed, raised in turn a whole lot of governance problems that sit uncomfortably with the classical dogma of individual responsibility on one's own economic affairs.

The picture of the three-fold relationship between the new reality of Corporate America, the partnership theory of the corporation and classical economics is thus less bright than one would expect even conceding that the biggest cloud – limited liability – may somehow be lifted. The picture gets almost unintelligible if we consider that the partnership theory could easily be turned into an argument *against* the corporate form.

As early as the 1890s, some commentators suggested that a coherent reading of that theory might subvert corporate privileges. The contractual origin of corporations should indeed be considered proof of the fictional character of corporate personality – of its mystifying nature as a facade erected by shareholders to avail themselves of undue privileges, such as limited liability or tax exemptions. Business law scholar Dwight Arven Jones made precisely this point to criticize the partnership theory. "The main value of a corporate charter", he averred, "arises from the fact that powers and privileges are thereby acquired which individuals do not possess. It is this that makes the difference between a business corporation and a partnership". The implication was clear: "It is not policy therefore for a corporation to break down its own independent existence by burying its original character in the common place privileges of the individual. It should rather hold to its independence and insist upon the fact of its existence as a distinct entity under any and all circumstances" (Jones 1892, 81). In short, those who wished to *ease* the spread of the corporate form – a list allegedly including classical economists – should *reject* the partnership theory and embrace some version of the entity theory. But the latter, we know, clashed with the individualism and anti-privilege attitude of classical economists.[38]

[37] The literature is huge and largely overlaps with that on the trust problem. See for all Hovenkamp 1991, Ch.20.
[38] For an extension of this argument, see Ciepley 2013.

The puzzle was further complicated by the fact that, following this way of reasoning, anyone *opposing* corporate consolidation – in the name of, say, free competition and economic democracy – should advocate the elimination of corporate entities and a return to an economy made of simple common law partnerships. To these ranks belonged classical jurist Tiedeman, with his shocking proposal to declare corporations unlawful (see §3). A few years after *Santa Clara*, the gist of the classical model of the corporation – the partnership theory – had turned into poison for corporate friends and ambrosia for corporate foes.

Conclusion: what classical scholars did not (could not) see

According to the conventional narrative, the classical economics that inspired most legal minds of the Gilded Age, both at the bench and the bar, was synonymous with complete laissez faire and unwavering support of business interests. Nothing should interfere with the decisions free businessmen could make in the exclusive pursuit of their own self-interest. Postbellum freedom of incorporation expanded the set of such unfettered decisions to include the option to create or join a corporation. Classical economics should thus welcome this development without reservation. Yet, contrary to standard accounts, several economists and jurists of classical penchant expressed their concern about, when not hostility against, the corporate form. While these reservations were understandable when incorporation was a state-granted privilege and a freeway to monopoly, they were much less obvious in the era of free incorporation. How to explain the classical authors' love-hate attitude towards corporations?

The vast literature on the trusts gives an obvious answer in terms of the blatant inconsistency between the enormous concentration of capital during the Gilded Age and the ideal of a competitive marketplace envisioned by the classical system of natural liberty. A complementary account exists, though, which calls into play the legal uncertainty about the true nature of corporations: the classical model could not accommodate a legal entity that was still conceived of as an artificial "creature of the State". The turning point here came with the *Santa Clara* decision that sanctioned the partnership theory of the corporation. That theory captured the true essence of the corporation as a manifestation of the partners' freedom of contract. Thus, the complementary account concludes, it was only after *Santa Clara* that economists and jurists could recognize that even corporations were fully consistent with the classical worldview. The era of the classical corporation reached its apogee.

The paper has showed that the latter reconstruction is unconvincing, too. Our bottom line is that one cannot disentangle the complex relationship between classical economics and the corporation on the sole basis of the affinity between the former's individualist penchant and the latter's partnership analogy. Too many facets of the partnership theory simply did not fit classical principles. While the most conspicuous of these inconsistencies, the privilege of limited liability, had been somehow tackled by John Stuart Mill, others, like the weak protection of minority shareholders, remained as the inevitable fruit of a governance structure burdened by (what later economist would call) moral hazard opportunities. Regardless of the trust problem and, even more, of the abstract debates on the corporations' "true nature", classical writers simply looked at the reality of corporate life and, economists and jurists alike, did not like what they saw. Hence, what they themselves praised as an especially effective way of raising capital and conducting business – indeed, the most advanced offspring of free entrepreneurial behavior – could nonetheless trigger their concern and, sometimes, strong opposition. Even classical authors could then join forces with those who from other ideological and methodological fronts criticized, or altogether rejected, the corporation.

Maybe equally important was also what classical scholars did *not* see in the corporation. One may indeed ask: "What did the adoption of a corporate form accomplish for the organizers of business that could not have been accomplished through other nineteenth century legal forms?" (Blair 2003, 389). Historically speaking, incorporation was indeed a legal device that accomplished something that would have been impossible through individual proprietorship, partnership, or other forms of contracts. We know that late 19th-century controversies focused on the status of legal entity that a corporate charter bestowed on a business. Yet, recent scholarship has demonstrated that the main advantage of incorporation lay – and still lies – elsewhere. The corporate form is the best organizational device to credibly commit resources to a certain business and, accordingly, lower the cost of credit.[39] In an era of escalating industrial investments like the Gilded Age, it was the enhanced possibility to commit resources and save on financing costs – a possibility that only incorporation could offer – which sparked the corporate revolution.

Modern economists know well that resource commitment is a way to solve many kinds of moral hazard situations – including some of the most important problems affecting the governance structure of a corporation. Alas, classical economics lacked this kind of knowledge and so could not encompass the crucial advantage of the corporate form. While, as noted above, smart classical scholars like Mill acknowledged the adverse selection and moral hazard problems that hindered business efforts to raise new finance, and while they also understood the key role played by limited liability to mitigate these problems, what they failed to recognize was the commitment side of the issue. Corporations were a success story because of their superior commitment powers, but this crucial organizational feature was never part of the classical model. Therefore, classical economists and jurists overlooked the main and, above all, *exclusive* benefit of the corporate form.[40]

It is of course impossible to argue that this specific analytical omission played for sure a decisive role. However, it captures a more general issue that may well have been crucial in the love-hate relationship between classical authors and the corporation. The commitment argument puts property law issues (who owns what rights over what asset) rather than contract law ones (bargaining for the allocation of those very rights) at centerstage of any explanation of the nature and function of the corporation. It emphasizes how with a single legal stroke – incorporation – it is possible to exactly, and effectively, allocate all property rights over the firm's and its owners' assets, thereby mimicking the result that private contracts could only achieve through costly and laborious negotiations. This however is a feature of the corporation that was alien to a worldview that placed absolute trust

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[39] The reference is to the so-called *asset partitioning theory* of corporations. According to Hansmann and Kraakman (2000a; 2000b), the corporate form is the most complete and effective way to implement the partitioning of a legal entity's assets – the latter being defined as the possibility to guarantee to participants to a business, as well as to third parties, that the pool of assets used in the business will be available to meet the needs of the business first, i.e., before these same assets can be distributed to the owners or their personal creditors.

[40] Hansmann and Kraakman do not deny the other, well-known gains of the corporate form (such as capital lock-in, better governance structures or easier transferability of shares), but stress the specific advantage that *only* the corporate form may bestow. Unaware of the latter, a classical economist or jurist could thus legitimately conclude that all the other advantages might as well accrue from other organizational solutions.

in the unlimited ability of free bargaining to shape economic reality. For those who, like classical economists and jurists, considered freedom of contract as the quintessential manifestation of individual economic liberty, the idea that much contracting activity could be made redundant by incorporation was simply unthinkable. With its limited awareness of the economic value of commitments and its unfettered trust in the power of contractual arrangements to allocate property rights, classical economics could not grasp this rationale. What classical economists and jurists saw in front of them was just a peculiar way of organizing business – the corporation – marred by governance troubles and often conducive to undesirable monopoly power. And they loved it not.

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