Business Organization and Combination

An Analysis of the Evolution and Nature of Business Organization in the United States and a Tentative Solution of the Corporation and Trust Problems

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Preface

This book deals with the organization of business enterprises, chiefly in the United States.

While the author has designed the book for use in American colleges and universities, he has kept in mind the interests of the business man and of the general reader. It is hoped that the book will be of service to that large class of thoughtful business men who desire a comprehensive knowledge of the economic and legal aspects of the organizations with which they are associated.

To accomplish his design the author has avoided unduly technical language wherever possible, and has sought to explain any unusual usage. Numerous concrete illustrations of business organization are given. Indeed, the author believes that in no similar work will so large a mass of up-to-date illustrative data be found.

It is believed that the reader may secure from the following pages a good general knowledge of the legal principles which concern the various forms of business organization and combination. On several important points the leading cases are cited.

If the book has any merits, one of them must be its careful definition of terms and its accurate classification of forms. Much thought has been given to accomplishing these ends without going so far from the current usage as to make the definitions and classifications impracticable. It is modestly hoped, therefore, that the work may serve as a step toward a more systematic and scientific knowledge of the forms of business organization.

Especial study has been given to the problem of making the corporation a more desirable citizen than it now is. In connection with that problem, the reader's attention is invited to the suggestion that a new form of organization is needed in the United States, — a limited-liability association which will occupy the gap between the partnership and the corporation.

The "trust," or monopolistic combination, is a form of business organization, and the trust movement is a movement in the world of business organization; and, accordingly, the student of the trust problem will find a concise and definite analysis of the evils of combination, followed by suggestions for specific remedies. Perhaps the author has gone too far in making detailed suggestions; but he has done so in the hope of making general principles more definite and concrete than they generally are.

The general scheme of the work is as follows: First comes a series of chapters describing and analyzing the various forms of business organization in such a way as to bring out the centuries-long evolution which has molded them. Then, the corporate form, being clearly dominant, the life history of a corporation is set forth in a series of chapters which describe in some detail the main events: promotion, underwriting, reorganization, and the like. Finally, great evils having appeared in corporate organization, the question of public policy is raised, and an attempt at a comprehensive and scientific solution of that question is made.

For two general reasons, a wide range of topics has been covered: first, such a treatment meets the needs of the general reader; second, it should make the book available to a greater number of instructors. Instructors differ in the scope of the work done in their courses in business organization and allied topics; and, in using this book, one instructor can omit the part which deals with public policy; another, the discussion of the simpler forms of organization; a third, the account of internal organization, promotion, etc.

It is the author's pleasure to acknowledge the receipt of kindly criticisms by which he has profited from Professor Richard T. Ely of Wisconsin, Professor A. A. Young of Washington University, and from his colleague, Professor Ira P. Hildebrand of the law faculty of the University of Texas.

The reader's attention is called to a collection of source material which comes to hand as this book goes to press. In Stevens' *Industrial Combinations and Trusts* (N. Y., 1913), a valuable supplement will be found to that considerable portion of the present volume which deals with combination organization.

Lewis H. Haney.
Austin, Texas, January, 1913.

Book I: Introduction: General Nature of Business Organization

Chapter I. Business Organization in General

Business Organization Defined. — The term "Business Organization" has a very definite meaning to the scientific student of industrial affairs. In the first place, he would explain that the idea of "business" is capable of pretty accurate definition. Business may be defined as human activity directed toward producing or acquiring wealth through buying or selling goods. Men do not, as a general thing, enter business for their health, but for the purpose of making money, and, as a rule, money making involves the production of things which men desire. Business reaches its culmination at the end of the technical processes of production and at the beginning of the consuming process; for everywhere in the world of industry "products" are being turned out by plants, mills, farms, stores, offices, etc., and taken over by other plants, mills, farms, stores, and offices as producing consumers, or by individuals as "final" consumers. Such transfers mean buying and selling, and in buying and selling lies the essence of business. On the one hand, business rests on technical processes of trade and manufacture; on the other hand, it looks to the market. At the junction stands the business man, either directing the technical process of production or gauging the market, or doing both; but always engaged in buying and selling for the purpose of gain.

Burglars make money, but burglary is not business — at least not ordinary burglary. Neither the economist nor the law can recognize anti-social and unlawful activities, for such activities tend to destroy society, without which business would be impossible; and they are carried on outside the pale of the laws, without which society could hardly exist. Business is founded upon the exchange of goods, and for exchange to exist there must be both an exchanger and an exchangee: without mutuality based on a *quid pro quo* exchange, business would soon cease.

Two kinds of business, however, must be recognized: business that is productive from the social point of view, and business that is productive only from the individual point of view. According to the social point of view, business is productive when it adds to the net sum of goods and services which men want; that is, when the amount of food, clothes, books, automobiles, teaching, medical service, etc., is increased. But individuals may grow rich in ways which do not increase the net sum of goods and services and still be actively engaged in business, or in production from the individual standpoint. A large part of advertising is merely acquisitive, not adding anything, but taking for one business man what another business man loses. So it is with some "speculation," and some middlemen's activities. But all this, when recognized as lawful and when the price is freely paid, is "business"; and in the long run the test of a good business man is simply the amount of income or private gain which he acquires legally. Business thus includes some activities which do not add anything to the sum total of society's wealth.

Most thinkers who are not socialists, however, believe that, while there are many hitches and mistakes, and while individuals may merely acquire without increasing total wealth, on the whole and in the long run

it is true that in the fields where competition prevails the more efficient business men there are, and the larger their total gains, the greater is production from the social point of view. This conclusion, of course, rests on the fact that men can generally make money in legal ways only by making things other men want. Or, to put the idea another way, it rests upon the fact that exchange — in which business subsists — must ordinarily be mutual, and be based upon a gain in utility — though not necessarily an equal one — to both parties to the exchange; otherwise exchanging will become one-sided and decline. Of course, this works out more readily under competitive conditions than under monopoly; but the ability to buy what one wants is in any case related to the ability to sell what one has.

Again, the critics of the modern business world, while sound on several points, are too prone to underestimate the real social service performed by those who direct the industrial processes, the business men. In the main these men are no mere exploiters. Without their leadership the effectiveness of industry would be far less than it is. In a social order in which private ownership of the instruments of production exists, we have separate groups of laborers and of capitalists, and some one must undertake to bring the labor and the capital of these groups together, so that they may cooperate; and especially under our present complex organization of industry it is highly important to have economically combined labor and capital skillfully directed to the use of our best natural resources. Moreover, the motivation behind such direction is strong. As one of the critics has observed, the stimulus to activity in production under the leadership of business men is so keen, that even if there is fraud and waste, there still remains so large a product that none need suffer want.[1] "There seems, therefore, to be no tenable ground for thinking that under competitive conditions the working of the modern business system involves a curtailment of the community's livelihood. It makes up for its wastefulness by the added strain which it throws upon those engaged in the productive work."

Inasmuch as the test of business ability is private gain, government activity, when conducted according to the principles of public finance, must be ruled out of consideration. Public finance is the science of getting and spending funds for carrying on political activity, and in such activity there is no question of profits: income is adjusted to expenditures, and a surplus is regarded as dangerous. But when, as is the case with German railways, an industry is prosecuted by government partly for the sake of gain, the state becomes a sort of business man.

"Organization" is a harmonious adjustment of specialized parts for the accomplishment of some common purpose or purposes. Economists have long agreed that the parts or factors of a business organization are "land," — including all the contributions made by man's physical environment, — labor, and capital (instruments used for production, like machines). When these factors are harmoniously combined for the purpose of producing or acquiring wealth, we have a business organization. But in order to effect such a combination, a fourth factor is necessary. This factor is business enterprise, or entrepreneurial ability, as economists often call it; and it thus constitutes the kernel or essence of the business unit. We may define a business unit, then, as *a more or less independent complex of land, labor, and capital, organized and directed for productive purposes by entrepreneurial ability.* Plainly, no pains must be spared to gain a clear understanding of the nature of this entrepreneur element.

The Entrepreneur and Business Enterprise. — Entrepreneurs, or business enterprisers, are the men or groups of men who organize and direct business units. The exercise of this function involves an expenditure of human energy which might be classed as labor; but the entrepreneur's service is so peculiar and well-defined and is associated with so characteristic a risk that it is best not confused with labor in any ordinary use of that term, and his function will be treated as single, separate, and distinct. In the first place, the entrepreneur stands over labor, land, and capital in a position of independent responsibility. When a laborer, say a carpenter, becomes a contractor, and so an entrepreneur, he may keep on laboring as before, but

something has been added. As entrepreneur, he stands over and directs labor, land, and capital; and he becomes responsible for the functioning of those factors which he directs. He makes the ultimate decisions on business plans: What shall be made? How shall the other factors be proportioned? Shall much capital be put in a tall factory building where land is high in value and must be economized, or shall less capital be expended and more land be used in a cheaper location? Shall he use more unskilled labor and less valuable machinery or shall he combine less labor of a skilled kind with the most machinery? How much shall be made? Under what conditions shall it be marketed? These are his problems.

We shall find that entrepreneurial ability has in the past generally been associated with possession — not ownership, necessarily — of capital. This is true, at least, of the time since the factory system became common. It would be. wrong, however, to think of the business enterpriser as a capitalist in the strict meaning of the word. His distinctive service is the direction of the business unit, including capital. Through his foresight and ability he directs the application of human energy in the shape of labor-power and capital-saving to the exploitation of the opportunities afforded by nature, and the possession of capital is simply a means to this end, a tool in his hands, Naturally, his profits are apt to be in proportion to his equipment of capital. But it would be erroneous to confuse the entrepreneur with the capitalist as many English and German economists have done; such connection as exists between the two is merely an expression of the peculiar relation which the entrepreneur bears to a combination of labor and capital and land.

As independent organizer and director, the entrepreneur acts as a distributer of the gross income of the business and undertakes to guarantee wages to his employees and interest to those who have lent him capital. These payments he makes generally at market rates regardless of the prices at which he can sell his output. His expenses are largely stipulated in advance.

It follows from the foregoing facts that the entrepreneur is subject to a relatively large and intense element of risk. Risk is found in all occupations, including the services of laborers and capitalists; but in none is it so intense or of such a quality as in business enterprise. The entrepreneur's position is more like that of the stockholders of a corporation; for they run the risk of there being no dividends and they must pay interest to the bondholders even if their stock loses its value as a result; and just so he must pay his rent, wages, and interest even if his profits become a negative quantity. Indeed, this is more than an analogy. The stockholders of a corporation as a group ultimately form its entrepreneur, and the bondholders merely supply the capital factor. The entrepreneur's risk arises from the impossibility of controlling prices and the consequent likelihood that the price of his product will not cover the expense. It concerns values, not physical products. Any one can make a *thing;* but few can make profits by selling things for more than they expend in making them. A well-known French economist estimated that out of every one hundred new businesses, twenty fail almost immediately; between fifty and sixty continue on a dead level, making no profits or losses; while only ten to fifteen — a little over one tenth — succeed.[2] This conclusion is supported by the common though not unquestioned observation that about 90 per cent of the would-be entrepreneurs fail.

This condition of affairs is closely connected with the fact that no market exists for entrepreneurial ability in the sense that there is a labor market. This is the reason for speaking of the "independent" responsibility. No one hires or discharges the entrepreneur. No one stipulates a certain return to him in advance. Indeed, entrepreneurial ability proper, in the nature of the case, cannot be hired nor delegated, and this suggests the distinction between the entrepreneur and the manager. If we liken the former to the commander in chief of an army, or the admiral of a navy, who has made the plans which determine the maneuvers, then the officers who, like lieutenants and captains, see that these plans are all carried out on the predetermined lines are the managers. Such work may require high executive ability, but it can be hired, and superintend-

ents and "managers" are salaried employees. In their capacity as managers they do not share the risks of the business, and, accordingly, they do not make the ultimate decisions as to its conduct.

We conclude, then, that the entrepreneur's function, however subdivided or combined with other functions it may be, is yet single and distinct; that it is the organization and direction of the other factors of production as assembled in business units. In exercising this single function, the entrepreneur necessarily plans the organization and relative amounts of the factors; as independent planner and designer, he directs their operation; and, of course, he pays rent, wages, and interest out of the gross income of the business. All this involves the risk that there will be nothing left over to compensate himself, but, if his entrepreneurial ability is good, "profits" will remain as his reward. The ability required, the service performed, and the risk borne are inseparable, and are but different aspects of the same function.

Naturally, ability of the highest order is required to make the more successful business enterpriser. It takes some brains to run a peanut stand on one's own hook, and to direct a railway system or a steel corporation is a giant's task. The man or men by whom it is best done must have ability to judge the markets, including the money market, to judge the men into whose hands the management of important branches will be put, to say nothing of ability to judge the bigger technical problems that are peculiar to the business organization. Not the least of the qualities required is the ability to bear risk, the moral quality of *responsibility.* Not every man can bear the strain of business risk with level head and mind unaffected by worry. The test to which all these qualities are put has become more and more severe. It is a far cry from the single entrepreneur at the head of his little shop to the captain of industry who from his New York office directs the world-wide operation of a "billion-dollar trust." The amount of capital embraced in a business unit has increased steadily. Operations have expanded both in scale and in period of time covered; and, at the same time, the relations with laborers, capitalists, and the public have become more complicated. Paralleling such developments, also, there has been an evolution in the forms of business organization from the simple to the complex, which will occupy our attention in the succeeding chapters.

It is no wonder that a division of labor has taken place in the field of business enterprise, and that the entrepreneur's function has been subdivided. Now it has become a separate branch of enterprise to organize the business and start it going: the "promoter" discovers the "proposition," assembles the elements, and plans its organization on the larger lines. This branch of the entrepreneur function is illustrated by such men as Judge Moore and John W. Gates. They turn the enterprises over to the entrepreneurs who direct them as going concerns. These are the men who, like Carnegie and Harriman, are generally associated with the name "captain of industry." As stockholders and directors they plan the general commercial policy of the plant or plants under their control, receiving not salaries but "profits" for their services.

The preceding sentence suggests another way in which the function now under discussion has been divided. In the simpler forms of business organization the owners are generally the ones who organize and direct the operations; but in the big business corporations of to-day it is quite impossible for all the stockholders so to participate. They therefore delegate authority to elected boards of directors, who in turn elect officers. Clearly, as bearing the risk of loss and as being the final source of authority for making the ultimate decisions, the body of stockholders hold the entrepreneur function, and that function is therefore divided among many individuals. But on most ordinary occasions the board of directors — or perhaps an executive committee of the board — passes upon important matters. Frequently, one personality dominates the board and is *de facto* the directive entrepreneur. In any case, all this suggests that the two aspects, risk and direction, almost necessarily become nearly dissociated; for under existing laws the directors may own merely nominal holdings of stock. Thus, in the business corporation, the entrepreneur's function is diffused, and is far more complex in its working than in the single-entrepreneur business unit or in the partnership. Never-

theless, in the same sense that "the people" govern in the United States, the voting stockholders of a corporation direct its general policy.

This delegation of authority and subdivision of ownership which characterize the corporation, while not fundamentally changing its nature, exert no small effect upon the nature of the entrepreneur. The risk itself is modified by the fact that the stockholder's liability is limited: he bears only a fixed maximum risk, and generally he cannot lose more than he has invested. On the other hand, his chance of gain is commonly unlimited. The very fact, too, that the risk and the directive authority are divided among so many men makes a difference: both are less concentrated, and are less closely correlated than in simpler forms of business organization.

Thus, we conclude that with the complex business units of to-day there may be promoter entrepreneurs and director entrepreneurs; and within each of these classes, but especially the latter, the directive and the risk elements of the entrepreneur function may be largely dissociated. This latter fact may open the door to irresponsible direction and clash of interests. So it is that in politics a dictator or "boss," whose interests are not those of the people, may do great harm.

Profits. — This is not the place to enter into the niceties of the problem of determining profits; but, as profits are the reward of the entrepreneur, or enterpriser, a brief statement is called for. It follows from the explanation of the entrepreneur's work which has just been presented that profits are the reward for certain valuable services in organizing and directing business units, and in taking the risks involved. The demand for entrepreneurial service then, like the demand for the services of the other factors, depends ultimately upon the prices which consumers are willing to pay for the products which business units are turning out, as modified by the relative abundance of the remaining cost factors. If demand prices are high, and labor and capital are abundant, profits will be great. The supply of entrepreneurial ability, in turn, depends upon the number and ability of men who are available for the conduct of business enterprise. If such men are scarce in relation to the demand, profits will be high. On the supply side, too, one must consider the costs of the entrepreneurs; and if the risks of business are enhanced by uncertainty, by difficulty of organizing the other factors, and so forth, profits must be relatively high in order to maintain the force of entrepreneurial ability which is demanded. To sum up, the rate of profits tends to be such that, in view of the quantity of entrepreneurial ability available at any given time, the share of the gross income which entrepreneurs get just compensates them for their costs, — just equilibrates demand and supply.

This way of explaining profits is not in conflict with that which is often taken by the business man. When the business man figures his profits simply as what remains of the gross income of the business after all expenses are paid, he is virtually taking his gross income for granted. To say that this income is due to the cooperation of all the productive factors jointly is correct, if the element of organization and direction which the business man himself contributes is included. But unless this element, with its attendant risks, is allowed for, no adequate explanation of the gross income is forthcoming. The same reasoning also applies to expenses. To dismiss profits as a residuum of scraps of net income which in some haphazard fashion are left over from various sources is no explanation. One gets the same result if one looks at profits in either of these two ways, but the second way of solving the problem throws little light upon the questions — why are profits what they are? why must they be paid?

Importance of Business Relations. — Having thus outlined the nature and functions of entrepreneurial ability, this introductory analysis may well be concluded by returning to the subject of business organization in general. The significance of the purely "business" part of industry has seldom been discussed, for its separate significance is the result of a relatively recent development, a development in the nature of a division of labor. Time was when the business enterpriser owned his plant and personally directed its operations.

He knew the details of the business from A to Z. Industry was comparatively stable, for the markets were not so wide nor was either progress in process or change in taste so rapid as now. Not only this, but credit played a smaller part in business transactions, and the joint-stock corporation with its dependence upon mobile investment funds was not as common. The result was a closer relation between business management and technical management. Financial relations were simpler. There was relatively little opportunity for manipulation.

How different the business world of to-day with its "trusts" and Wall Streets, promotions and "melon cuttings"! Nowadays, we have a vast force of "business men" in a new and narrower sense. As already indicated, these men seek gain in buying and selling. They need know little or nothing of the technical processes of extractive industry, transportation, or manufacture. With large use of credit, with capital raised by "floating" transferable stocks and bonds, and with technical management in the hands of salaried managers, they run their businesses with their eyes on the stock markets and the financial columns. Markets are wider and less stable, financial relations more complex, and manipulation common. Technical management and business management are frequently separated, and the former is more dominated by the latter. Businesses are interrelated in a complex network of "pecuniary relations," to borrow Professor Veblen's suggestive terminology. These relations have become the sensitive means for transmitting "panics" and "booms." A new field for highly speculative and chance gains has been formed, within which by manipulative strategy business men may make and unmake the industrial balance. A relatively high degree of mobility characterizes the situation, and by shifting investments great changes may be wrought in the technical operations.

One instance may be cited to illustrate how these forces work. Many will remember how the "Sugar Trust," the American Sugar Refining Company, dealt with its rival, the Arbuckles. The latter company which had been engaged chiefly in the spice and coffee business began to compete with the trust in the refining of sugar. Immediately the trust retaliated by purchasing a plant which handled spices, and began vigorously cutting into that part of the Arbuckles' business. It forced an "understanding." Thus, through mobile investment funds and stock exchanges, technical manufacturing units are made subservient: the whole machinery for importing, manufacturing, and distributing coffee and spices was ready, and the trust through pecuniary power directed it at will. For further suggestions, let the reader turn to the recent hearings of the Pujo committee of Congress which investigated the so-called "money trust." Here he may learn how groups of financiers through control of financial houses can sometimes control the marketing of securities and the direction of investment.

While there are obvious limits set by material environment and technical conditions, it is interesting to reflect how, by shifting investments, the fundamental material side of production may be deeply affected by this buying and selling side.

In line with the foregoing conclusions is the fact that the forms of business organization which now predominate are working a profound change in the significance of property rights. The significance of private property has often been explained. We know that the pride of ownership spurs most men to put forth their best efforts in production. Direct ownership often begets an interest in the business or property, and diffuses technical and business knowledge. It means stability, economic and social: as the saying is, "make proprietors and you make good citizens." Now all this refers to direct ownership, — to personal familiarity with the property. What, then, must be the effect of a system which makes ownership indirect, and takes away personal contact with property? And is this not the effect of reducing business property to ownership by "stockholders"? The holders of the shares of a joint-stock company need know little of their property and can take little personal interest in their products. They are too far removed from the property. And what shall we say of a "holding company" in which shares of stock represent ownership of other shares in subsidiary

corporations; those shares, in turn, represent ownership in sub-subsidiary companies; till finally, by a devious route, we reach the tangible technical property? The result must be a vastly different relation between owner and property, and the institution of private property itself must change in significance as the scope of ownership by shares grows. The more readily transferable the interests in property (stock certificates), and the more permanent and distinct the business organizations (corporations), the stronger becomes this tendency.

We see here a transformation which is analogous to that which took place in industrial technics when handicraft was supplanted by machine production. Indeed, it is the "business" aspect of the same evolution. The single business enterpriser and the ordinary partner are, so to speak, the handicraftsmen of business. As with productive processes, so now with property, there is less stability and more flexibility. Sentiment is either less influential or of a different sort. Interest in the thing concerned is less personal. More than ever, "business is business."

We should not forget that this transformation has its beneficial features, just as the industrial revolution had. While technical processes and ownership are both becoming more roundabout, the possibilities of diffusing goods and property are becoming greater. Few men can own factories, but many can own a share of factory stock. And if the many have some voice in the affairs of the organization whose stocks they hold, need they lose all interest in property and products? Truly, the transformation has great potentialities for good or for evil, and it should be the aim of the statesman to retain the interest of the mass of stockholding proprietors in their real productive property, and to insure such a democratic conduct of corporate affairs that corporate shares may become the means of diffusing property and of democratizing business.

Chapter II: Classes of Business Organization, Their Evolution, and the Tests of Efficiency

It is no simple matter to understand and discuss business organization, even when the purely economic point of view is taken and attention is confined to forms of business units. Something must be left out. Some basis of classification must be adopted and followed at the expense of other bases. It is the purpose of this chapter to mention several classifications and to discuss them briefly before passing to a fuller discussion of the one selected for detailed treatment. Also, the general tests which have operated in determining the evolution of the forms of business organization and which may be applied in judging their efficiency to-day will be outlined.

Classes of Business Organization and their Development. — 1. Size of Establishment. — The most obvious point of difference in business units is their size. Large business units came first in foreign trade and banking. In the former industry relatively large risk-taking ability and capital have always been required. Operations must extend over a great territory and a long period of time, and accordingly the joint-stock plan of raising capital was very early applied in this field. Banking and insurance, too, require great funds to insure the public against loss, and have always been associated with relatively large-scale operations.

But when one turns back into history, going to the seventeenth century in England and to the eighteenth in America, one finds none but small business units in manufacturing and agriculture. The typical unit was the family and the typical market, if it can be called a market, was the family or immediate locality. Toward the end of the eighteenth century Alexander Hamilton referred to American industry as "a vast scene of household manufacturing." Though early in the eighteenth century there were in England some few large establishments in the cotton and silk industries which employed a hundred or more men under one roof, it was not until the importance of capital was realized that large-scale business units became common. This development came with the invention of machinery and the application of mechanical power. These new factors made it economically necessary to divide labor, and to utilize as fully as possible the expensive machines and the buildings required to house them. In England the big factory came in late in the eighteenth century, beginning in the cotton industry; but its rise was retarded in America. The census of 1900 truthfully observes: "It seems probable that until about the year 1850 the bulk of general manufacturing done in the United States was carried on in the shop and the household, by the labor of the family or individual proprietors, with apprentice assistants, as contrasted with the present system of factory labor, compensated by wages, and assisted by power."[3] The chief exceptions were in the New England towns like Lowell and Lawrence, where cotton mills of considerable size were established as early as 1830.

Although one must be extremely careful not to imagine that any establishments just like the average

are actually to be found, and not to forget the great variety of sizes and kinds of businesses that exist, still it is of some significance to note the change in the size of the average manufacturing establishment which is indicated in the figures which follow:

Census Date	Amount of Capital	Number of Wage Earners	Value of Produce
1850*	$4,300	7	$8,200
1890*	18,300	11	26,000
1900	43,200	22	54,900
1910.	64,800	25	76,900

* Figures include hand and neighborhood industries.

One may form a rough picture of the average manufacturing establishment of 1850 having a capital of $4300, employing 7 wage earners, and turning out products valued at $8200. Over against this may be put the establishment of 1910 with its capital of $64,800, its labor force of 25 men, and its output valued at over $76,000. In contrast with Hamilton's characterization one may put the words of a living economist: "The typical unit of production is no longer a single family or a small group of persons working with a few cheap, simple tools upon small quantities of material, but a compact and closely organized mass of labor composed of hundreds of individuals, cooperating with large quantities of expensive and intricate machinery, through which passes a continuous and mighty volume of raw material on its journey to the hands of the consuming public."[4]

The thirteenth census of the United States reported that in 1909, out of a total of over 268,000 manufacturing establishments, slightly over 3000 made products valued at $1,000,000 or more. These *very large establishments formed* 1.1 *per cent of the total number.* This was an increase of 0.2 per cent over 1904, when they equaled 0.9 per cent. The medium-large establishments, which produced products valued at from $100,000 to $1,000,000, formed about 10 per cent of the total number in both periods, while those which produced to the small amount of $5000 or under made about one third of the total number. This makes a little over 3000 of the very large establishments and 93,300 of the very small establishments, with such increases in each class that the percentage each forms of the total number has not changed much of late years, — a fact which seems to show little tendency towards concentration in large businesses. It is not numbers that count, however, but output.

On this latter score we find that the 1.1 per cent of very large establishments employed 30 per cent of the laborers engaged in manufactures — nearly one third —and contributed over 35 per cent of the value that manufacturing added to the value of the raw materials used. Here is striking evidence of the great concentration of manufacturing in very large establishments! Nor is this all. The percentage of output coming from such establishments is increasing. The very large establishments produced 38 per cent of the total value of products in 1904, while, as just indicated, they produced nearly 44 per cent in 1909. The next census may show that 2 per cent of the number of establishments produces 50 per cent of the value of products!

Another indication of the trend of developments is seen in the fact that during the five years 1904–1909 the average value of products per manufacturing establishment increased from $68,400 to $76,900. Because of a great increase in the number of laborers in small establishments the average number of wage earners per establishment remained stationary at 25 during this period.

A more general indication of the movement in this regard is found by comparing the increase in number of establishments with the recent increase in capital, employees, and the value of products. If the former

item increases less rapidly than the latter ones, a larger average establishment may be inferred. The facts are as follows:

Five-year period	Increase in number of establishments Per Cent	Increase in capital Per Cent	Increase in wage earners Per Cent	Increase in value of products Per Cent
1899–1904	4	41	16	30
1904–1909	24	45	21	30

During the decade covered by the statistics, value of products increased 60 per cent, but there were only 28.4 per cent more establishments at the end than at the beginning.

The situation is similar in the case of railways. There were 1224 operating roads in 1900; in 1910 there were 1306. Meanwhile the railway mileage increased from 193,300 to 240,400, with a tremendous increase in tonnage. The insurance business also shows an increase in the size of its business units.

Taking banking as a whole, however, the average unit establishment does not seem to be increasing in this country, on account of the large number of young, growing communities; but there is a marked tendency to large-scale banking and big establishments in the "reserve cities," and in the older European nations. Agriculture is still the home of the small business unit, the latest statistics showing a smaller average acreage per farm for 1910 than for 1850. The average value of all farm property has increased greatly, but this is largely due to increases in land values, the amount of capital used in farming being relatively small.

The manufacturing industries in which in 1909 very large establishments clearly predominated, together with the percentages of the value of the products made by such establishments, are as follows: smelting and refining, lead (99.2 per cent) and copper (99 per cent); iron and steel, steel works and rolling mills (91 per cent); petroleum refining (88 per cent); iron and steel blast furnaces (85.8 per cent); slaughtering and meat packing (85.8 per cent); railway car manufacturing (80.7 per cent); liquors, distilled (72.5 per cent); automobiles (68 per cent); agricultural implements (64 per cent). If statistics were available for sugar refining, that industry would undoubtedly appear in this list.

Conditions Determining Size of Establishment. — In concluding this brief statement of the facts and tendencies as to the size of business units, it is fitting to analzye the factors which determine the scale of business. It is no mere chance that in some industries there are many large business units and in others not. According to pretty definite conditions within and without the industry, there is a certain size of establishment which will give the maximum efficiency of production, and toward this size all establishments *tend.* Chance and the character of the entrepreneur may, of course, modify this tendency.

At the outset care must be exercised lest we confuse two separate problems: the problem of *large-scale production,* and the problem of *combination.* The former concerns the size of the single industrial plant, and the plant and the business organization are conterminous; the latter concerns the size of a group of industrial plants combined under a single business organization, and here the plant is narrower than the business organization. Both are problems of business organization, but the question of large-scale industry is more closely connected with industrial technique, while combination is more a matter of management and finance. We will first consider those conditions which affect the size of the simple operating plant, or establishment — the question of large-scale production.

A. *Simple Establishments.* — In any particular case two groups of conditions determine the size of the establishment: I. The capacity of the entrepreneur, and II. The industrial conditions outside the entrepreneur,

including the nature of the industry and the character of the market.

I. The first condition stands alone as opposed to all extra-human factors. It is, so to speak, a subjective condition. The qualities requisite in a successful business enterpriser were indicated in the preceding chapter, and it is clear that according to the degree in which a man possesses such qualities his capacity to direct a business unit will vary. The larger and more complex the unit, the greater will be the capability required. As an entrepreneur, or business enterpriser, enlarges his business establishment, his powers are more and more taxed, until he reaches his limit. His direction becomes more remote from the details of his business and at the same time more diffused, so that sooner or later it becomes impossible for even the greatest Napoleon of industry to secure further economies by enlarging his establishment. Executive committees or "finance committees" may be put in charge, but this is apt to bring a lack of unity in direction which diminishes efficiency. One conclusion from these facts is that at any given time the size of the average business establishment is limited by the average capacity of the existing business enterprisers.

II. Under the head of industrial conditions comes a large number of interesting factors, some of which are within the industry and some outside in the market. These factors may be discussed under the following heads: nature of materials, nature of productive processes, nature of product, and nature of the market.

1. *Materials.* — Industries differ greatly in the nature of their raw materials and the proportion of their expenditures for such materials. To some extent this is a factor in determining size. The ease and expense of obtaining materials affect the size of the establishment. In some cases, if the material is bulky, the scarcity and localized character of the sources of supply cause large plants to prevail, as is the case in the paper and wood-pulp industry, and to some extent in the tanning of leather with its use of tanbark. In the latter case the high specific value of hides facilitates concentration. Where the supply is limited in area or necessarily involves large transportation expense, and, at the same time, *the percentage of total expenditures for materials is high,* the tendency will always be toward the predominance of large plants. This may be explained on the ground that here large investments in circulating capital are required to buy and handle the large quantities which economy dictates. It is an interesting fact that census figures show a very high percentage of expenditures for materials in the great majority of businesses in which large-scale production is predominant,[5] and a correspondingly low percentage in industries characterized by relatively small establishments.[6] With relatively few exceptions the big establishment industries are of the smelting-refining-slaughtering type and have a direct dependence upon extractive materials.

It is very desirable in such cases to acquire control of the sources of supply, and this can only be done by large units. Moreover, great economies lie in large-scale handling of ore, grain, and such bulky, durable materials by tram, crane, and other mechanical devices not available in smaller plants. On the other hand, when the raw material is not bulky and has a high specific value, that fact may facilitate concentration and large-scale production induced by the other factors mentioned. Such a condition is illustrated by the boot-and-shoe and leather-goods industries whose raw material consists of hides.

In some cases the refractory or resistant character of the material may necessitate large investment in machinery.

2. *Processes.* — As to the methods and processes of production, the chief conditions are: the complexity of the industry, its potentiality for specialization and division of labor, its potentiality for integration and utilization of by-products, and its adaptability to machinery, (a) Obviously where the industry is simple in the sense that it lends itself to routine methods it will be relatively easy, other things being equal, to direct a large establishment; but where great complexity and variety of process abound, the point of maximum profitable size will be sooner reached. It has long been recognized that banking, insurance, and transportation furnish examples of routine industry, whereas agriculture and retail trade show great variety of process.

Accordingly, large-scale business came very early in the former industries, (b) The possibility of specialization and division of labor is a very important factor on the industry side. The greatest division of labor is only possible in the largest plants. In order to allow that minute specialization which brings the maximum skill and best utilization of each individual's capacity, it may be necessary to subdivide the process of making a single article into scores of steps or sub-processes; and this can be done only where the output and the number of employees are large. In a small establishment, one man may slaughter the cattle and prepare the beef; but in the large and efficient packing house many groups do the killing, removing hides, cutting up carcasses, and so forth.

(c) Closely related to division of labor is the question of potentiality for integration and utilization of by-products, but here we deal with a union or composition rather than a division of labor. Of course, the labor will be divided as it is integrated. Many establishments are confined to one branch of industry like the manufacture of steel from iron. If, now, there are great economies in an integration which will bring the mining and smelting of iron ore within the same business unit, that development will probably come. So it is with by-products. In the petroleum industry, for example, great economies have been effected by the saving of such products in the shape of volatile oils, residual materials, and dyes,—savings which only production on a large scale could have made profitable. The same results have been gained in the industry of slaughtering and packing. (d) The adaptability of an industry to machinery is interwoven with such points as complexity of process and division of labor, as well as with market conditions, and in many instances is only an external sign of the large-scale production. But it has its separate significance; and when machine methods can profitably be applied, the business establishment is apt to be large.

3. *Products.* — The character of the product that is turned out by the plant is of primary importance in determining the size of that plant. The industries of ice making and pie making, furniture making, dressmaking, and cigar making, will wait some time for the era of the giant factory. In the first two cases, the commodity is perishable; in the second, it is not sufficiently portable; in the next, the article is so changeable under the dictates of fashion as to defy standardization for large-scale production; cigars, unlike cigarettes, are of such a construction that manufacturing by power machinery cannot be successfully applied in making the finer grades. Other instances occur in the case of artistic products such as lace, oriental rugs, pictures, and the like.

In all cases in which the establishment furnishes a service which must be used locally in connection with the plant a peculiar condition arises. For example, the statistics of the printing and publishing industry show little if any tendency toward concentration, largely because of the great numbers of newspaper publishing establishments whose products are wanted only by the local communities. If the industry is one that tends to monopoly, that tendency will be facilitated within the locality, as is the case with gas, electricity, and street railway transportation; and the establishment will be relatively large. Otherwise, the business unit which produces local consumption goods will be relatively small.

Doubtless the ability to standardize products facilitates the building up of large establishments: when the commodity can be easily graded and marketed in a uniform manner, large-scale methods can be adopted where a widespread demand exists. This is the case with petroleum, salt, sugar, and whisky, and the standardization of machine parts has made the manufacture of machinery a large-scale industry.

4. *Markets.* — The nature of the market, as determined by the character and number of consumers, reacts upon the size of the business unit in several ways, (a) For one thing, the area covered is of some importance, as it will ordinarily require a larger unit to handle an extensively scattered business. (b) The quantity demanded has an obvious influence. (c) The complexity and (d) the stability of the market also have their influence. If the demand is large and stable, the opportunity for business on the largest scale is good.

Great stocks may be accumulated, and a large, well-organized plant be run on full time. This has been a characteristic feature of the development of large scale manufacturing in the great staple industries of to-day: cloth, iron, boots and shoes, leather, paper, and others. If, moreover, the market is simple in that it is rather uniform and does not require careful and minute attention, the tendency to large-scale production is facilitated. It is to be remembered also that these factors act to encourage the use of machinery and the division of labor, which use, in turn, reacts to encourage large units.

Certain economies in selling are also to be mentioned in connection with market conditions. When advertising is a large factor in marketing the product, there is a *tendency* to large-scale production, though this tendency need not necessarily work itself out fully. The reason is that the larger the output, the less the cost per unit for the advertisement: it costs no more to advertise the products of a big firm than those of a little one. So it is with salesmen: a given number can attend to a given territory regardless of the quantity sold. It has been one of the economies of large industry to dispense with much commercial traveling. Finally, a large establishment can fill orders more promptly and carry a more varied line of goods than a small one. In many cases this fact helps determine the size of the business organization.

B. *Compound Establishments.*—The problem of combination arises out of a tendency to form large business units by federating existing establishments, while retaining their separate existence as operating units. Such compound establishments are the "trusts" and combinations of the day. It goes without saying that such compound organizations are generally larger than simple ones, and that the discussion is incomplete until just a word has been said about the factors which determine combination. We return to the subject elsewhere in this volume.

In general, the conclusion must be that three, desires are the chief active factors in bringing about combination: the desire (1) to save the wastes of competition, (2) to acquire monopoly power, and (3) to make the economies of large-scale production. The last factor has just been treated, and most of what was said about its working in the simple business establishment will apply to the combination, — except that in the combination the large-scale is obtained by federating different plants and specializing by plants. Furthermore, combination is generally resorted to to secure production on the very largest scale. It is probably the first factor, the elimination of competition, that is the real moving force in a majority of cases.

Without attempting a careful analysis of the wastes of competition at this point, it may be said that the chief ones are the acquisitive expenses of advertising and salesmen, and the uneconomic use of plant. Under the latter head come the wastes of duplicated plants, — especially the fixed capital part, — leading to burdensome fixed charges on all competitors; failure to use the most productive devices, and suppression of patents; waste transportation and needless "cross freight" bills; and irregularity and idleness, leading to incomplete utilization of capital and skill. Such is the case against competition as it often works, and the preceding points outline the forces' that tend to cause the formation of large *compound* business establishments.

The desire for monopoly power is an interesting cause of combination, but is one which may be more logically discussed in later pages. The pessimist is apt to assert that most combinations are impelled by that desire rather than by the effort to make economies and save wastes. Certainly this is sometimes the case; and it must be recognized as a distinct cause of combination; also desire for gain on issues of watered stock.

The census of 1900 attempted to present statistics of combinations, and the results are not without interest. There were found to be 185 "combinations"[7] in manufactures, controlling 2160 separate plants. These plants formed a little over 0.4 per cent of the total number of establishments; they employed over 8 per cent of the total number of wage earners; and they were reported to have turned out over 12 per cent of the value of all manufactured products. By far the largest number (489) were in the iron and steel industry, with

a large number in "food and allied products," chemicals and allied products, and "liquors and beverages." The census of 1910 will certainly show a larger proportion of products turned out by combinations or "compound establishments."

2. Relative Importance of Factors of Production in the Establishment. — If we regard the business unit as a complex of land, labor, and capital, operating under the direction of entrepreneurial ability, we may find another basis of classification in the relative importance of these factors within the unit. Which is the dominating element, — land, labor, capital, or entrepreneur? One great development has been in the increasing relative importance of capital; and to-day two great classes of business units may be distinguished on this basis: the shop-handicrafts class and the factory-machine class, the former being often regarded as a survival of early days.

From the point of view of evolution, one may see at least four stages and as many types of business organization. First came the primitive household stage. "The industrial family, owning the raw material and the requisite tools, and working with the power of their own bodies in their own houses, produce commodities for their own consumption."[8] Here, in one sense, there was no question of dominance of any factor; but capital was relatively unimportant and could have been produced by an individual's labor time of a few months at the most. Such a productive unit — it can hardly be called a business unit — can now be found only on the receding outskirts of civilization.

Next came the gild system and handicraft production. Primarily the gild was a means of regulating the business units of medieval times; but it was associated with a characteristic type of unit organization, which differed from the preceding type chiefly in that family lines were less closely followed, more capital was used, and the entrepreneur's function emerged more clearly. The master workman who directed the business organization owned the capital and worked at the trade along with his journeymen and apprentices. Human power was still mainly used, and, as goods were produced only as ordered by customers, no great stocks were maintained. Thus both fixed and circulating capitals were small, and relatively unimportant. As has been well observed, "The size of the representative firm under a system which compelled the master to be a skilled artisan, a shrewd financier, and an able salesman, but insisted on each article bearing the impress of his individual skill, must of necessity have been very small."[9]

The "domestic system" which followed is characterized by the fact that the workman owned his tools and simple machines, and worked at home, whereas the marketing of the product was done by a middleman. Gradually the workman became dependent upon the merchant middleman for his raw material, and the same condition began to appear in the ownership of such simple machinery as existed, *e.g.,* the "frames" used in weaving stockings. But the domestic system flourished in the pre-machinery era, and, although some small developments occurred, fixed capital still played a slight part. Furthermore, the markets were narrow and processes slow, so that circulating capital in the shape of stocks of materials and products were also small. Labor still predominated on the whole, and small business units held their own.

The transition to the "factory system" came in the middle part of the eighteenth century. The business unit under this system is characterized by the relatively important part played by capital, especially fixed capital in the shape of machinery and buildings, by a wage-earning class which is almost divorced from the ownership of capital, and by an employing entrepreneur class which is closely connected with the ownership of capital. With the separation of labor and capital the entrepreneur's function of coordinating the factors became more important.

Perhaps the time has come to distinguish a fifth stage, the stage of combination or the "trust system." In this stage the business unit is generally compound, and while it embraces more capital then ever, the entrepreneur—the promoter and director—is the dominant factor. The capitalist class is more and more

separated from any direct participation in the direction of industry.

A glance at the census figures reveals recent tendencies as to relative amounts of labor and capital. Since 1850, both value of capital and cost of materials used in manufactures have pretty steadily increased at a far more rapid rate than the number of wage earners and the total wages.[10] This is the tendency, taking manufacturing as a whole. But still one may see all the types mentioned above: handicrafts system in the various "custom" trades, cigar making, farming, etc.; domestic system in the clothing industry; simple factory system in most manufacturing; "trust system" in iron and steel, petroleum refining, sugar refining, etc. Moreover, within the factory system industries, labor forms a relatively more important part in the organization of some than in others, and the same is true of the capital factor. On the last point, the following statement of the census bulletin just referred to is of interest: —

> "Some of the industries that hold a very high rank in gross value of products rank comparatively low in the number of wage earners employed and in the value added by manufacture. Where this is the case it indicates that the cost of materials represents a large proportion of the total value of products, and that therefore the value added by manufacture, of which wages constitute usually the largest item, is not commensurate with the total value of products. Thus the slaughtering and meat-packing industry, which ranks first in gross value of products, and the flour-mill and gristmill industry, which ranks fifth in that respect, both hold a comparatively low rank with regard to number of wage earners and value added by manufacture. The blast-furnace industry, the smelting and refining of copper, the manufacture and refining of sugar and molasses, the manufacture of butter, cheese, and condensed milk, the refining of petroleum, and the smelting and refining of lead are other industries which rank much higher in gross value of products than in number of wage earners or the value added by manufacture.
>
> "There are several industries the rank of which according to number of wage earners and the value added by manufacture is decidedly higher than the rank according to value of products; in other words, the cost of material is relatively a smaller part of the total value of products for these industries than for most others. Among the industries of this class are the making of women's clothing, the manufacture of automobiles, furniture, electrical machinery, apparatus, and supplies, hosiery and knit goods, silk goods, and agricultural implements, and the confectionery and marble and stone work industries."

It will be observed that the industries having the highest concentration in large establishments generally have the highest proportion of capital.

Relation of Labor and Capital to Direction. — So much for the relative importance of labor and capital. It remains to note that in none of the types discussed so far, has the entrepreneurial function or the direction of the business been placed in the hands of labor. It has not been associated with wage earners. Beginning with the handicrafts system, where we find production for gain, which is business proper, always there has been at the head of the business an employer who has been the owner of more or less capital or allied with the owner thereof. Always, in a more or less distinct fashion, allowance has been made for expenses of labor, capital, and land, and anything left over has remained as profits in the hands of an individual or group of individuals who have not been mere wage earners. In no case has a type been maintained in which, after the rise of a wage-earning class, labor and directive ability have been combined. All this is to say that the industrial types so far mentioned have been types of entrepreneurial business organization.

But there is another way of organizing the factors which is called productive cooperation, and the cooperative unit must be set over against the entrepreneur unit. In the cooperative organization the business is managed by one elected by the wage earners. With their own or borrowed capital, a group of laborers form

a business unit. They choose a manager. From the total income of the business they pay the manager, the interest on capital, the rent, and then, if anything remains, it is shared among themselves. In this way the conflict of interests between labor and capital is removed by making labor the controlling element and associating the direction of the enterprise with it. Productive cooperation has met with little success, and the number of business units organized on that basis is relatively small. It has worked in a few cases where industrial processes were simple, where labor was more important than skillful direction and management, and where the market was stable and easily gauged. But when these conditions have not existed, cooperation has shown serious defects in the motivation of the entrepreneur function: its councils have been divided and its managers have been underpaid.

As to socialistic and communistic units, they can hardly be called business organizations, save in the case of a communistic community like Amana, which as a unit carries on industry for gain. In such an organization, land and capital are owned by the whole community, and direction on a democratic basis is provided for through the election of directors by popular vote. Here the entrepreneur function is fundamentally modified by delegation and the representative principle, and lacks much of the stimulus of private initiative. All socialistic schemes aim to make labor the dominant factor; but in reality they necessarily tend toward a diffusion of the functions of the various productive classes throughout society, as they make each individual at the same time a laborer, a capitalist, and, to the extent of his vote, an entrepreneur.

3. Classes of Business Organization as to Complexity. — Something has already been said of the differences in complexity of organization that are found among business units, and such differences are related to differences in size. The development of industry has been accompanied by a differentiation through specialization in function and structure, and by an integration through combination of related stages of production. In the earliest stages of business development, the unit was *simple and unspecialized.* The blacksmith made the whole tool and the carpenter the whole chair. On the other hand, these same men combined such occupations as agriculture, candle making, and brewing with their other activities; for just as there was little specialization, so each unit in undifferentiated solution contained numerous potentially separate occupations. In the course of time these occupations were precipitated as separate trades, and then ensued the era of *trade specialization.* Specialization by trades began in England about the handicrafts period and continued to increase well down to the present day. Separate business units arose from each trade or occupation. At the same time a twofold process was taking place within the unit; for, on the one hand, there was an increasing subdivision of processes, and, on the other, a massing of processes or trades in larger establishments. On the whole, however, specialization and division of labor were the dominant aspects of business organization during the eighteenth and nineteenth centuries. More recently we have reached the stage of *integration by industries,* in which, while differentiation through division of labor goes on apace, the distinguishing characteristic is a combining of the stages of production within great branches of industry under a single direction and management. Under this same characteristic, the concentration of closely allied processes should be treated. The general trend of development, then, has been from unspecialized simple units, through units increasingly specialized by trades, to units highly integrated by industries. As in biological evolution, differentiation and integration have gone hand in hand. And as business organizations have grown larger, they have grown more complex.

It is clear that complexity depends upon the twofold process of specializing and of combining. The reason for specialization or division of labor hardly needs discussion here. Common information covers the advantages of splitting processes up so that machinery and special skill can be utilized to the largest extent. But, as yet, less is known of the integration side of complexity. Integration, or industry combination, has two chief objects. In the first place, by integration producers seek control over their raw materials, and, in the

second place, they seek control over markets. In addition, of course, the general economies of large-scale operation may be gained. By integration, the United States Steel Corporation, which is perhaps the most striking illustration of this development, gains control over the supply — and so a partial control over the price — of ore and other raw materials. These materials it assembles by means of its own transportation agencies, smelts in its own furnaces, changes to steel in its own converters, and finally rolls, hammers, and draws into rails, plates, and wires in its own mills. It can insure a steady stream of materials throughout the entire chain of plants, thus using its labor and capital more economically. Waste, through cooling and reheating, and deterioration between stages, is reduced.

In a way, each stage in the chain is not only the source of the materials for the following stage, but is also the market for the preceding stage, and so illustrates both of the chief objects. But by control of the market is meant something nearer the so-called "ultimate consumer." By taking in pipe lines, refrigerator cars, warehouses, and storage plants, the marketing of the finished products is carried close to the consumer. This phase of integration is best illustrated by the establishment of retail shoe and cigar stores by big shoe factories and the American Tobacco Company, respectively. The great department stores of the city illustrate the same thing, and they frequently operate factories of their own to the profit of both industries. Economy of advertising may be a big item in inducing integration on the marketing side; for when the name of the business unit becomes favorably known, why not profit by attaching it to other lines of product? If such products are related, the result may be called integration.

Sugar, iron and steel, tobacco, petroleum, slaughtering and packing, liquors, etc., are illustrations of highly integrated manufacturing industries. Clothing, bread and baking products, leather, furniture, printing and publishing, cotton and woolen cloth, among others, furnish examples of less highly integrated industries. There are marked cases of integration in banking and insurance; as, for example, in the expansion of function by trust companies. In agriculture, however, there is relatively little occasion for specialization of organization by stages, and a proportionately small amount of business integration.[11]

4. Classes of Business Organization as to Degree of Association. — The classification of business organization which will be followed in detail in the succeeding chapters is based upon the character of association. In the simple individual-entrepreneur organization there will be no association. When partners are added, we have a simple association with some greater complexity of organization. Joint-stock corporations illustrate a still higher degree of association. But in all these forms the unit of association is the individual. Having developed the simple corporate form, the next step is the beginning of a new cycle, with compound units rather than individuals. Accordingly we find agreements and pools arising, then trusts and mergers; until finally we come to the securities-holding company — a corporation of corporations.

The Tests of Efficiency of Business Organization. — What have been the tests of efficiency which have determined the development and survival of the different forms of business organization? What are the tests for judging their relative efficiency to-day? The general test of economy is too indefinite for easy application. We may subdivide it into some five or six more particular and specific tests, as follows: —

1. *Facility of Formation.* — At the outset, the question of the ease of setting up in business differentiates one form of business organization from another. Aside from the question of raising capital, which is to be made a distinct test, there are questions of suitable associates, of expense, legal restrictions, etc. The problem of promotion is a big one nowadays, and one of the promoter's usual duties is to devise a suitable organization for his enterprise.

2. *Amount of Capital.* — With the growing importance of capital in production, it has become increasingly essential that the form of business organization shall be one that facilitates the acquisition of large amounts of that factor. To this end it must afford a maximum degree of security, and appeal widely to the

investing class. To be sure, where small capital is required, other tests may decide, but the preceding statement holds for industry as a whole.

3. *Liability.* — Closely connected with the subject of capital is the liability point. Risk is one of the chief elements in all business, and the form which will reduce risk to the minimum will most appeal to business men, when other things are equal. A certain amount of liability is essential in order to secure a proper motivation and direction of industry, and to insure those who deal with the business organization of fair treatment; but any greater liability than will attain these ends is undesirable from all points of view. Liability may be of two kinds: financial and legal. The former concerns economic responsibility in case of insolvency; the latter concerns juristic responsibility for criminal and civil offenses.

4. *Direction.* — Assuming that the capital has been raised, what efficiency will the form of organization, within which it is combined with the other factors, afford? The test of effective direction is in reality to be reduced to several subordinate tests. First, there is motivation, which concerns the intensity and directness of the stimulus to business activity. Then there are economy of operation, continuity of policy, flexibility of organization, to mention the more important points. By flexibility is meant adaptability to changing conditions, such adaptability being needed now for capital, now for membership, and again for centralization of management.

5. *Endurance and Stability.* — The degree of permanence of the various forms of organization varies considerably, and this is a matter of no small importance. It is important to the individual to be able to lay business plans for the future and to make investments running for considerable periods of time. To the society it is important that some agency should exist for continuing in uninterrupted life the undertakings upon which its members depend for the satisfaction of their economic wants. In order to satisfy these needs the organization must both be able when undisturbed to last through a long period of time, and also to resist temporary disturbing influence, — that is, be stable.

Finally, (6) a *legality* test may be mentioned. In every civilized society there is a changing body of legal rules which must be observed if the form of organization is to be most effective. A form of organization like the trust, for example, is obviously inexpedient because of legal conditions. Thus the law reacts upon economy. Indeed, from the association standpoint the various forms of business organization are, as such, children whose father is economic expediency and whose mother is the law.

That the foregoing tests may be applied both from the point of view of the individual — the "private point of view" — and from the point of view of society — the "public point of view" — must ever be borne in mind. In this volume we are primarily interested from the private point of view, but the other will by no means be neglected.

Book II: Evolution and Forms of Business Organization

Chapter III: Individual-Entrepreneur Organization

The individual-entrepreneur system, or the single-entrepreneur system, as it is sometimes called, is that industrial order hi which business is carried on mostly by individuals or families. The individual-entrepreneur form of business organization, accordingly, is an organization at the head of which stands an individual—or sometimes a family group of individuals—as the one who is responsible, who directs its operations, and who alone runs the risk of failure. Formerly the predominant kind of business unit, it is still common, and calls up the typical picture of the born business man whose sagacity, boldness, and organizing ability have put him at the head of a union of land, labor, and capital which he directs with the responsible initiative of a captain steering his own ship.

Two great logical stages in the development of the character of the individual-entrepreneur system are, apparent when its whole course is surveyed. In one, the entrepreneur is but little separated from the laborer and the capitalist; he combines three functions, and, according to circumstance, his function either as laborer or as capitalist may dominate. This condition was general in early handicrafts business, and is common among farmers and professional men to-day. Indeed, wherever, the business is small and produces for "custom" trade, it will be found that the entrepreneur's function is apt to have little *separate* importance. As business grows in magnitude, however, a phase of division of labor is evidenced by the emergence of the entrepreneur as a distinct and prominent factor. In this capacity he may own no capital and do no labor, but give his whole energy to organizing and directing the business. Then alone is he entrepreneur pure and simple.

Of course all degrees of difference lie between these stages; and a sort of halfway stage is illustrated by those industries in which a manufacturing entrepreneur is supplied with materials by a separate middleman entrepreneur who labors and uses his own capital and later markets the product. Such organization existed in the old "domestic system," and is found to-day in the clothing industry. In this way risks are divided, and ability is economized, in that the merchant does not have to supervise labor and materials, while the manufacturing artisan does not deal with the broader problems of marketing.[12]

The origin of business organization is to be found in the single-entrepreneur form as defined above, and the origin of the single-entrepreneur form as defined above is to be traced to the activities of the family. Doubtless the simply-associated group labor incited by the earlier clans or gens in hunting or fishing, might be mentioned; but this hardly constituted a business undertaking, and certainly in it there was no question of a gain through exchange. Such simple associations based on a rather broad blood relationship could not compete with a more specialized organization. Rather, it is the family with its closer union and more centralized control that has furnished the seed of business organization. True, the early family lacked the business motive, but it was a distinct and lasting organization which was effective in combining the labor of a group

and in collecting and administering a group property. It facilitated division of labor, while subordinating all to the control of the father. Thus the family is the seed out of which, as a money economy and exchange developed, sprang the business unit.

As already indicated, business undertaking of a simple embryonic kind came very early in agriculture and handicrafts. The great estates of the Roman aristocracy (the *latifundia*) show evidences of it; and the medieval monasteries sometimes produced and marketed a surplus. But custom and feudal rules long hampered such development, and it was not until the rise of a free labor class beginning in the fourteenth century in England, that we find much of the "business" element in farming. In the earlier cases, the undertaking was not on a basis of free contract, but was authoritative and generally carried on under more or less compulsion: at one extreme was slave economy; at the other, the normal dominance of the father of the family. A word about the latter may not be out of place, inasmuch as some remains of it may be found in backward rural regions even to this day.

The small farmer or peasant proprietor may market little or no produce. By long practice, however, he gains considerable skill and special ability for his work; and he is directly motivated by self-interest in all that he does. Control and discipline are provided for through the sense of duty and obedience of the family group. Moreover, such a unit has great capacity for adjusting expenses to meet the ups and downs of crop yield and prices. But the amount of capital and credit available is narrowly limited, and a notable lack of technical progressiveness is usually characteristic.

But to-day the "farm" is generally subject to the regime of free contract which prevails in the modern business world. It is one of the strongholds of the individual-entrepreneur system; and it must be remembered that in number of people affected and value of products, farming is the chief industry in the United States. Too frequently we forget the business aspect of agriculture, — indeed this is often forgotten by the farmer himself. To the economist, however, the farm is simply a going combination of land, labor, and capital, each of which factors should be used in such a proportion as to give the maximum net income to the farmer. Obviously, such a business unit will have a minimum size determined by the necessity of maintaining the farmer's family; while the maximum, barring speculative landholding, will tend to be set by the ability of the farmer. The exact size of the farm unit, in so far as determined by normal economic forces, will be limited by the value of the land, the entrepreneurial ability of the farmer, the character of the crop and soil, and the amount of labor and capital available. Small-scale farming, which is the predominant kind, illustrates that phase of single-entrepreneur organization in which the entrepreneurial function is not separate from the other factors, the labor element often seeming most important. But on the "ranch" or "plantation" one finds a business organization which rivals the factory in division of labor. Especially is this true where a single commodity is being produced, like cotton, wheat, or cattle. Thus, in such cases, the farmer may be nothing but an entrepreneur. He may even delegate active management to a superintendent who buys raw materials and supplies, supervises the planting, growing, and harvesting of the crop, and finally undertakes its marketing. As a rule, however, in this industry such careful adaptation of processes to the varying soil and weather conditions is required that the supervision of the entrepreneur is most economically limited to relatively small areas. It must not be forgotten, however, that a large amount of labor and capital may be applied to a small area of land, and that in such a case the farm is, economically speaking, a large one. This observation is of increasing significance in these days of rising land values; for the more valuable the products of a given quantity of land, the larger the amount of labor and capital — to say nothing of the entrepreneurial ability — necessary to secure the maximum return. All this is bound to bring into greater prominence the business-organization aspect of the farm.

The first simple beginning of the entrepreneur system *in manufactures* is found in handicraft produc-

tion carried on in the family by a master workman working alone or with a few helpers. Sometimes the wife and children help him, and his apprentices are virtually members of the family. His capital is small, consisting of his tools and raw materials; the shop and the house are one. He produces for custom trade and has a direct personal relation with those who consume his wares. The element of risk is small. Yet, withal, the entrepreneurial element is not absent; for does he not buy and sell for gain? Does he not organize his small labor force together with his stock of materials and tools for productive purposes? His success depends on more than his skill as an artisan: it rests partly on his ability to plan his business.

The men of the same craft early united to form the gilds which played an important part in the business organization of the middle ages. These gilds controlled apprenticeship and other relations between labor and capital; they limited competition and assured a market for products; they often aided in purchasing materials; etc. In this way the problem of the early entrepreneur was much simplified. But during the sixteenth century the gilds lost their power. Among other factors the growth of wider markets and the rise of the labor class put an end to such organization. Closely connected with these developments came an increase in the separate importance of the entrepreneurial function; for with the changes in markets and production there was put upon his shoulders the duties of organizing larger and more complex masses of labor and capital, and the greater risks attendant upon production for wide and varying markets.

It is worth while noting that to-day the numerous associations of retailers, and of the more skilled artisans, to some extent accomplish a part of the work done by the gilds, and this appears to be increasingly true.

The individual-entrepreneur organization whose nature and development have been thus briefly sketched has by no means vanished from the face of the earth. It now prevails in small local business, like retail trade, in agriculture, and in the professions. Furthermore, the handicrafts way of making things survives in such industries as blacksmithing, tailoring, baking, and many others; and here the single entrepreneur is common.[13] In fact, he persists wherever standardization of product is impossible, or wherever a personal relationship between producer and consumer is important, as in most professions.

A study of the census figures shows that the relative field of individual-entrepreneur business organization, while still considerable, is decreasing relatively to the corporate form. In 1900 the number of business establishments under individual ownership was over 171,000 and formed 63 per cent of all establishments. In 1904 the figures were 113,900 and 53 per cent, respectively, showing an absolute and relative decrease. The latest figures for 1909 show some increase in the absolute number of individually owned establishments and an almost constant percentage of the total number, 52.2 per cent. The same general situation is found in value of products, the proportion produced by individually owned establishments falling from 16 per cent in 1900 to nearly 12 per cent in 1904, and from, that point to 10 per cent in 1909.[14]

Advantages and Disadvantages.—The great advantages of the individual-entrepreneur organization may be summed up under two heads: (1) facility of formation, and (2) effectiveness of motivation.

(1) Obviously a minimum of resistance exists to the possibility of starting a business under this form of organization. It is applicable to all kinds of business, for it involves the grant of no special powers by the state and is open to all private initiative. A minimum of time and trouble is involved in its formation. Under this head, too, the element of expense may be noted: save for license fees collected by some States, it costs nothing for the individual to set up a business, and he does not have to pay the special taxes sometimes levied on the corporation, for example.

(2) As to motivation: the directness and intensity of the stimulus to industry are to be observed. A fairly exact relation exists on the average between effort and ability on the one hand and gain on the other. The judgment, energy, skill, and determination of the individual entrepreneur are put in a direct relation to his

profit or loss. Not only that, but he may act with a promptness and vigor which would be impossible in a more complicated organization. Without consultation or the sanction of others he may seize an opportunity or meet a crisis.

A further advantage may be found in the secrecy which the individual-entrepreneur organization facilitates. There is no large group of stockholders who might be interested in other businesses, nor is the state apt to require such information as in the case of some other forms. But if the proprietor chooses to operate under some such title as the "Model Laundry" or the "New Process Company" rather than under his own name, usually he must file information with the state, showing who actually carries on the business, and so let the public know who is responsible.

On the other hand, serious limitations attend this form of organization, (1) For one thing, the judgment and wisdom at the disposal of any individual are limited as compared with those which may be brought to bear upon problems of a partnership or corporation. It follows that the advantages of directness of incentive and promptness of action must, to some extent, be counterbalanced by the fact that the one head may not be so good as two.

(2) Again, the amount of capital which can be got together under this single-entrepreneur individual responsibility is decidedly limited. True, considerable amounts have been so applied in certain cases; but these are exceptional, and in no case could such large capitals as those of the big corporations of to-day be raised. According to the United States Census estimate for 1905, while over 52 per cent of all business establishments were owned by individuals, such establishments commanded only 7.6 per cent of the capital of all establishments. It is hardly necessary to state that this is partly due to the fact that the individual entrepreneur alone determines his business policy, the result being that investors cannot readily be induced to give their funds into his keeping, and he is generally limited to such funds as he may own or raise on his own personal credit.

(3) Indeed, another disadvantage from the individual point of view is the "unlimited liability" of the single entrepreneur: his debts run against his entire property and not merely the amount employed in his business. Thus he has strong inducements to "put all his eggs in one basket," for if he goes into several lines of undertaking, he makes each liable for the other, and so may increase risks. Thus, risk is concentrated in what, to the individual, seems a dangerous and uneconomic manner.

Social Point of View. — The permanence of any form of organization must be considered in judging its utility to society, though this consideration is also of significance to the individual. What is to become of the organization and of the wants which it served to satisfy when its leader dies, is an important question in the case of most successful business units. Both from social and individual points of view, then, it must be noted that the single-entrepreneur's life and health limit the duration of the business unit which he heads. The persistence and virility of the system now under discussion depend on the continued existence of a body of men having the rather high qualities demanded for the successful conduct of a business unit by a responsible individual. The principle upon which such continuity must largely depend is that of heredity and inheritance. But only too often the heirs are lacking in the requisite qualifications and the business falls into weak hands in the second or third generations. As Professor Marshall has pointed out, the son of the business man has special advantages in the shape of observing the conditions and problems of his father's business; he often inherits considerable capital; and he starts with an established machine and trade connections. But he lacks the discipline and stimulus of the earlier struggle, and history shows many cases of deterioration, with the result that the unit is either dissolved or else is perpetuated only through the agency of adopting new blood.

As to efficiency, and regarded solely from the social point of view, the gist of the matter is this: in the individual-entrepreneur organization society has a form of business which, assuming competition, insures

an efficient working of selective processes. This is true because of the direct relation between entrepreneurial ability and income which this form insures. Moreover, the unlimited liability, which is a part of the foregoing idea, means adequate responsibility to the entrepreneur's fellows in society. And the effective motivation means much for social productivity. But this selective process and this motivation can work only in a limited field; for under the individual-entrepreneur system the scale of production and the division of labor are so restricted that in many industries the most economical production would be impossible. The conclusion is that (1) this form will survive in that considerable field in which small capital is required and considerable personal liability is important, and that (2) its merits being what they are, society should insure to it a square deal in competing with forms having more capital and operating on a larger scale.

Neither economist nor statesman can afford to forget that the qualities of self-reliance, responsibility, and initiative are of great social importance, and that these qualities are developed among single entrepreneurs.

With reference to the question of permanence, Professor Marshall says, "The oldest and simplest plan for renovating the energies of a business is that of taking into partnership some of its ablest employees." Naturally, then, we turn next to an examination of the partnership form of business organization.

Chapter IV: Partnership Organization

Ordinary Common-law Partnerships: Definition and General Nature. — The broadest concept of partnership would make it include any *association* of individuals acting with a common purpose. In a more specific business sense the partnership may be defined as *the relation existing between persons who agree to carry on a business in common with a view to private gain.* Such an organization involves the combination of the property or skill, or both, of the members and the sharing of profits and losses in certain proportions. In general, there is no legal limitation on the number of partners, but English law provides that in most cases partnerships of over twenty members must become incorporated. The members of a partnership may be either natural persons, partnerships, or, in some States,[15] corporations.

The general characteristics of a partnership are as follows: (1) It is a contract relationship and does not require a franchise nor special sanction by the State.

(2) The partnership and the members who compose it are not legally distinct. For reasons which will appear later the law in general regards the "partners" and the "partnership" as one, and in theory does not recognize the separate existence of the partnership. It follows that, barring special provisions to be mentioned later, each partner can make contracts which within the scope of the partnership business are binding on the partnership and the other partners. Claims against the partnership, moreover, must be satisfied by suit against one or more of the members — at common law all the partners must be joined; and a claim upon one partner is a claim upon his fellows. Finally, the partnership is dissolved by the death or incapacity of any one of the members, or by the sale of his share in the business.

(3) A third general characteristic of partnerships is the "unlimited liability" of the members, although in special cases this may not be true of all members. Each member of a partnership is personally liable for the debts of the firm, including those contracts made by any of his associates on account of the joint undertaking, and when the firm becomes insolvent, he may be forced to pay the full amount of his property.

The thoughtful reader will at once observe the emphasis on personality that the partnership retains. It arises out of contract between persons, which persons are sued rather than the organization and are personally liable to the full amount of their individual property. We say that the partnership "retains" such an emphasis, because the individual personality might easily be dimmed in association and the main characteristics of the single-entrepreneur organization be lost. But in the form of organization now under discussion a remarkable combination of association activity and distinct individual personality is apparent. The individual is not submerged, but stands federated with his associates in a copartnership.

The law and business usage are somewhat at variance in their attitude toward the collective aspect of the partnership, or "firm," as this form of business organization is often called. Although, in case of liability for damages, the firm's property must be exhausted before the property of the members can be taken, and to

that extent the courts recognize the partnership as distinct from the partners, in English and American law the tendency has been to emphasize the individual personal element: in the abstract, at least, the firm has generally been regarded as a mere collection of individuals. According to the mercantile conception, however, the firm is looked upon as an entity having some considerable distinctness from the partners; and this view is taken by the law of such countries as Scotland and France. The underlying reason for the mercantile conception is the simple fact that the business of a firm is carried on as a unit and its accounts are kept as though it were a separate entity, which could be debited and credited in relations with the individual partners. The element of "good will" and the value of a firm name also play a part; for frequently a firm gains such a reputation for fair and efficient dealing as to constitute an important asset, the value of which would be impaired by disturbing the partnership. It is not to be wondered at, then, that business men, in their desire to retain this asset, have emphasized the entity aspect of the firm. Their attitude is perhaps illustrated by the common custom of having a retiring partner agree not to set up a competing business in the same locality for a year or more, and it appears in the transfer of good will in connection with the firm name. Business practice has not been without its affect upon the law. Some English decisions have virtually treated the firm as a distinct entity, and in England actions can now be brought against partnerships in the firm's name. Indeed, some American writers speak of the partnership as an entity, and some of the States by statute have authorized suits against partnerships as such.

In France and Italy partnerships may be formed by written agreement only, while in England and the United States the agreement may be oral. Generally, however, written articles of copartnership are drawn up, and this is always desirable. Such a contract should include statements of the purpose of the partnership, of the rights and duties of the several partners in managing the business and the powers of majorities, of the interest payable on advances of capital and salaries for services, and of the division of profits. As Conyngton puts it: "The plan of salaries drawn from the firm business for partners has several advantages. It not only affords a ready means of adjusting the varying claims of the partners upon the earnings of the partnership, but also reduces the amount which each partner draws from the firm for personal use to a fixed and definite sum. Also it makes more apparent the real results of the partnership undertaking." Too often salaries and profits are confused. Profits cannot be declared until after salaries have been deducted, the latter being an expense of the business. Sound economic policy dictates the closest possible relation between service and reward, and this can only be secured by (1) rewarding each class of service (labor, risk-taking, etc.) separately, and (2), within each class, rewarding each individual according to his contribution. In this way only can accounts show the true condition and earnings of the business. In this way only can doubt and distrust be prevented. In this way only can the maximum motivation be gained. Provisions concerning the dissolution of the partnership and the rights of the partners to carry on other business in competition with the firm are often included in the partnership contract. It is especially desirable that the articles should clearly define the scope of the firm's business, as this sets limits to the field within which the acts of any partner bind the others. By covering such points as the preceding in a carefully drawn contract, the partnership may be made far more safe and efficient than is often supposed.

This brief statement of the general characteristics of the partnership should not neglect the various forms which that type of organization may take. Thus there are "general" and "special" partnerships, the former comprising those which exist for the continuous exercise of a general line of business, the latter including only those formed to carry on a single and more special line of business, or a single transaction. Ordinary mercantile and professional firms illustrate the former class; partnerships to deal in a particular piece of land and syndicates to finance particular corporations illustrate the latter. The purpose of the special partnership being restricted, the powers of the partners are proportionally limited. The law also distinguishes

trading or mercantile partnerships from those which, like professional, brokerage, and farming firms, are non-trading or non-mercantile. "Commandite" and "limited" partnerships will be described below.

Origin and Development. — Without going into the details of the origin and history of partnerships, it may be said that the modern partnerships can be traced to the family. In Roman days the *societas* probably arose out of the need of a family group for administering an inherited estate in common; though later, voluntary contractual associations, also called *societates,* were formed for the purpose of private gain, and the Roman law of partnership became pretty detailed. The *societas,* however, in some respects resembled the corporation, and the modern partnership, as described above, does not descend directly from it. Rather it is to be traced to the small ventures in fishing, trading, and handicrafts carried on by family groups beginning at least as early as the eleventh century and reaching full development about the sixteenth century. Such partnership ventures reached their earliest complete development in the Italian cities; but everywhere the story is similar: Family groups, remaining together for various reasons, — sometimes limited land in cities, — held property in common, and, under the stimulus of a money economy and growing commerce, expanded their activities beyond the supplying of the group's needs and pursued an enterprise for common gain. As the members worked in common, with a common purpose, and all shared the risks and profits of the enterprise, the group name became personified, as it were, and each member was recognized as a representative or agent of the firm or company, — *cum-panes,* those who ate bread together. On their part, the members of the group came to look upon their common property as something in which each had a share, a view which was reenforced whenever independent property and income outside the group developed. Indeed, the capital used in the enterprise was early separated from the individual property of the members, and the debts of one member did not always make the other members personally liable, although those debts lay against such property as was held in common.[16] Just as, in early days, a "clan" as a body paid damages for personal injuries inflicted by its members upon others, so it was the idea that the *common property* of the household industrial group should pay the debts of a member. But gradually the present custom of holding each partner liable to the extent of his *individual property* developed, and here the question of origin and growth is not so clear. Perhaps individual personal liability also had some connection with the clan idea of personal responsibility for personal injuries. However that may be, it is certain that the growing commercialization of the group's activities was an important factor; for, ere long, family lines became less closely drawn, and, from including only blood relatives, the business unit extended its bounds to bring in skilled and trusted persons who were not relatives, until finally unrelated individuals came to form voluntary contractual associations to trade under a single name with a single capital. All this is illustrated by the familiar stories which tell of the medieval fathers, some of whom took one or more sons or sons-in-law into their business organizations, either to provide for the said sons' welfare or to perpetuate the business; while others brought in trusted apprentices. At the same time labor groups were organized, which in form were probably influenced by the family group, but whose membership was not held together by family ties. Not unnaturally the tendency was to demand more stringent liability of these more loosely knit organizations. Moreover, as credit relations developed, it became more important to strengthen the credit of the group by making its members personally liable. Certain it is that by the sixteenth century unlimited-liability partnerships had become the leading form of business organization.

All this came to pass under pressure of business necessity. Organization was needed for production on a larger scale. Larger capital and credit were required, and the individual-entrepreneur was unable to meet the situation. The necessary result was an association of individual entrepreneurs, and the most natural form of association was along personal family lines. This meant the partnership.

To-day, the partnership appears to be losing ground as a form of business organization. It is common in

retail trade and moderate-sized mercantile establishments; not a few small manufacturing businesses are conducted under the partnership form; and in the professions partnerships are still prevalent, though probably decreasing. Census figures show that in 1900 "firms" equaled 23 per cent of the total number of establishments and produced goods having a value which was 19 per cent of the total value of all products; whereas in 1904 firms comprised 22.2 per cent of all establishments and produced only 14 per cent of the total value of products. In 1909 the statistics indicated a continued decline: the number of establishments had fallen to 20 per cent though the absolute number had increased, and the proportion of the value of products had fallen from 14 per cent to 10.6 per cent.

Advantages and Disadvantages. — Inasmuch as the ordinary common-law partnership retains such a large personal element, it partakes of several of the characteristics of the individual-entrepreneur organization. Like that organization, (1) the partnership enjoys great facility of formation and is widely applicable to varying industries. Naturally, assuming the other factors to be equally available, it will be somewhat more difficult to get a group of men organized than to start with the individual; and the personal relationship involved tends to confine partnerships to men who are known and trusted; but, aside from these limitations, all that was written of the individual entrepreneur under the head of facility of formation will apply here. (2) So it is with motivation. So great is the risk arising from unlimited liability, so direct is the relation between effort and reward, so personal is the relation between partners, that the stimulus to production operates powerfully. Yet the association element is not without its effect in modifying the directness of relation between effort and reward, and cases of manipulation and fraud within the firm are by no means unknown.[17]

(3) Closely connected with the foregoing point is the "flexibility" of the firm organization. The partnership being a contractual relation, its objects, membership, and capital may easily be adjusted to meet varying business conditions.

(4) On the other hand, as an association the partnership has certain advantages coming from combined ability and resources. In some cases, and in some types of business, the possession of the combined judgment of several heads is an advantage. Furthermore, association allows some degree of differentiation and specialization, so that each partner may give his attention to that part of the business in which he is most efficient. But, historically, the most important advantage lies in the possibility of collecting greater capital than is possible under a single individual. It is not necessary to say that the resources of one man are more limited than those of many, and as larger capital became necessary, both in commerce and manufactures, partnerships grew in number and size.

(5) In this connection, it must not be forgotten that the great liability for debts which attaches to general partners gives the partnership excellent credit. Its borrowing capacity is not only increased above that of a single individual, but also it is greater in proportion to capital than that of corporations and other limited liability organizations.

(6) Finally, it is sometimes — not always — an advantage that the minority interest in a partnership may often secure adequate representation. A dissatisfied partner may withdraw and dissolve the firm, or, if that be undesirable, he may so hamper its affairs as to force his partners to buy him out. Because of this advantage in their position, minority partners are generally loath to have their firms incorporate.

The foregoing point suggests the likelihood of friction within the firm, and, as compared with the individual entrepreneur, (1) the chief disadvantage of the partnership lies in a frequent lack of *prompt* and *united* management. "Too many cooks" may spoil the business broth, and a divided council may act with indecision, though ordinarily in most questions of management a majority decides. And if the partners seek to meet this difficulty by delegating management to one of their number, they soon realize that their unlimited liability will not allow them to forego passing upon questions of vital significance to the business. All

this is on the assumption that the partners act in harmony and honesty; but too often this is not the case. Over 2000 years ago Aristotle wrote: "The partnerships of fellow-travelers are an example (of the difficulty in men living together and having things in common): for they generally fall out by the way and quarrel about any trifle which turns up." While a recent writer who is pretty pessimistic concerning partnerships concludes that, "Among a large number of persons there is almost sure to be at least one who would develop dishonest traits or prove unwise, and whose action would involve all the members in unfortunate complications."[18] In short, a serious problem in partnership organization is to secure harmony of interests in management.

(2) Thus, the number of partners being limited, the amount of capital which can be raised by a firm is also limited. Though superior to a single individual, it is inferior to more highly developed forms to be discussed below. Clearly, too, the common-law partnership makes no satisfactory instrumentality for collecting and handling the investments of a large number of people. With liability unlimited, investors who have not the capacity or the desire to participate in management could not afford to enter a partnership. Not only this, but a share in a partnership business is transferred with such difficulty that it presents disadvantages to many investors. Such a share can only be sold to a copartner, or to a stranger with the consent of the copartners, a condition which so limits the market that it may often have to be sold at a sacrifice. In this country, too, even after the sale of his share, a withdrawing partner is liable for debts to creditors whose claims were incurred prior to his withdrawal if those creditors are not actually informed of his withdrawal, and to other creditors unless constructive notice has been given.

(3) In fact, the liability of the individual general partner may , be regarded as excessive for most purposes. When the business unit embraced but a small amount of capital and business relations were very personal, the heavy personal liability for firm obligations was not so burdensome, and probably did good service in making possible wider business dealings. But now that trade and commerce on the largest scale are well established, and, moreover, require vast capital and extensive credit operations, the personal liability of partners may be increased beyond all reason. The larger the number of partners and the scale of business, the greater the partner's liability. This means a cumulatively concentrated risk. It may be said that on the score of liability the individual and associational elements have not been happily synthesized; for the gains are on the basis of association, while the risks remain on an individual basis. Doubtless the situation is to be explained on the principle that responsibility should be commensurate with power, and that as each partner may make contracts binding on the others, so he should be liable to creditors for all. But, whether considered as a deterrent against fraud or as an incentive to efficiency, one must conclude that something less than the partner's whole property would be adequate. Moreover, the property might not be adequate entirely to compensate the creditors; and, in any case, it is debatable whether the whole responsibility for the misjudgment should be removed from creditors. Would it not be conducive to the general efficiency to allow some part of the risk to be taken by those who deal with the partnership?

(4) The liability of partnerships to be disrupted is a disadvantage which must be set over against their flexibility. Any one of the following contingencies may dissolve a partnership: death, lunacy, or insolvency of any partner. Nor can a person retire from the firm or transfer his interest without thereby dissolving it. Of course this may not break up the business, for it may be carried on by the remaining members, or new ones be taken in; but, on the other hand, it may do so, and this fact increases the risks of doing business as a partner.

Limited Partnerships and Partnerships in Commendum. — Some of the objections to the ordinary common-law partnership are obviated by other forms of partnership organization, the chief of which is the "limited partnership," a form virtually identical with the Continental *société en commandite.* Probably no historical connection exists between the origins of the limited or commandite partnership and of the com-

mon-law form. Rather the two forms rest upon different principles, the limited partnership being based upon the association idea, and the other upon the idea of the individual personality; for, as we shall see, in the one the members may merely participate in profits and losses whereas in the other they are personally liable for the debts of the firm. In so far, however, as the adoption of the two in the United States is concerned, the limited partnership came in as a means for modifying a common-law liability which was proving excessive under modern conditions. The limited partnership was introduced into the United States from the French law early in the nineteenth century. It is characterized by having two classes of partners: "general partners" and "special partners." There may be one or more general partners, and the management of the firm's business is in his or their hands. Also the general partner is subject to the common-law liability. On the other hand, the special partners merely contribute capital and share in profits; not unnaturally, then, they are liable only to the amount of their investments. This arrangement enables men to invest in a business without assuming the entrepreneur's risks, and is thus a virtual recognition of the distinction between capitalist and business enterpriser.

Though very old, and similar forms are perhaps older than the ordinary partnership, this form of organization as found to-day is a creation of statute law, deliberately introduced into Anglo-Saxon countries as a modification of the common-law form to meet business needs. Acts providing for it generally require that the nature and location of the business, the names of the partners, the amount of capital authorized and paid in, and the amount of liability and its duration must be made public. The contributions of the special partners must be actually paid, and in cash.

The "partnership in commendum" which exists under the laws of Louisiana is virtually the same as the limited partnership, and it will be remembered that the law of that State is largely drawn from the Civil Law.

This suggests the *sociétés en commandite* found in those parts of Europe where the Civil Law prevails, and calls to mind the origin of the kind of partnership now under discussion. The distinctive word of the title comes from the Latin *commendare* (cum-manui-dare), meaning to give something into the hands of another. According to Roman law, one or more persons could give property (*peculium*) into the hands of a slave and trade through him with limited liability. The practice appears to have been extended to include trading through the agency of others than slaves. Then, with the development of the Italian cities as commercial centers, the *commenda* became a commonplace form of business organization. The *commendator* or capitalist partner supplied the funds or goods, while the *commendatarius* or active partner managed the venture. At first, such a relationship was entered into temporarily for a single voyage or similar enterprise, and the active partner invested no capital; but later, as business became more established and was prosecuted on a larger scale, it became more permanent and more highly organized. There might be several *socii stantes,* or sleeping partners, who merely contributed capital, while the active partner not only directed the business with unlimited liability, but also invested capital himself. The commandite partnerships of the present descend directly from these early forms.

As compared with the ordinary partnership, the limited or commandite form has certain advantages. While retaining the direct motivation management found in the common-law form, it furnishes a single direction of management which may act with greater unity and promptness. Moreover, it conies nearer to satisfying the wants of the investing public, and through its special partners a greater capital may be collected. Thus it affords a chance for an industrial leader who may have little capital to secure what he lacks and put his genius and energy at the service of society. On the other hand, (1) limited partnerships are criticized because of the great power given to the general partner. In the absence of fraud special partners cannot interfere in the management, with the result that the investor's interests may be abused, while it is difficult to withdraw without loss. (2) Moreover, while discontent on the part of the special partners is

common, in other cases the special partners may in practice exert considerable influence over the general partners, a situation which gives them a chance by collusion to defraud creditors. Thus such sums might fraudulently be paid to the special partners as to more than offset the property liability of the general partners, making failure profitable. The commandite has been used considerably in banking, but its use is decreasing. Writing on *The German Great Banks,* Riesser says of this kind of partnership: “If the manager dies, the business will have to be liquidated, which in most cases is not to the interest of the bank, or, if the agreement contains special provisions for this event, as is generally the case, the bank may become involved in great difficulties and annoyance until a suitable successor is chosen. The fact is that the commandite is essentially bound up with the person of its manager, not only in its success, but to a large extent in its very existence.” (Part IV, Chap. III, Sect. 3.) The limited partnership, then, will be found advantageous where a highly concentrated and responsible management is desired at the same time with considerable capital, especially if incorporation is not desirable either because of expense or regulatory provisions.

Other forms of partnership, so-called, like “mining partnerships” and “limited partnership associations,” are virtually joint-stock companies, and such business organizations are dealt with in the following chapter.

Social Point of View. — As contrasted with the single-entrepreneur form, the partnership follows the principle of adoption in order to perpetuate itself. The individual enterpriser transmits his business through inheritance, and not infrequently his personal ability passes on through heredity. The partnership, however, must *adopt* its children. Sometimes this causes a split in the family, but probably it affords a wider choice and one somewhat less likely to be affected by mere family ties. On the other hand, the danger of dissolution through incapacity of partners has been indicated. We must conclude, then, that while the partnership provides a somewhat better means of perpetuating itself, the existence of that self at any given time is more precarious.

The workings of motivating forces and of responsibilities are not so simple as in the case of the single individual’s business. The chance of gain, the spur of profits, is both limited and divided among the partners, whereas the responsibility or liability of general partners is “unlimited “; and the result is that the motivation works under the friction of excessive caution and divided councils. Moreover, motivation working through the partnership finds a field limited in much the same way that the field for individual business activity is limited; for the difficulties of management and raising capital restrict the scale of the business. Yet the fact that a large element of direct stimulus, coming both positively from a proportionate share in gains and negatively from a personal liability, is found in the firm, must not be forgotten. Nor is the further fact of an adequate financial responsibility to society to be overlooked.

Certainly the field for the common-law partnership has steadily decreased relatively to that for other forms of business organization. If, however, a word anticipating “some conclusions to be drawn in a following chapter may be presented here, the author would say that there is good reason to believe that the reaction against the disadvantages of the partnership may have gone too far in the direction of removing personal responsibility. There is something to be said for restricting the use of limited-liability forms of organization or for reducing the degree of limitation, and by the same token there are reasons for wishing that something like the limited partnership might be more widely used. To this end it would be well for the state to modify somewhat the restrictions which now limit the use of this form of organization.

Chapter V: Joint-Stock Company Organization

Among the shortcomings of the partnership as a form of business organization were found to be its limitations for amassing capital, its easy disruption, and its lack of facility for centralized management. To furnish the large capital, the complex but centralized administration, and the stable organization required for the vast and risk-filled industries of to-day, some new business machinery was imperative. In the present chapter we are to deal with one of the most important industrial inventions ever devised, — one which went a long way toward supplying the needed machinery. This is the joint-stock idea. In the United States we are accustomed to draw very little distinction between the corporation and the joint-stock company, for here most joint-stock businesses are incorporated; but such is not the case in England, for example, and at any rate it is highly essential to keep the joint-stock feature of our business corporations in mind as a distinct element not necessary to the corporation as such. What, then, is the joint-stock company as distinguished from other forms?

Definition and General Nature. — *A joint-stock company is a voluntary association of individuals for profit, having a capital divided into transferable shares the ownership of which is the condition of membership.* The essential economic features of the modern joint-stock company are: (1) the capital is divided into equal shares; which (2) are readily transferable; and (3) indicate the holder's part in the income of a business, as well as (4) his risk. The legal essentials are: (1) formation by contract among the members, without a charter or certificate from the state; and (2) personal liability of members. One's first thought is, How does such a company differ from the corporation with which every one is familiar in a general way?

In answer, it must be noted that the joint-stock company is in a special sense a transitional form of organization and stands as an intermediary between the partnership and the business corporation of to-day. This intermediary position means that it must extend over a wide gap; and such is the fact, one result of which is found in the variety of joint-stock forms. Thus there are common-law and statutory joint-stock companies, as well as a number of related forms like mining partnerships and limited partnership associations; and it is indicative of the situation that most of these organizations, while containing the word "partnership" in their names, are sometimes called "quasi-corporations" by lawyers. The common-law form is almost a partnership; the statute-law form is almost a corporation.

As will appear shortly, the joint-stock company as a legal form grew out of the partnership; and, as a step toward comparing it with the corporation, it is necessary to understand its relation to the earlier form. The ordinary common-law joint-stock company differs from the partnership only in that (1) its capital is divided into shares which may be transferred by the owner at will without the consent of the other members; (2) its affairs may be conducted by a board of managers or directors, who may bind the company when acting within the scope of their authority; and (3) it is not dissolved by the death or incapacity of any

member. Other less essential differences are the facts that generally it has a specific name not that of its members and that generally it embraces many individuals. We must conclude that the heart of these differences is the less personal relation among its members; they are not necessarily acquainted with one another nor is their consent required for changes in membership. Aside from these differences, it is not incorrect to think of the common-law company as a kind of partnership, and its members have the same rights and are liable to the same degree as are partners. On the other hand, the statutory joint-stock company is a quasi-corporation, having in the State of its domicile virtually all the characteristics of the corporation except that liability is generally unlimited. The statutes, however, may provide for limited liability.

Coming now to the question of the difference between joint-stock companies and business corporations, we note first, that the former are not, as such, clothed with a legal personality entirely distinct from the natural persons who are their members, and so are less permanent than corporations; secondly, they arise out of a contractual relation among their members, and "the relation they assume is wholly the product of their mutual agreement and depends in no respect upon any grant of authority from the State"; thirdly, unless expressly authorized by statute, they have no right to limited liability. The gist of the matter is that the joint-stock company involves a more personal relation among its members than does the corporation, a condition expressed in the absence of a complete and separate legal entity.

In an interesting case not long ago decided by the New York courts, some difference of opinion was expressed concerning the likeness of a joint-stock company to a corporation.[19] In this case, Hiscock, J., maintained that —

> "... there can be no doubt that a joint-stock association differs from a corporation, or that in its original conception and ultimate analysis it is like a partnership in respect to the individual liability of its members. But, upon the other hand, so many of the attributes and characteristics of a corporation have been impressed upon the modern joint-stock association that in my opinion, for the purposes of the question now before us, we are amply justified in regarding simply the joint, *quasi* corporate entity.... They are, like corporations, organized under and regulated by statutes. They have, and transact business under, an artificial name. Their capital and ownership is represented by shares of stock transferable at will, and their existence is not dissolved or affected by the death of or transfer of interests of members. They have regular officers in whose names actions may be commenced in behalf of and against the association, and upon a judgment rendered in the latter case, execution may be issued only against property belonging to the association or to all of its members jointly... And, as illustrating the complete and separate existence of the association as between it and the individual members, suit may be brought by it against such members."

On the other hand, E. T. Bartlett, J., contended that: —

> "The association has not appealed to the sovereignty of the state for its right to exist, and is, therefore, free from the visitorial powers to which corporations are subjected; nor is it amenable to those various commands of the statute which if disobeyed lead to the imposition of certain liabilities and penalties. The association need not disclose the amount of its capital, or the number of its shares; the corporation is obliged to do so. It is the obvious policy of the state to maintain this distinction, to wit: If men desire to embark in great business adventures, practically exempt from governmental control, they must do so subject to the joint and several liability to pay the debts thereby incurred.... The distinguishing feature of the joint-stock association is the personal liability of its members."

The difference of opinion appears to arise largely from the fact that the one learned judge dwells in his

thought upon the manner in which the business is conducted in ordinary private relations, whereas the other is concerned with the public relations and takes the social point of view. Perhaps, too, the one is looking at things as they are; the other as they ought to be under the law.

Articles of Association. — In forming a joint-stock company, articles of association, or "deeds of settlement," as they are sometimes called, are executed by all members.[20] Such articles should set forth the object of the company, the amount of stock, number of shares and manner of assignment, the number and duties of directors, and, in general, the duties, rights, and obligations of members among themselves. Historically, it was by a common signing of an agreement to the effect that their deaths should not dissolve the association, that a mere private member should not have power to act as an agent, that property should be vested in a board of trustees, and that shares should be transferable, that the members of the joint-stock partnership secured the most important advantages of the modern business corporation; and much the same procedure is followed to-day.

Some of the provisions of the articles of a prominent statutory joint-stock company (the Adams Express Company) are as follows: "The amount of capital, surplus, and reserve fund of the association shall be as the managers may from time to time determine and as they shall deem necessary or expedient in their discretion for the conduct of the business of the Association and to provide for losses and protect the shareholders against personal liability or assessment." The certificates representing the shares shall contain a clause "stating in substance that the holder thereof is subject to all obligations and liabilities of, and entitled to all the privileges of, a member of the Association and resting on the shares represented by such certificate as fully as if he had signed the original Articles of Association." In order to illustrate how this company secures a virtually limited liability, the following clause from its bond issue is interesting: "no person or future shareholder, officer, manager, or trustee of the Express Company shall be personally liable as partner or otherwise in respect to this bond or the coupons pertaining thereto, but the same shall be payable solely out of the assets assigned and transferred to the said Trust Company or out of other assets of the Express Company."

The business of the company is governed by a board of managers which forms a self-perpetuating body. The articles provide that upon the written request of the holders of one third of the shares, a meeting shall be called by a board of managers; and at any meeting the officers may be removed by a two-thirds vote. The property of this company is in the custody of trustees elected by the board of managers from among its own members. In this way the right to sue for any breach of contract or injury to the company's property is vested in a small number of men, avoiding the necessity of making all the members parties to any suit.

Origin and Development. — The joint-stock scheme of business organization, like the representative scheme of political organization, may be traced to many and early rudiments. Now but a trace or suggestion of the idea is found, again a clear-cut but fleeting application of it; in some cases it is combined more or less loosely with the corporation, in others not. It would be unwise in the present state of our knowledge to attempt a complete and connected account, but a brief sketch which may touch accurately upon some salient points of origin and development should interest those who like to trace the roots from which things grow.

We know that in the twelfth century associations were formed in the Italian city-states among the subscribers to the public debts. These subscribers contributed on shares, and their associations in several respects resemble companies of subscribers in modern joint-stock concerns, — though they were more like bondholders than stockholders.[21] Later, joint-stock banks were organized, notably one in Genoa (1419), and finally in 1694 came the great joint-stock Bank of England. These financial joint-stocks developed the idea of raising large capital by means of selling many small equal shares.

But meanwhile the joint-stock idea was being applied and developed in other fields. Probably this

appears earliest in maritime trade. In the early commandite partnerships already described, we at once observe that the special or inactive partners were investing capital without active participation in management, somewhat after the fashion of shareholders in a stock company. And by the fifteenth century we actually find business undertakings in which a single individual or a group built and operated vessels for profit on a joint-stock basis. Indeed, as early as the thirteenth century, under Venetian laws, we are told that sea voyages were conducted somewhat as follows. The shipowners were not traders, but acted as entrepreneurs of ocean transportation. The owners would build a ship as partners in the venture. Before building, the size and cost of the vessel would be determined. Then, if any member should fail to contribute his share, he would become actionable. If he should die before payment, however, his heirs were not to be bound. If it were desired to enlarge a ship, a majority vote of the members would decide. The venture would be governed by a board of four, composed of a *patronus* representing the shipowners, a mariner, and two representatives of the merchants who had chartered the vessel. The business side of the vessel's operation was managed by the *patronus,* and he paid the wage's of the sailors. While on the voyage the partners could not sell their shares; and, in any case, the *patronus* had certain prior rights to purchase shares.[22]

Most interesting of all, however, and of direct importance to an understanding of the development of the joint-stock idea in English-speaking countries, is the history of the rise of that idea in the craft gilds. This began during the fifteenth century, and became well established by the seventeenth. Doubtless the forces at work were the accumulation of funds in the gild treasuries or in individual hands, and the growing possibility of larger business operations. Thus cash from fines and entrance dues would accumulate, successful merchants would leave bequests, and returns from investments would accrue. Such funds were employed in various ways, as in making loans to young men and in purchasing raw materials for the gild members. A case in point occurred in 1482, when the Pewterers' Company bought tin as a profitable investment of their surplus joint funds. Also groups of rich members of certain gilds appear to have been formed with the consent of their fellows for purposes of private speculation; and here, of course, the joint-stock was separate from the corporation and without a definite legal status. Professor Unwin tells of an instance in the reign of James I in which the same Pewterers' Company mentioned above allowed several of its members to form a copartnership with the aim of raising a joint capital to purchase tin. In 1615 the company itself ventured £800.[23] A little later, the feltmakers attempted to apply the joint-stock idea to an industrial corporation and to raise capital from outside the company.[24] The scheme failed, however, whereupon a nominally separate company of "stockers and shareholders" with a capital of £5000 was formed to buy wool. In this case an individual who had loaned them £500 sued and obtained judgment against the Feltmakers' Company (1625), it being held that the company in its capacity as a corporation had borrowed the said sum and "did employ the same in stocke." Somewhat inconsistently, the individual feltmakers were held liable under this verdict and some seem to have been imprisoned for debt.

The earliest case of an industrial enterprise (not a gild) organized on a single joint-stock basis that has come to the writer's attention is that of a mining company as chartered by Elizabeth in 1568.[25] Steps were taken to form this company as early as 1561; and from 1564 to 1568 it existed as a kind of partnership, or unincorporated joint-stock company. The ownership of the enterprise was divided into 24 shares, part of which were held in Germany. In England, the average price received was £1,200 per share. Large as this amount is, it was merely a payment for the privilege of entering the enterprise, and heavy calls were made to defray working expenses. One of the earliest balance sheets ever prepared by a joint-stock corporation was presented by this Society of the Mines Royal in 1571.[26] With the granting of monopoly charters by the Stuarts, it became not uncommon for the individual masters who composed the corporations to seek to raise a common fund for buying materials and supplies on advantageous terms. Sometimes the subscribers fur-

nished supplies of the various materials needed in the industry, in place of cash. Thus the joint-stock idea crept into industry.

These early joint-stock experiments mostly failed for want of a suitable legal machinery and organization for administering responsibly their collective capitals. For illustration, the Pewterers' joint-stock group ended with a suit by the majority holders against a leading member.

Meanwhile, some of the great medieval trading companies were operating on a joint-stock basis. Probably the earliest of these was the Russia Company formed in 1553 with a capital of £6000 subscribed in 240 shares of £25 each.[27] This company soon became narrowly monopolistic, and in 1604 a Parliamentary committee complained that "the directors limited the proportion of stock held by individual members, made 'one purse and common stock,' consigned their goods to one agent in Moscow, and on the return voyage to one agent in London, through whom they disposed of all imported commodities, and then rendered what account they pleased."[28]

The most typical case, and ultimately the most highly developed one, was the East India Company. In 1599 a number of merchants subscribed some £30,133 in shares varying from £100 to £3000, and petitioned the crown for incorporation as a joint-stock company on the ground that "the trade of the Indies being soe remote, could not be traded on but on a joint and united stock." A charter was granted in 1600. At first, voyages were undertaken by groups of members on joint-stock, and not by the company in its corporate capacity. In 1612, however, the company decided to trade on a common joint-stock as a company, profits to be shared according to the amounts subscribed; and £429,000 was raised for voyages to be made during the four succeeding years. At the end of that time a second joint-stock was raised, and others followed it. These were all separate ventures, though having the same directors. The capital fluctuated from time to time, and the shares were not equal and readily transferable. In the second half of the century, stocks were subscribed for longer periods; and the joint-stock became a definite sum, with equal shares, transferable only by purchase and sale in the market. Omitting that interesting bit of medieval high finance by which the old and new East India Companies were merged, we hasten on to note that after this time joint-stock corporations sprang up in great numbers, forming so rank a speculative growth during the early years of the eighteenth century that in 1720 the "Bubble Act" forbade joint-stock companies as public nuisances, and for over one hundred years thereafter this form of business organization was illegal in Great Britain. Like most such prohibitions, the statute was ineffective.

As a result of this little excursion into history, we conclude that the joint-stock company is the result of a long evolution. Traces of the joint-stock idea are found wherever a group of men own shares in a common property, as in land, workshops, and ships. It is suggested, though not realized, in the early *montes* of the Italian cities (twelfth century), which were formed by compulsory loans from the citizens who received interest on their contributions. But joint-stock, in the present-day sense of transferable shares which indicate participation in the risk and the net earning of a business undertaking, awaited the development of commerce and industry on a larger scale. During the fifteenth and sixteenth centuries we find it springing up here and there, most notably in shipowning and craft-gild operations. Then came the full realization in the great trading companies and banks of the late sixteenth and the seventeenth centuries. The medieval corporations (gilds and regulated companies) had merely correlated the activities and capitals of individuals in a loose fashion; but a need for more closely associated enterprise arose. Then groups of merchants and of craftsmen who could raise a capital organized for single ventures in common; then for a series of ventures; till we find joint-stocks created as permanent funds divided into transferable shares. This development was partly due to greater experience with and improvements in business organization itself, and partly due to the requirements of larger business and more capital — especially fixed capital.

There appears to be no way of estimating the extent to which the unincorporated joint-stock form of business organization is now in use. In England, incorporation is more expensive than in America, and one result is that mere joint-stock companies are common there. In the United States, on the other hand, relatively few large businesses are not corporations. Most of the exceptions are organizations formed under the statutes of New York, and the most notable exceptions are the great express companies. The Pierce-Fordyce Oil Association is another prominent example of pure joint-stock company.

	Establishments			Persons	
	1895	1907	Increase	1895	1907
All business establishments with employees	1,350,880	1,813,922	35%	8,554,718	12,984,038
1. Partnerships (*Mehrern Gesellschaftern*).	55,239	82,370	49%	1,475,081	2,151,248
2. Commandite associations (*Kommandit-gesellschaften*)	1,117	1,636	46%	90,155	129,907
3. Commandite associations with shares (*Kommanditgesell. auf Aktien*)	334	340	1.7%	42,945	47,825
4. Limited-liability associations (*Gesell. mit beschränkter Haftung*	1,028	11,001	970%	66,055	534,328
5. Joint-stock companies (*Aktienges-ellschaften*)	4,749	9,832	107%	801,143	1,759,406
6. Mining Companies (*Bergrechtlichen Gewerkschaften*)	440	510	15%	132,104	229,993

The preceding table shows both the relative and the absolute importance of the joint-stock company and its related forms in Germany. Forms 3 to 6, inclusive, are all unincorporated associations having transferable shares.

Related Forms. — Closely resembling joint-stock companies are two distinct forms of business organization: "mining partnerships," and "limited partnership associations." Mines and oil wells are generally operated by "mining partnerships," and, as the supreme court has said: "Mining partnerships, as distinct associations with different rights and liabilities attaching to their members from those attaching to members of ordinary trading partnerships, exist in all mining communities."[29] Several reasons are advanced by lawyers for the existence of these "abnormal" partnerships, among them being (a) the large number of members usually embraced, and (b) the necessity for continuous operation in order to prevent great loss of property from flooding, etc. The economist would add that, in such extractive industry as is involved, the life of the property is peculiarly limited and often uncertain, a condition which may help explain the fact that in mining partnerships the profits of operation alone are concerned, the mining property generally being outside the scope of the partnership proper. In view of the foregoing characteristics, it is easy to account for some of the most salient legal attributes of this form: (1) under it, shares may be transferred and new members be brought in without disturbing the ownership of the property or dissolving the operating partnership. Even the

death of a partner does not work a dissolution of the firm. (2) Management is delegated to a board whose powers are narrowly limited to the necessary business of the firm.

Limited partnership associations are created by statute in a few States.[30] These associations are sometimes called quasi-corporations, but may be more accurately styled limited-liability joint-stock companies. In Pennsylvania, at least, stock is only transferred subject to the election of the purchaser by the existing members. "Stock may be issued, by-laws passed, a seal may be adopted, and in the home state they may sue and be sued under the association name."[31]

Advantages and Disadvantages. — Inasmuch as the joint-stock idea is generally associated with the corporate entity, and joint-stock organizations are generally also corporations, full discussion of the former will be withheld at this point and be presented in the next chapter. Here we will merely note some of the chief advantages of the joint-stock principle over the ordinary partnership idea. To begin with, it is most obvious that this principle goes far toward removing the partnership limitations for raising large capital. By the sale of a large number of transferable shares a much greater aggregate fund can be amassed. Even when the holder is liable to the full amount of his property, the relatively ready salability of a joint-stock share gives him some chance of safeguarding his interests; and the fact that only the authorized agents of the company can bind it and him further reduces the risk as compared with partnerships. Moreover, the fact that the operations of the company are carried on under the direction of a board of managers under delegated authority makes active supervision by the investor unnecessary. In short, the joint-stock organization furnishes a more efficient machine for appealing to an investing class.

Again, the joint-stock principle results in a greater stability of organization. By this is not necessarily meant permanence or endurance in time, but a decreased liability to disruption at any given time. The relation between investors is less personal and requires less mutual acquaintance and trust. Membership is conveyed by transferable shares. Accordingly it may change without dissolving the organization, a fact which differentiates the company from the firm.

Finally, the joint-stock idea provides a way for the efficient management of large business ventures. It applies the principle of association not only to capital but also to management, for in joint-stock companies a large number of investors vote for directors who as their representatives administer the, collectiye property of the company. Though, as we shall see, not free from weaknesses, the plan of delegated control furnishes the element of concentration which is essential to prompt and consistent action by a large body.

It may be added that from the private point of view the joint-stock company, in common with partnerships, possesses certain advantages over corporations. It is not subject to franchise and other taxes levied on corporations. "Unless the statute expressly includes joint-stock associations they are not taxable upon their capital under a statute subjecting all moneyed or stock corporations deriving an income or profit from their capital or otherwise, to such taxation."[32] The members of a joint-stock company are taxable as partners rather than as corporation stockholders.

It might prove an advantage, too, that, being a contractual relationship, a joint-stock association may by mutual consent go into voluntary insolvency at any time and wind up its affairs. In general it is a more simple and easy matter to dissolve such an organization than a corporation.

As to disadvantages, the chief point against the stock company, as compared with the partnership, is the greater likelihood of waste and inefficiency attendant upon an indirect, delegated management. This is an old count. As long ago as 1776, Adam Smith wrote: "The directors of such companies, however, being managers rather of other people's money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which partners in private copartnery frequently watch over their own.... Negligence and profusion, therefore, must always prevail, more or less, in the management of the

affairs of such a company."[33] The spur to zeal and fidelity is not so sharp as in the partnership where the partners are the active managers. And there may be a lack of identity of interests between the company and its management, leading to manipulation, speculation, and ruin. In a word, motivation is less direct and certain than in the simpler forms.

Another notable disadvantage, not as against partnerships, but as compared with corporations, lies in the joint-stock company's lack of a separate legal personality. It is unlike the corporation in that the law gives it no entity separate from its members. This affects its permanence, its position in actions by and against itself, and its jurisdictional status, (a) Being at common law more closely identified with its members, its existence is not so well guarded against the vicissitudes of life as is the corporation's; it is more readily dissolved, (b) Barring statutory qualifications, all the members of a joint-stock company are necessarily joined in actions either by it or against it. Similarly, a member cannot sue or be sued by his company on a contract between them, for the law holds that he and his company are one, and logic demands that he be prohibited from playing a double part.[34]

Finally, we remember that the members of joint-stock companies generally have unlimited liability. At common law they are in precisely the same position as are general partners. This condition is modified by statutes in some of the States, and liability may be limited by special agreement with creditors. As remarked in discussing partnerships, this is a disadvantage from the private point of view, and only a mixed advantage from the public standpoint.

From the private standpoint, it is a disadvantage that joint-stock companies are less secret than simpler forms with their smaller memberships; their business plans and financial standing are more likely to leak out.

Social Point of View. — The joint-stock principle goes a great way toward supplying that continuity of business organization which is so necessary to the best development of industrial plans. Though not associated with a legal personality, the joint-stock company may draw upon the whole class of investors for its members and continue undisturbed by altered personnel. The individual-entrepreneur organization depends upon inheritance and heredity for its continuance; the partnership, upon a sort of adoption; the joint-stock company upon free association or initiation. As to capital, at least, the type last named demands less of individuals in an intensive way, but draws upon a more extensive field. It is, therefore, less dependent upon local or individual exigences.

From the purely economic standpoint, probably the most interesting characteristics of joint-stock organization, whether incorporated or not, are the differentiation or even the partial dissociation of entrepreneurial, managerial, and capitalist functions, and the division of the entrepreneur's duties, which it encourages. Instead of all these functions being closely united, as in the case of single-entrepreneur and partnership business, we find, in the first place, a body of stockholders who ultimately bear the risk and who should jointly constitute the true entrepreneur. They are also the capitalists. But the active direction of the company's affairs is in the hands of the board of directors or managers, who often have little capital invested in the company and have little acquaintance with the details of its operations. Under their general supervision is a staff of managers and superintendents who conduct the operations of the company as salaried employees. For the most part they supply little or no capital. It follows that the interest of the shareholders may suffer from lack of knowledge and of voice in the direction of the company's affairs. The motivating industrial forces may be retarded or deflected by the machinery. It is the old problem of securing efficient democracy appearing in industrial government.

But such division of labor is the necessary concomitant of large-scale business, and against its dangers must be set its certain potentialities for good. Without it, many great undertakings would be impossible at

the present time, including those which involve great capital, great risk, and delayed returns. Moreover, as partly offsetting the losses of indirect motivation, it must, be remembered that joint-stock companies *are able* to employ the men of highest industrial genius and to adopt quickly the most improved methods.

From the social point of view, the effects of joint-stock organization upon the distribution of wealth are highly important, and several chapters might be devoted to that aspect alone. Clearly it has great potentialities both for good and for evil. On the one hand, it might tend to diffuse wealth by encouraging widespread investment in small amounts and distributing the profits and interest of industry accordingly. On the other hand, it might result in a vicious and undemocratic concentration of wealth in the hands of a few industrial dictators. Down to the present time, the common opinion that inequality in wealth distribution has, on the whole, been encouraged by joint-stock organization, seems indisputable. The great evils of "promotion" frauds, over-capitalization, and over-speculation or stock gambling, are associated with joint-stock.[35] But these conditions by no means obscure the possibilities that lie in a more direct and democratic arrangement of such organization.

In fact, if properly guided, the form of business organization now under discussion may be made to favor business publicity. In 1865 John Stuart Mill was led to add the following paragraph to his *Principles of Political Economy*:[36] "Another advantage of joint-stock or associated management is its incident of publicity. This is not an invariable, but it is a natural, consequence of the joint-stock principle, and might be, as in some important cases already it is, compulsory. In banking, insurance, and other businesses which depend wholly on confidence, publicity is a still more important element of success than a large subscribed capital. A heavy loss occurring in a private bank may be kept secret. But this cannot so easily happen in the case of a joint-stock company, whose accounts are published periodically. The accounts, even if cooked, still exercise some check; and the suspicions of shareholders breaking out in general meetings put the public on their guard."

The upshot of the matter, from the social point of view, appears to be (1) that society should seek to encourage the extension of the joint-stock principle in all that great and growing part of the industrial world in which operations must be carried on on the largest scale with a maximum of continuity and financial security to the public. To this end, provisions may be made for greater publicity and truer democracy within the company, and for a better adjustment of liability. No pains should be spared to spread commercial morality and education. Such provisions will be discussed below in the chapters on Corporate Organization and Public Policy. But (2) in recognition of the dangers and limitations of joint-stock organization, its application should be discouraged (a) wherever the single-entrepreneur organization is entirely adequate on the score of capital, permanence, and effective management; and (b) in certain pretty definite cases where government management is necessary to insure the quality, safety, and widespread consumption of some article of vital importance to society.

In the chapter on Partnership Organization, it was stated that while the individual personal idea was retained as to management and liability — and "permanence" might have been added — the association idea was applied to capital. In the joint-stock organization, we find the individual personal idea still uppermost in liability relations; but management and capital are both brought under the principle of association. There still remained an incomplete synthesis: another step remained to be taken in order to give dominance to association in all phases of business organization. In the modern business corporation, as will appear in the next chapter, this step was taken; and by it, personal liability, or financial risk, was limited according to associated impersonal conditions, and permanence was made completely independent of natural personality.

Chapter VI: Corporation Organization

The "corporation" is to-day the dominant form of business organization. It is easily the leading agency for associating individuals for private gain. In the United States about 80 per cent of the products of manufactures is made by corporations. Above all other forms of business organization, then, it behooves us to understand its nature, and to weigh well its advantages and disadvantages. Volumes have been written to this end; but we may attempt to master the essentials of the corporate form from a briefer treatment, especially as a large part of the business corporation is based upon the joint-stock principle, which has already been discussed at some length.

Definition and General Nature. — That definition of corporations which prevails among lawyers in the United States has been affected by the words of a single jurist as uttered in a single case. In the now classic Dartmouth College case, Chief Justice Marshall said: "A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence.... Among the most important are immortality, and, if the expression may be allowed, individuality; properties by which a perpetual succession of many persons are considered as the same, and may act as a single individual."[37] The prestige of this opinion has served to keep alive a misleading conception. Marshall's statement strikes the keynote for the great majority of legal definitions. They center in "the idea of "artificial personality" or "legal entity"; the corporation is a cold, abstract, artificial creature of the law, which is, for many purposes, at least, separate from the flesh and blood of mortal man. Such a being does not present a charming personality to the lay mind; — but such is the dominant legal conception.

It is but fair to observe, however, that all legal formulae do not lay the emphasis in just this way. For example, Clark on Corporations cites Bronson, J., to the effect that "a corporation is a *collection of individuals* united in one body, under such a grant of privileges as secures a succession of members without changing the identity of the body, and constitutes the members for the time being one artificial person, or legal being, capable of transacting *some kind of business* like a natural person."[38] Here the association of natural persons is emphasized, and some limitations on the artificial person are implied.

To the economist or to the lay student of history, however, the legal definition appears somewhat inadequate. It will be well, therefore, at once to set over against the preceding statements a definition which may be called historical and scientific. An approach to such a one is given by a recent writer when he says: "A corporation is a body consisting of one or more natural or artificial persons established by law, usually for some specific purpose or purposes, and continued by a succession of members."[39] Nothing mysterious — merely a group of individuals continued by succession.

As a more complete definition of the corporation the author would propose the following: *A corpora-*

tion is a voluntary autonomous association formed for the private advantage of its members, which acts with compulsory unity, and is authorized by the state for the accomplishment of some public good.[40] Let us analyze this statement of the case.

The essential characteristics of the corporation, together with some of their implications, may be summed up under half a dozen heads. First would come *association.* The corporation stands for group activity, and an essential attribute is its close-knit correlation — amounting almost to a fusion — of the investments of its members.[41]

In the second place, a corporation is a creature of the State, from which source alone it derives its ultimate authorization. This may come about through special laws authorizing particular corporations, or through general laws providing for all corporations in a given jurisdiction. Maitland somewhere says: "There seems to be a genus of which State and Corporation are species. They seem to be permanently organized groups of men; they seem to be group units." This admirable statement serves to emphasize the fact that the corporation enjoys a characteristic of the State. The State, needless to say, is the primary institution; the corporation is derivative and secondary. The former could not suffer an independent sovereign power within its bounds. This origin of the corporate organization sharply differentiates it from the partnership and other purely contractual relations.

Thirdly, the corporation is of voluntary formation, but of compulsory continuance. The former fact is a corollary of the private-gain motive which actuates the members; and, moreover, as Morawetz puts it, "the legislature has not the power to create the natural consent which is essential to every contractual relation" (§ 12). But, once assumed, the corporate form is compulsory from the side of the state. The law concerning the dissolution of corporations seems well established. The corporate existence may be terminated by the expiration of a time limit placed in the certificate of incorporation, or "charter." Or it may be forfeited on several grounds, among which are misuser, non-user, and non-performance of obligations to the state. A stock corporation may cease to do business upon the vote of a majority of its stockholders, but the corporation still exists in the eyes of the law, and may sue or be sued in the courts. Neither neglect to appoint officers and agents nor insolvency works dissolution until the law is content. This principle will be most rigidly applied in the case of public-service corporations.[42] The reasoning is simple: since the corporate "charter" is held to be a contract with the State and one not to be forfeited unless that right is expressly reserved, the corporation cannot end its duties without the consent of the State. If we regard the certificate of incorporation as being in any sense a contract between the incorporators and the State, or if we look upon the corporation as an institution authorized for the public good, we can hardly escape the conclusion that the existence of a corporation must be compellable within certain limits. It is essential to the valid and binding surrender of a "charter" that that surrender be accepted by the State. Of course, it is, as it were, an implied condition in the certificates of private business corporations that, if legal requirements are observed, they may wind up their businesses upon a majority vote of the stockholders; but if the business were affected with a public interest, the corporation might be compelled to perform the service for which it was established, and it seems that the State might insist upon the operation of any corporation during the period of time for which it was "chartered."

In so-called voluntary dissolution, the stockholders must sanction the step, and a formal surrender of the charter be drawn up and accepted by the legislature or court or some officer designated to accept the surrender. It must be shown that the interests of creditors are cared for.

A fourth essential characteristic is autonomy. Within the limits set by the constitution, the general law, and its charter, the corporation is a self-governing organization. It is self-sufficient, self-renewing, and, within its jurisdiction, self-controlling.

After autonomy we must, in the fifth place, put "compulsory unity" of action. This is a most important element in the situation. Blackstone thought of corporations as little republics, and, although they have too often turned out to be oligarchies, such is the ideal. Now unity of action comes in just the same manner as in government—namely, by majority rule. Where the majority rules, a single course of action is the only possible result. Such a course is necessary to the preservation of the group by preventing non-user of charter and franchises. Thus, though the corporation is an association, it acts as a unit — a group unit. As corollaries, it may sue and be sued in the corporate name; and its members are not each the agent for the other, as is the case in a partnership.

But, some one says, it is the corporation's legal personality which brings this unity of action. The point is not so clear, however; and there are good grounds for deeming this a *post hoc ergo propter hoc* notion. Whence comes the legal personality? From the law: But why such a grant or provision by the law ? In explanation we are driven back to the simple necessity of the associational joint-stock organization with its lack of personal relations and supervision. To many, the only rational view appears to be the one which accounts for the legal personality on the ground of compulsory unity, rather than *vice versa,* since the law's conception of a separate entity is but a fiction, and a fiction which has been a lurking place for evil. How subtle is this tendency to beg the question and put the cart before the horse, appears in a statement to be found in a recent textbook: "It is true, also, that this artificial person, the corporation, has neither mind nor body and cannot, therefore, think or act. The law, however, easily gets over this difficulty by treating the manager and officers of the corporation as agents empowered to carry on *its operations*."[43] But who is "it"? And what are "its operations"? To say that it cannot think or act, and in the next breath to assume that its exists and operates, leaves unexplained the logical relation between the entity idea and that of unity of action, and begs the question.

The true conclusion would seem to be that there is something like an artificial legal personality in the corporate association, and that the concept may be useful in enabling men to grasp concretely an abstract relationship. There may be little harm and much truth in regarding corporations as *legal* persons in the sense that a relationship among individuals has been endowed with endurance and given a name. But one must regard the personality, so called, as derived. It is not fundamental nor casual; and it has been made the basis for evils to be pointed out later. It is the sound, rational procedure, then, to begin at the beginning and to grasp the concept of unity-through-association — of the river through the drops and the forest through the trees.[44]

In the same connection, the limited-liability characteristic should be disposed of. As a matter of fact, it is not an essential characteristic, and corporations have existed with members liable in. various degrees, running from the amount invested up to complete personal liability. A very little analysis, together with some study of history, will show that the idea that members are not liable for corporate debts, though doubtless reenforced by the artificial personality notion, is an outgrowth of the conduct of business by unincorporated joint-capital organizations, such as the medieval partnerships already discussed.

Limited liability was not a feature of early English corporations; it came after the corporation. As the membership was thrown open to any one who could buy a "share," and so became less personal, it became illogical and, indeed, impossible to demand of each of a large body of corporate members that personal liability which was characteristic of the less numerous and more intimately related members of a partnership. Furthermore, the necessity of delegated management worked powerfully against the retention of an unlimited liability; for it was thought that those who had no direct voice in determining the company's action should not be personally liable for its debts. If we add the conception of legal personality, which made it easier to think of the debts of the corporation as distinct from those of its members, the basis for the

addition of limited liability to the business corporation proper is clear. It is to be remembered that no reason, other than grounds of expediency exists against increasing the financial liability of stockholders.

Finally, in the sixth place, the function of the corporation is public: the corporation is authorized by the State on the assumption that the public will be benefited by its existence. As the courts have held, "The purpose in making all corporations is the accomplishment of some public good. Hence, the division into public and private has a tendency to confuse and lead to error in investigation, for unless the public are to be benefited, it is no more lawful to confer exclusive rights and privileges upon an artificial body than upon a private citizen."[45] While, strictly speaking, the mere right to be a corporation may not be a "franchise," yet the State in chartering a corporate company gives it important privileges; and, as with all social institutions, the only ultimate justification for existence is public welfare. While the formation of a corporation is voluntary on the part of the individuals concerned, and while their motives may be private gain, it is still true that the State allows associated activity in this form in order to utilize private interest best for public weal.

The "corporation problem," as we will see, arises from the difficulty of harmonizing private-interest motive with public-welfare function.

The Certificate of Incorporation. — One can not well under-stand the nature of a corporation without some study of the paper which, subject to the law of the land, authorizes its existence. This document is commonly called a "charter" in the United States, but better usage would term it a "certificate or incorporation." Concerning it, Machen writes: "It delineates the limits of the company's powers, and the exercise of any power for which authority, express or implied, cannot be found in this instrument is *ultra vires* of the corporation. It marks out not merely the powers and objects of the company, but also in some measure the means by which these objects may be pursued.... It is the constitution of the corporation, and subject only to the laws of the land, the supreme law of its government and being."[46]

This instrument has a two-fold aspect. First, it virtually includes the articles of association of unincorporated joint-stock companies: just as the business corporation itself includes the joint-stock principle, so its certificate of incorporation is, in part, a private contract of association among its stockholders. But, secondly, the corporation *is* more than the mere stock company, and, accordingly, the certificate is more than a private contract: it is also a statutory condition, and records the compliance of the incorporators with statutory requirements. It is, in this sense, a contract with the State. In the United States, the courts have gone further than in England in recognizing the certificate of incorporation as a contract with the State, and in granting privileges and immunities to corporations under the constitutional provision that a State cannot impair the obligation of a contract.

Certificates of incorporation are apt to vary somewhat in their scope and detail according as they are issued by special enactment or under general laws. Formerly the formation of each corporation was the occasion for a special authorizing act of the legislature; now there is usually a general law setting forth certain powers and limitations for all corporations and providing a general authorization. Under such a law the certificate is more in the nature of a private contract than of a statute.

The following short simple certificate will serve to illustrate the more common and essential provisions of such instruments: —

Certificate of Incorporation
Of the Carhart Drug Company

We, the undersigned, for the purpose of forming a corporation under and by virtue of the provisions of an act of the Legislature of the State of New Jersey, entitled "An Act concerning corporations (Revision of 1896)," and the several supplements thereto and acts amendatory thereof, do hereby severally subscribe for

and agree to take the number of shares of stock of the said corporation hereinafter placed opposite our respective names, do further certify and set forth as follows:

First. — The name of said corporation shall be

"Carhart Drug Company"

Second. — The location of its principal office in the State of New Jersey shall be at No. 15 Exchange Place, Jersey City.

The name of the agent who shall be therein and in charge thereof, upon whom process against this Corporation may be served, is the Corporation Trust Company of New Jersey.

Third. — The objects for which this corporation is formed are:

(a) To manufacture, prepare, compound, mix, combine, buy, sell and generally deal in all manner of chemicals, chemical products, drugs, and pharmaceutical compounds, and preparations, and to patent, register, or otherwise protect the same.

(b) To obtain, purchase or otherwise acquire formulae, patents and secret processes for the manufacture and preparation of chemicals, drugs, and compounds and preparations thereof, and to operate under, sell, assign, grant licenses in respect of, or otherwise turn the same to account.

(c) To enter into, carry out or otherwise turn to account contracts of every kind; to, have and maintain offices within and without the State; to acquire, hold, mortgage, lease, and convey or otherwise use or dispose of real and personal property in any part of the world; and in general to carry on such operations and enterprises and do all such things in connection therewith as may be permitted by the laws of New Jersey and be necessary or convenient in the conduct of the Company's business.

Fourth. — The total authorized stock of the corporation shall be twenty-rive thousand dollars ($25,000), divided into two hundred and fifty (250) shares of the par value of one hundred dollars ($100) each, and the amount of capital stock with which said corporation will begin business is five thousand dollars ($5,000).

Fifth. — The names and post-office addresses of the corporators and the number of shares subscribed for by each are as follows:

Names	Addresses	Shares
Willis J. Carhart	15 Exchange Place, Jersey City, N.J.	40
Sheldon McCammis	15 Exchange Place, Jersey City, N.J.	5
John B. Whelan	15 Exchange Place, Jersey City, N.J.	5

Sixth. — The period of existence of said corporation shall be unlimited.

In Witness Whereof, we have herunto set our hands and seals this 21st day July, A.D. nineteen hundred and eight.[47]

Willis J. Carhart (L.S.) Sheldon McCammis (L.S.) John B. Whelan (L.S.) In the presence of

Harmon Watson. Thomas O'Connell. (Execution in due form.)

This charter contains most of the essential points, (1) First comes the matter of the *name.* This should be descriptive of the corporation's business. If the law requires, it must be followed by the word "limited" (Ltd.) in the case of limited-liability companies. The name must not be fraudulent or misleading, and, under this principle, the right to choose a name is somewhat limited by the names previously taken by existing corporations, especially those of the same jurisdiction. For the details of this rather complicated point, the reader should consult some standard law book.[48] The selection of an attractive trade name may have considerable importance from the economic point of view, both as an advertising feature and as an asset in connection with good will.

(2) *Location of chief office.* — The great majority of the States require a definite statement as to the location of the corporation's chief office, or principal place of business. Nearly all States require that this

office shall be located in the State which grants the certificate of incorporation. Moreover, it is common to require that one or more of the incorporators shall be citizens of the said State; but over half the States do not require that any directors must be residents. Thus, unless considerations of expense or convenience outweigh, it is best to incorporate in the State where most of the business will be transacted. The main operations of a going corporation, however, may be and frequently are conducted from an office in a distant State by officers acting as its agents. Few New Jersey corporations manage their business from the nominal offices which the New Jersey statute requires them to maintain in that State.

(3) The most important clause of the certificate of incorporation is that which states the *objects* of the corporation. An individual or a partnership may in general engage in any lawful business or undertaking, but the corporation is limited by its "charter," and possesses such powers only as are expressly or impliedly conferred by the statute or the certificate of incorporation. The corporation laws of at least forty States allow incorporation for any lawful business or purpose. Considerable latitude is given by way of implied powers, among these being the power to borrow, to mortgage and issue bonds, to acquire and hold advantageous property, to alienate property, and, in general, to do things which are calculated to extricate it "in the most practicable way from any difficulty by which without its fault it may be beset." Surely it is a reasonable principle that the limitations upon the powers of the corporation are intended not to hinder business, but to help it. Moreover, the corporation does not have to carry out all the objects which may be expressed in its certificate. But in spite of the foregoing facts, it is now generally conceded to be wise to include a broad and, at the same time, detailed statement of purposes.[49] True, such a course may enable a majority unwisely to expand a business by going into new lines, and it may deter investment by causing doubt as to future policy; but, from the private point of view, the possibility of some day finding operations hampered by a too narrow list of objects far outweighs these considerations. The third clause of the above certificate of incorporation is illustrative of good policy in this regard.

One subject that may well be covered in the statement of objects, in view of the recent importance of intercorporate control, is the right to hold stock in other corporations. The certificate of incorporation of the United States Steel Corporation authorizes it: —

"To acquire by purchase, subscription or otherwise, and to hold or to dispose of, stocks, or any other obligations of any corporation formed for, or then or theretofore engaged in or pursuing, any one of the kinds of business, purposes, objects or operations above indicated, or owning or holding any property of any kind herein mentioned; or of any corporation owning or holding the stocks or the obligations of any such corporation."

This same document specifies as objects, the manufacture of various metal and wood products; the ownership and development of mineral, oil, and timber lands; the extraction and sale of products from such lands; the construction and operation of railways, canals, ships, etc.; and many other rights. For good measure, it then concludes the section with this sweeping proviso: —

"And in carrying on its business, or for the purpose of attaining or furthering any of its objects, to do any and all other acts and things, and to exercise any and all other powers which a copartnership or natural person could do and exercise, and which now or hereafter may be authorized by law."

(4) *Capitalization.* — The capitalization clause is next to the objects clause in importance. It sets forth the total amount of capital stock and the number and amount of shares into which it is divided. Often the classification of shares into "common" and "preferred" is set forth; and, less frequently, a statement of the character of liability, whether limited or not, must be contained. Some States, as Texas, require a statement to the effect that all, or a main part of the stock, has been subscribed and a certain per cent paid in; but at least forty-one States place no maximum limit to capital stock, and most of these make no requirement that stock

shall be issued for money. The certificates of ordinary corporations are, like the sample one above, generally very brief, the details being relegated to the by-laws; but in the case of some very large companies, and especially public-service companies, the subject is covered fully in the main document.[50] This is well, as the by-laws are more readily changed and so afford less protection to minority holders.

(5) *Indebtedness.* — Some States (*e.g.,* Iowa) require that the certificate of incorporation shall fix a maximum limit of indebtedness. Others provide in the statutes that indebtedness shall not exceed the corporation's capital stock;[51] but in this case no statement need appear in the certificate.

(6) Many States require that the duration of the corporation's existence shall appear in the certificate; and several of them limit the life period of corporations, though the danger that such organizations may outlive their usefulness is generally provided for by reserving the right to alter, amend, or repeal their certificates of incorporation. Where such a limitation is found, the law generally makes provision for a renewal of the "charter" by vote of the stockholders. Some States (about twenty-four) allow perpetual incorporation, and the certificate of incorporation of the Steel Corporation reads: "VI. The duration of the corporation shall be perpetual." At common law, corporations were held "immortal."

(7) It is common to require that the certificate shall state the number of directors together with the names and post-office addresses of the first board. This is of some importance as an item of publicity to the stockholders and the public, and enables the attachment of some responsibility for illegal acts.

The foregoing are the more essential clauses of a certificate of incorporation. Needless to say, some contain many other provisions, concerning the election and powers of officers and committees, the Capitalization, the declaration of dividends, and similar subjects.

By-laws.—When the certificate of incorporation is brief and general in its terms, the by-laws are usually full and detailed. If the certificate is thought of as a sort of constitution of the corporation, then the by-laws may also be likened to its statutory code. Indeed, as the term indicates, they are laws enacted, impliedly at least, by the stockholders, and are readily amended or repealed by them. They are internal rules of management subordinate to the "charter." While, in a way, subordinate to the certificate of incorporation, the by-laws are of no mean legal significance; for in certain cases they may determine whether the acts of a corporation's agents are authorized and binding on the corporation, and may affect important rights as among stockholders or between stockholders and directors or officers.

There are important objections to corporation by-laws as passed and used at present. Their enactment is so informal and their enforcement so irregular that they are not much respected by stockholders. Generally, they are made by mere majority vote, and sometimes directors may pass them without calling the stockholders together. They may even be unwritten or unrecorded. It would be very desirable for the various States to follow the lead of England, and require both a more formal passage of by-laws, perhaps requiring a two thirds majority, and also the filing or registration of by-laws along with the certificate of incorporation. In this way the dignity of the legislative branch of corporation government, so to speak, would be increased.

For, in spite of objections, by-laws seem to be a necessity. Especially is this true with general incorporation laws. So great is the variety of conditions as to character of business and size of corporation, that it would be impossible to cover the whole situation in the general law. Furthermore, there is need of a body of working regulations which may readily be altered under changing industrial conditions.

The subjects which are generally dealt with in the by-laws of business corporations are: —

(1) *Stock,* the issuance and transfer of.

(2) *Stockholders,* regular and special meetings, notices of meetings, quorum, order of business, inspectors of elections.

(3) *Directors,* number and term of office, and meetings (as in case of stockholders).

(4) *Executive Committee* (in some cases), number, powers, quorum.
(5) *Officers,* titles, tenure, powers, and duties.
(6) *Financial management,* dividends and care of funds.
(7) *Amendments,* amendment or repeal, power of directors to make by-laws.

A short form of by-laws under the laws of New York will be found below in the Appendix.

Speaking very generally, it may be said that, in the United States, by-laws must be of a general and uniform character in dealing with stockholders and creditors; they must not unreasonably restrict the right of a stockholder to transfer or sell his shares; they must not limit the right of a stockholder to resort to the courts in case of injury; and they cannot bind a minority holder to support any fraudulent or *ultra vires* acts of a majority.

Classes of Corporations. — Numerous classifications of corporations have been devised, none of which are entirely satisfactory from the economic point of view.[52] From that point of view, all corporations may best be divided into I. Economic, or business, corporations, and II. Non-economic, or non-business corporations. Under the head of economic, or business corporations comes the classification according to various kinds of business: (1) Transportation and communication, (2) Municipal public service, (3) Limited natural resources, (4) Financial, and (5) Industrial. These five industrial classes, in turn, may be regrouped with profit under two heads according as they are naturally monopolistic or not.

Under the head of non-economic corporations comes a list which will not concern us, but which may be briefly mentioned once and for all: (1) Quasi-political corporations (civic associations), (2) Eleemosynary corporations (asylums), (3) Educational (colleges), (4) Scientific (learned societies), (5) Religious (churches), (6) Social-fraternal (secret orders). Such corporations have primary objects other than business dealings.

One closely related classification of corporations is that which takes the means and evidence of membership as its basis and divides them into stock, and non-stock, or "membership" corporations. In the former class, membership is determined by the ownership of stock; in the latter case it depends upon the consent of existing members. Generally, economic corporations are at the same time stock corporations, and non-stock corporations are usually non-economic in purpose.

There is a third classification, proceeding on the basis of liability, which is of interest to economists. Some corporations have an unlimited liability, though this is far from common, and is exceedingly rare in the United States. On the other hand, there are two classes of limited-liability corporations: those "limited by shares" and those "limited by guarantee." Corporations whose liability is limited by shares constitute the great majority; and generally, in such corporations, the members are liable only for the amount unpaid on the par value of their shares. In some cases, however, the statutes provide that stockholders shall be liable, not only for any balance not paid on the par value of their shares, but also for an additional amount equal to the par value. This is called "double liability." There are probably no limited-by-guarantee corporations in the United States. They are authorized by British law, and their members are liable for such amounts as they guarantee to pay in case the corporation becomes insolvent.

The following tabulation will serve to make clear the relations among the preceding classes: —

I. Economic, or Business, Corporations: —
a. *Naturally Monopolistic*: —
i. Producing Necessaries: —
a. "Public-service":—
1. Transportation and communication. (Railways and telegraphs.)

2. Municipal public utilities. (Gas, water, telephone, etc.)
b. Non-"Public-service": —
3. Limited natural resources.
(Anthracite coal, iron ore, water power, etc.)
4. Abnormal-competition industries.
(Iron and steel? Smelting and refining? Sugar? Petroleum?)

ii. Producing Luxuries: —
3'. Limited natural resources.
(Diamonds, etc.)
4', Abnormal-competition industries (if any in luxury class).

b. *Not-naturally Monopolistic*: —
5. Financial.
(Banks, trust companies, insurance.)
6. "Industrials" and mining.
(Manufacturing, mercantile, etc., not included in 3 and 4.)

II. Non-economic Corporations: —
1. Quasi-political.
2. Eleemosynary.
3. Educational-scientific.
4. Religious.
5. Social-fraternal.

Except at a few points the above classification requires little discussion. This chapter is concerned only with corporations existing for economic purposes and organized on a joint-stock basis. Within this field two great divisions are becoming more and more strikingly distinct. Naturally monopolistic corporations are those which operate businesses in which competition cannot normally prevail. Economists may differ in their detailed analyses of the forces which cause such a condition, but all agree that the condition exists. Without attempting a complete statement of the case at this point, it may be said that wherever expenses are such that they do not vary with the amount of business done, while, at the same time, net returns increase with an increase in the scale of business, there the tendency to monopoly is very strong. And if the business is one which must occupy some special location, or one whose products cannot be imported, — but must be consumed in connection with the local plant, — that tendency becomes irresistible. Take the railway, for example. It has a very large "fixed expense" account for maintenance and general expenses; therefore, as the traffic increases, there is no proportionate increase in expense. The net return per unit of traffic, then, increases; and the rate of profit grows with the increasing bulk of profit-yielding traffic, so that the desirability of doing business on the largest scale is doubly great. Moreover, it often occupies a right of way and terminals which cannot be duplicated for another road. The result has been that competition has not been able to persist among railways: they constitute natural monopolies, and such corporations have a peculiar significance.

Though the law does not recognize all naturally monopolistic corporations as "public-service corporations," the peculiar nature of naturally monopolistic corporations is partially allowed for in the character of

the legal limitations put upon public-service companies. For one thing, the power of such corporations to mortgage their property is subject to special limitations; they cannot create incumbrances whose foreclosure would result in alienating property which is necessary to the performance of their public duties. The right to alienate property is an implied power, except in case of public-service corporations. Such corporations, too, are more rigidly prevented from abandoning the objects for which they are incorporated than is the case with ordinary corporations. Finally, it is now generally recognized that the State has power so to regulate the rates charged by public-service companies that they will receive only a reasonable return on the actual investment.

Those corporations whose business is not necessarily monopolistic may be divided into two general groups, the financial and the "industrial." The reason for this division is the quasi-fiduciary relation — a relation of trust — that exists between financial institutions and the public. Banks, trust and investment companies, and insurance companies, are formed to deal with the funds of others; and long experience has demonstrated the danger of allowing unregulated corporations to conduct such dealings. Consequently it will generally be found that financial business corporations are subject to several special regulations. It is common, for example, to require that their applications for charters be approved by some special authority; full payment of stock subscription must generally be made in cash before the corporation may begin business; a special liability ("double liability") is required of the stockholders; and regular reports of the condition of the corporation's business are prescribed.

The great mass of common manufacturing and mercantile corporations is comprised under "industrials." Outside of their corporate existence, they have no special duties or privileges, and act as ordinary individuals or private organizations.

Chapter VII: Corporation Organization (*Continued*)

Historical Sketch: Origin and Development. — As with the other forms of associated business organization, the basis of corporate form probably lies in the solidarity and continuity of the family. Very early, certain functions of the family, both religious and economic, were taken over by Roman "Colleges" of priests; and it was in Roman law that the corporation first became a well-developed social institution. Besides the religious societies or colleges of priests, various gild-like organizations existed: there were military groups (legions), official societies (*scribes*), and trade societies (*fabri, navicularis,* etc.); and with increasing trade and wealth, organizations mainly for business multiplied. Such organizations enabled aristocratic Romans to engage in vulgar trade secretly, and served as an entering wedge for the commercial spirit. These Roman *collegia* had virtually all the legal characteristics of the corporation; they could sue and be sued in the name of an agent, were autonomous, and remained in existence in spite of changes in membership.[53]

Now Rome fell, and it is not true that the present-day corporation springs directly from the Roman *collegia;* but the Civil Law of Rome remained and has doubtless affected the corporation law of later times. Moreover, Roman civilization profoundly influenced the church and the municipality, — two institutions which persisted, and which, in a non-economic sphere, embodied principles that underlie the corporation. And finally came the rise of the various medieval gilds, which, in so far as connected with trade and manufacture, were closely associated with municipal life. Such appear to be the roots of the modern corporation.

Indeed, early English corporations were generally either ecclesiastical or municipal bodies. Originally, at common law, these corporations were formed by special charter only, which charter, of course, came from the crown. Under such charters all sorts of municipalities and gilds (trade and industrial corporations in towns) were incorporated,[54] the operations of such corporations being local and directed toward protecting the lives, property, or trade of local groups. These charters were frequently granted for aid rendered to the crown, an early instance being the incorporation of the goldsmiths in 1327. It cannot be too strongly emphasized that the weakness of the central government in medieval times played a capital part in determining the nature of these early corporations: when the State could not protect, when it could not administer, when it could not collect duties or taxes, then it was prone to grant powers and privileges to agencies that could. Such agencies included several of the most important early chartered companies.

Not till the sixteenth century can it be said that corporations became important as forms of business organization, — and it will be noted that they possessed limited liability in only a few special cases. The *gild* was a kind of corporation;[55] but it was a rather loose federation of individual traders or craftsmen which supplied a general framework of regulations within which the members worked as individuals. Then, the *regulated companies* grew out of trade gilds, being formed to meet larger problems of foreign trade. Such a company was formed by the celebrated Merchants of the Staple," which organization dates from the early

thirteenth century at least,[56] and appears to be one of the first corporations chartered by the English crown. The regulated-company form dominated trade down to the seventeenth century, but three or four joint-stock companies being in existence before 1600.[57] Under it, each member paid a fee and traded on his own account and on his own liability; but, along with his fellow members, he enjoyed an exclusive right of trading in certain districts. Finally, during the seventeenth century, the regulated companies were largely superseded by corporations organized on a joint-stock basis, and in most ways these early *joint-stock companies* more nearly resemble present-day business corporations than did the gilds and regulated companies which had preceded them. The East India Company, for example, has been referred to in an earlier chapter; and, shortly after it, were formed the various colonial companies, so interesting to Americans. Among these were the London and the Plymouth Companies, which, as organized in 1606, were corporations that had as objects not only trading, but also colonization and extended British dominion. The members of each formed a temporary joint stock, and were divided into two classes, — the "adventurers," who put in money, and the "planters," who came as colonists.

In the colonies established by such chartered companies the crown erected several corporations by charter during the eighteenth century, among them Dartmouth College, which was to play so important a part in corporation law. Another instance is the Ohio Company, which was incorporated in England in 1749 to deal in land. The colonial governments, too, incorporated several religious, educational, and military societies. Business corporations, however, were of very slow growth,[58] the earliest case that has come to the author's attention being that of a mere quasi-corporation formed in 1709, when the Connecticut General Assembly gave the Simsbury copper mine owners the right to appoint a committee with directors' powers. It is in 1732 that we find the first clear case of a business corporation for profit organized under a legislative charter. This was the "New London Society United for Trade and Commerce in Connecticut." Though created for trade, it proceeded to set up a land bank, and issued bills with such disastrous results to currency that the "charter" was repealed in a year.

It was not till after the Revolution that any large business corporations were formed in America, and then the earlier manner of creating such organizations bore fruit in a serious prejudice toward them. When the Bank of North America was established by the United States in 1781, it had to be chartered on the basis of the implied powers of the Constitution. There was discussion of a national general incorporation act, but the idea was not adopted because of a widespread distrust of corporations which had been begotten of the practice of conferring exclusive privileges upon them by the crown. In the beginning, then, corporations in this country were associated with two ideas: the idea of a royal charter, and the idea of monopoly. These notions concerning corporations persisted after such organizations had come to be authorized by legislatures rather than chartered by kings and had ceased to be entirely monopolistic, a persistence which served to magnify the franchise aspect of the certificate of incorporation. Men clung to the old voluntary associations, partnerships and joint-stock companies, for a long time. In 1800 probably not over one hundred corporations could have been found in America, and most of them were located in Massachusetts. The great majority of such business corporations as had been formed down to that date were of the public-service class, being mostly for constructing and operating roads, bridges, canals, etc., or for banking and insurance companies.

Not long after the nineteenth century opened, a marked increase in the use of the corporate form occurred. This came about partly because of the growth of industry, and partly because of the rise of an investing class. The Napoleonic wars caused American shipping to flourish and the long embargo stimulated manufactures. Between 1800 and 1815 manufacturing and turnpike companies sprang up rapidly, with the result that in 1811 New York passed the first law providing for the general incorporation of manufacturing companies the world had ever seen. Under this law, any five persons could form a corporation for

manufacturing purposes with a capitalization not to exceed $100,000. By 1837 Connecticut and Michigan had similar statutes. Between 1815 and 1835 came the canal and railway era, to say nothing of banking, and it gave a new field and a new importance to the joint-stock corporation; for the great, permanent investments required could hardly have been raised in any other way at that time. In the year 1837, Massachusetts alone incorporated some seventy companies.

At the same time, corporations began to be more encouraged by public opinion and law as a means of setting savings in motion and providing the country with much needed "internal improvements." This encouragement was increased by the waning of Federalism and the downfall of State participation in industry; for these developments resulted in a greater readiness to resort to private associations for the undertaking of the needed enterprises.[59]

Meanwhile, somewhat similar developments were taking place in England, and a natural result was a parallel development in the law of corporations. The Bubble Act having been repealed, in 1835 English law authorized the crown not only to create "unlimited-liability" corporations, — that is, corporations whose members should be individually liable for the debts of the company, — but also to grant such companies the right to sue and be sued in the name of an officer, thus giving them more of the true corporate idea. The first great step, however, was taken in 1844, when individuals were allowed to form corporations under a general law without applying for a crown charter or an act of parliament. Tlus act retained the common-law idea of unlimited liability; but showed some little progress toward the later organization and away from the partnership idea, for it provided that before a creditor could sue a member on the debts of the company he had to prove that the company itself did not have sufficient property to satisfy his claim.

"Parliament could and sometimes did by special Acts form companies the liability of whose members was limited,"[60] but down to the middle of the century public opinion was on the whole against empowering the members of a company to limit their liabilities. The year 1855, then, is notable as marking a change in this state of affairs by the passage of the first general limited liability act (18 and 19 Vict., c. 133). Under its terms future companies were to be assumed to be registered under the act of 1844; stocks were not to have a par value of under £10; and the word "Limited" was to be added to the company's name. Upon such conditions, whenever execution against the company did not produce enough to cover its debts, action might be brought against individual stockholders by order of the court, but only for the amount of the difference between the par value of their shares and the sums paid in. In 1856 another act was substituted for the preceding measure, and it served as a model for the Companies Act of 1862, which, in turn, is the basis of existing British "Companies Acts." Thus the modern business corporation, capable of being formed on the initiative of private individuals, of acting as a single person, and possessed of limited liability, became firmly established in English law.

About the same time like progress was made in America. About 1850 the principle of general incorporation entered the constitutions of the various States, and contemporaneously the limited-liability principle became generally recognized. The provision for general incorporation in the Iowa constitution (1846) is typical: "No corporation shall be created by special laws; but the General Assembly shall provide, by general laws, for the organization of all corporations hereafter to be created, except as hereinafter provided."[61] Not all the States, however, granted limited liability in their general laws. Thus Missouri in her general incorporation law of 1845 provided that, except where certificates of incorporation should expressly state to the contrary, all stockholders in corporations should be subject to "double liability." This enactment appears to have hindered investment and soon exceptions had to be made.

The causes of this common adoption of "general laws" are of interest both as historical facts and as logical problems. The most obvious one was the discrimination which resulted from bringing a clash of

private interests before the legislatures where "bribery" and "pull" could be made to count; sound enterprises sometimes found difficulty in securing a certificate of incorporation, while unsound enterprises met with no obstacle. This condition is coupled historically with a general distrust of the State legislatures on the ground of corruption. Also, the time of legislatures was too largely taken up with the consideration of special acts of incorporation. Again, with the development of highly capitalistic industry, uniformity and stability of business conditions became essential, a fact which is notably apparent in the case of railway systems. Variety and fluctuation in the conditions of incorporation became extremely undesirable. Another difficulty inherent in incorporation by special legislation was found to arise from the lack of continuity of sessions of the legislatures. No matter how important it might be to organize a corporation at some particular time, if the legislature were not in session the project would have to wait and industry be impeded. Finally, the prevalence of the doctrine of *laisser faire* was important; for that doctrine meant a tendency to minimize state intervention in industrial affairs, and laws which once for all provided a general scheme under which individuals could freely incorporate appeared to be more in accord with that tendency. The general demand for the exploitation of natural resources also worked in favor of a measure which would facilitate the formation of business corporations.

Some Conclusions from History. — A number of pertinent conclusions crowd upon one as one casts one's eyes back over the history of business corporations, (1) The root idea of the corporation is not that of the joint-stock principle, but of a *closely knit unity of action with an assured endurance of succession.* Evolving from such group units as the church or the town, this idea was fused with the joint-stock idea and the transferable-share idea to form the modern business corporation. To these elements, in the fullness of time, was added the element of limited liability.

(2) Beginning with more loosely knit corporate associations, such as the gilds and regulated companies, which did not entirely fuse the business activities of their members, the evolution of the business corporation was toward firmer association, passing through a stage in which the corporation and the joint-stock idea were fused, then developing equal transferable shares, and reaching the present condition about the middle of the nineteenth century.

(3) The evolution has been from "charter" to "certificate," or "memorandum." The early English and American corporations were chartered by crown and legislature as exceptional institutions and generally received monopolistic privileges. Under such circumstances the charter was unhesitatingly regarded as a "franchise" in itself. With the adoption of freer incorporation under general law, the tendency has been to look upon the corporate form less as a franchise in itself and to emphasize the private initiative aspect as it is manifested in the free application of groups of individuals for incorporation.

(4) Corporations were originally chartered when governments were weak, and the State delegated to them certain of its powers. This was because of inability to meet the problems either of growing commerce and industry or of expanding territory. The force of this observation is evident in United States history between 1825 and 1870. In dealing with the corporation problem, then, we must not forget the circumstances which begot the corporation in its present form and with its present powers. The question may logically be raised — Is not the logical remedy for corporation abuses a resumption by the State of such powers when the exigency which led to their delegation is past?

To-day, outside of farming, the corporation, as organized on a joint-stock basis, is far and away the dominant form of business organization. This statement applies to power and efficiency, not to number of business units, for in the United States corporations make but 26 per cent of the total number of establishments. Corporations, however, employ over 75 per cent of the wage earners engaged in manufactures and produce 79 per cent of the value of manufactured products. This dominance is rapidly increasing, for even in

1904 corporations employed only 70 per cent of the wage earners and made only 73 per cent of the products. More than this, the number of corporation establishments has increased relatively faster than individual and firm establishments: 23.6 per cent of all establishments were corporations in 1904; in 1909, as already stated, the percentage was 26. In transportation and finance the corporation is even more clearly in the ascendant. Returns for the fiscal year 1910–1911 under the Federal law providing for the taxation of corporate incomes show the existence of 270,000 corporations in the United States. These corporations had stocks and bonds outstanding to the amount of over $88,000,000,000 and reported an income of $3,360,000,000.

Advantages and Disadvantages. — The existing business corporation being a mixture of the joint-stock and legal entity ideas, certain of its merits have been indicated in a preceding chapter on joint-stock organization. Here, attention may be confined to the corporation idea proper. The weakness of the association principle lies in the centripetal tendency which is inherent in it: there is an ever-present *tendency* to break down into the constituent elements. Now incorporation makes association stable. Or, to change the figure, it puts an iron hoop around the barrel, and so binds the units — the staves — into a new, enduring, compound unit. The hoop is the entity idea. It is the specific legal provision for unity of action and continuity of succession. Indeed, the hoop may exist without the staves, and in a similar way, the law may regard the corporation as existing when there are no members.[62] One advantage of the corporation, therefore, is its greater endurance. It may be permanent. The unincorporated joint-stock association may equal it in temporary stability *de facto,* but this is not the case of necessity or *de jure,* and endurance in time is even less certain.

A second advantage lies in the limited-liability feature. This feature is not essential; it is not necessarily associated with the corporation, but is more largely a logical outgrowth of joint-stock organization; yet it is in fact now so closely associated with the business corporation that it may be treated as an advantage of that form of organization. Moreover, the corporate form has facilitated the spread of limited liability, for anything which increases the distinction between the business unit and the individual members makes it easier to separate the credit and liability of the one from those of the other. This is illustrated by the British act of 1855; for that statute indicated that execution was to lie against the company as a separate entity first, and then to a limited extent creditors might resort to individual members. No single phase of the development of business organization has done more to facilitate investment than the legal provision for limited liability. In this way alone can risk and returns be correlated. Most men will not invest under conditions which require risking two dollars for the sake of one, yet this is the condition which may confront one in the common-law partnership and joint-stock company. To sum the whole development up, we may say that the partnership applies the idea of association to capital investment alone; the joint-stock company extends it to cover management; the corporation further applies it not only to capital and management but also to risk. It is only under the incorporated joint-stock organization (or some form closely approaching it) that the financial responsibility of members is made coordinate with their investments.

A third advantage lies in the increased efficiency of direction: Under the corporate form nearly all doubt as to the possibility obtaining concentration and unity in the direction of manage-nient disappears. Of course there may be dissension within the organization; but this does not disrupt it and it must act as a unit. Let the reader recall the struggle which took place within the ranks of the Illinois Central Railway Corporation not many years ago when Mr. Harriman was engaged in ousting the old administration led by Stuyvesant Fish. The issue was long and closely contested; but the corporation continued to act with unity. All this *may* be true of unincorporated joint-stock companies, but it is not so certain. The corporation gives the business a definite standing and facilitates binding actions through its agents, making all subterfuges, special contracts, etc., unnecessary to secure this end.

The skill and flexibility of administration may also be increased as a result of limited liability and the entity idea. The wisest and most skillful directors may be chosen, whatever their other interests, and may give at least occasional attention and advice; for even though required to hold a small interest in the corporation, they thereby incur but a small liability. As they need make but a nominal investment, the directorate may be changed as desired.

In the fourth place, it follows from the preceding advantages that no business form is so well adapted to raising large amounts of capital as the joint-stock corporation. Its use is intimately associated with the vast aggregations of capital which characterize the industry of to-day. To give one or two illustrations, there are the United States Steel Corporation with an outstanding capitalization of $868,583,600 and 120,000 stockholders, the Pennsylvania Railroad Company with a capitalization of $450,974,050 and 69,760 stockholders, and the American Telephone and Telegraph Company with a capitalization of $263,335,600 and 41,128 stockholders.[63] It is doubtful if such units could be built up under any form other than the corporation. The addition of the legal proviso for unity of action and permanent succession to the joint-stock idea was all that was needed to perfect business organization regarded as a machine for combining large elements of land, labor, and capital in units of whatever size might be demanded by economy of operation.

Some disadvantages may be found in the corporation form, even from the private point of view. Most of these are to be associated with the joint-stock element, however, and have already been touched upon. Limited liability serves to increase most of such weaknesses. They will be remembered as lack of personal interest on the part of managers, leading to inefficiency and waste; and conflicting interests between directors and officers on the one hand and stockholders on the other, finding expression in manipulation by "insiders," the payment of exorbitant prices for materials, etc.

(1) More especially connected with the corporation is the difficulty of securing in practice adequate responsibility of officers and directors for their fraudulent acts. The abstract theory of the law is that directors stand in a fiduciary relation to their corporations and are bound to deal with the most scrupulous honor; but the law has not so far seen fit to impose such penalties for the breach of this rule as to form an adequate deterrent. When directors secure personal debts by mortgages on corporate property the mortgages are set aside, and when property belonging to directors is fraudulently sold to the corporation at exorbitant prices the excess over a reasonable price must be returned; but under these conditions there is much to be gained and little to be lost by fraud. Punitive damages, at least, should be a practicable possibility. More especially still, it is a principle of law that when a loss results to a corporation on account of the fraud or negligence of its directors or other agents, an individual — and consequently a minority — cannot maintain an action at law. This is due to the theory that the corporation is a separate legal person, that the directors are the agents of the corporation and not of the stockholders, and that the corporation has suffered the injury, not the stockholders.[64] True he may sue in equity when he cannot get the directors and stockholders to act.[65] But in this and other ways the law's emphasis of a separate artificial personality for the corporation has made it difficult to hold officers responsible to the stockholders. The former can shelter themselves behind the legal personality, claiming responsibility to it alone. This fact, by increasing the risks of investment, to some small extent offsets the advantage of limited liability and restricts the number of those who invest in corporate securities.

Other special disadvantages, looked at from the standpoint of the individual, are (2) a restricted credit due to limited liability. Naturally, borrowing capacity is limited in proportion to financial responsibility. (3) The expense of forming a corporation may be considerable, varying in different States and increasing with the amount of capitalization.[66] The initial fees and taxes of such bargain-counter States as South Dakota, Arizona, and Delaware are low, but companies incorporated there are under suspicion. (4) It is common for

the various States to impose various limitations on "foreign" corporation, — limitations in the nature of oaths, taxes, limited durations and the like, and it is believed that the foreign corporation not infrequently suffers at the hands of State courts. (5) The liability to regulation and publicity is to be considered: Certificates of incorporation and general laws have their limiting clauses; legislatures may prove hostile. Indeed, the popular distrust of corporations is a very real disadvantage. The expense of bookkeeping, too, and of making reports required by law may be a considerable item to a small concern.

Social Point of View. — All that was written under the head of social point of view in the chapter on joint-stock company organization applies to the business corporation, and the reader is referred back to that section. The great advantage to society of the corporation element, as such, obviously is to be found in its added encouragement of investment and the possibility it affords of efficient direction of large-scale industry. The element of stability, also, is notably well cared for by the corporation.

The corporation has the same advantage for publicity that was noted in the joint-stock company, and more; for it must be publicly authorized in a way not required of the latter. Its certificate of incorporation is a public document that grants it special powers which can be exercised only under delegated authority from the State, and the tendency has been to require the filing of information adequate to safeguard the public interest as a condition of granting the certificate.

This raises the question, is the right to be a corporation a "franchise"? There is a growing tendency among law writers to state that such is not the case, but that incorporation is now, under general laws, free to any individual who may care to organize a company, and so is not to be thought of as a special privilege. Now the distinguishing mark of a franchise is the conveyance of powers or privileges which do not ordinarily rest in an individual or private group of individuals, but which are attributes of a sovereign state and are conferred by it upon private parties. Under the influence of the old regime of crown-granted charters conveying exclusive privileges — sometimes for the purpose of securing aid to the state from the corporation — the franchise aspect of corporations was emphasized. The right to be a corporation was thought of as a franchise. Did it not confer in an exclusive way privileges which belonged to the state? "But," Mr. Machen writes, "the mere right to be a corporation for some purely private purposes is no longer of this character.... Always should the fact be recognized that nowadays when the right to organize a corporation is almost as free as the right to execute a deed of real estate, corporations are very different things from what they were when that right was confined to a few favorites of king or parliament."[67] Certainly the older idea was extreme, but, to the author, this newer doctrine also seems to require qualification. Its premises appear to be a little unsound in that they are limited to corporations for "some purely private purpose" and they lay an undue emphasis upon the freedom of the right to organize a corporation as a test of franchise. As already pointed out, all corporations exist as social institutions authorized for the benefit of society, whatever the motives of the individuals who form the membership. And, as just defined, the test of franchise is possession of privileges belonging solely to the state. It seems that to empower a group of individuals to act as an autonomous, self-perpetuating unit, is to grant such a privilege; and certainly such a grant can only come from the State. General incorporation acts sum up and, as it were, codify those provisions which were generally found in the special acts of incorporation, and the general character of the law merely stands for a certain uniformity in the various preceding special acts: it does not do away with the fact of a grant of power to each corporation. The granting of limited liability, too, strengthens this view of the case. The logical conclusion is that while not all of the elements found in the business corporation of to-day are franchise rights, some of them are. The modern joint-stock corporation is a complex organization.

From the social point of view, a number of disadvantages may attend corporate organization. In the first place, all that was said about indirectness of motivation under joint-stock organization also has a bear-

ing here. Furthermore, the intensity of industrial motivation may be materially decreased as a result of limited liability and imperfect responsibility. In general, if a form of business organization can be freely used, increased liability will, up to a certain point, mean increased motivation. But more than this, it is too often forgotten that financial security may be regarded as one test of efficiency, especially in certain kinds of business, and that in some cases ordinary limited liability is not a sufficient motivation to produce results in the shape of the security needed.

The fundamental social principle that with power should go responsibility is not fully operative at present. Neither financially to public and stockholders, nor legally for criminal acts, are the members of the corporation subject to a full measure of responsibility. Too often its officers have been able to shelter themselves as agents behind the entity which has "no soul to be damned."

Again, the corporate form, while in no wise to be confused monopoly, has facilitated the formation of monopolies. The "trust" is generally a monopolistic corporation. This fact is probably best regarded as a misuse of a desirable institution, but nevertheless the likelihood or mere possibility of abuse demands attention.

Finally, the liability of corporations to regulation has led them to seek to influence the source of that regulation, the legislatures. Political corruption has been a result. This is not to be laid at the door of the corporation as a form of business organization, but it is a fact that the closeness or relations which necessarily exists between corporations and government makes it a problem. Especially is this true where public-service companies are concerned.

The consideration of corporations from a social and historical point of view leads to several conclusions. For one thing, it is clear that the present-day business corporation is a mixture or complex of elements which have changed and developed and of which some are not essential to the corporation idea. Such is the case with limited liability. This suggests the possibility of a further change if found desirable. Again, while the corporate form must be kept distinct from the business which it may chance to cover, and monopolistic corporations are best thought of as corporations engaged in a monopolistic business, the classification of corporations into public-service or naturally monopolistic, as opposed to non-naturally monopolistic, is of importance and must be recognized as a first step toward solving "the corporation problem." Fortunately the tendency of the law is now in that direction. It has also been made clear that certain disadvantages are coupled with the corporation form, and the conclusion follows that unless these disadvantages can be overcome the field for corporate activity should have its limitations. Certainly the common notion that the corporation is a sort of disguise, which may be put on by any little business concern which may desire to shun social responsibilities, should be made impossible. On grounds of motivation and responsibility, it is the author's opinion that other forms of business organization should be encouraged where the greatest capital and the maximum stability are not essential. A healthy struggle between different forms of organization may still have salutary results.

Chapter VIII: Simple Business Trusts

When the word "trust" is mentioned, most men at once think of some illegal combination.[68] The term is in bad odor. Yet if one were to inquire of a lawyer concerning trusts one would probably be told that they are very desirable social institutions, and that they are perfectly legal. Moreover, in the conservative State of Massachusetts, one could find scores of harmless business organizations which are carried on under the trust form. Whence comes this seeming paradox?

The trusts thought of by the layman are the "Standard Oil Trust," the "Sugar Trust," and the like. These are all more or less monopolistic combinations of corporations, and will be discussed in a later chapter on "Combination Trusts." The lawyer, however, has in mind the general idea of the trust institution, which is a very different matter. While trusts may be readily perverted when used for combinations, they are necessary and beneficial in many other relations. The lawyer may be thinking of the trustees appointed by the courts to administer the estates of deceased persons, infants, etc. Also, in some States, trustees are chosen to carry on businesses for groups of individuals, and to supervise investments. Such uses of the trust institution need involve no monopoly; and they need combine no corporations. They may be entirely legal, and beneficial to all concerned. To the partnership, the joint-stock company, and the corporation, therefore, the trust must be added as a form of business organization under which a simple association of individuals may legally carry on a business.

Trusts Defined. — The simple business trust which forms the subject of this chapter is a form of business organization under which the legal title to property is vested in an individual trustee or individual trustees,[69] and the property is managed by them in the interest of the former title holders who become "beneficiaries" (*cestuis que trustent*). The trustees thus become, not agents — as are partners — but principals; and they can make contracts, and can sue and be sued in their own names. The beneficiaries, in turn, are neither partners nor agents. They cannot convey the property to others; nor can they usually maintain any action at law for its protection. They only have the right of action against the trustees. With such a relation existing between trustees and beneficiaries, it is apparent that without any special provision to the contrary the debts of the business lie against the trustees, not against the beneficiaries.

Under the common law, trustees may and do issue certificates of beneficial interest, the capital embraced in the trust being divided into shares. These certificates are much like the stock certificates of a business corporation.

Origin of Trusts. — The idea of the trust may be traced directly back to medieval times and to the doctrine of "use." This doctrine arose from a desire on the part of churchmen to evade the statutes of mortmain, which then limited the rights of those who would fain have willed estates to them in perpetuity. Accordingly, the wily men of that day had such estates deeded to some friend for their "use," which meant that they

retained the right to any income from the estate; and for a time this practice was effective. Clearly, this process is very similar to transferring property to trustees to be managed by them in the interest of certain beneficiaries. Thus, at the very outset, trusts were associated with evasion of the statutes.

The trust proper appears to have developed from the necessity of devising some suitable agency for managing the property of incompetent persons; and such agencies were early recognized at common law. Indeed, they were imposed by the law in the interest of society. As developed along this early line, the trust was merely an equitable right in real or personal property. It involved the creation of a trustee or group of trustees who had possession of the property as the legal owner, and whose proper function was to carry out the terms of the trust instrument with regard to that property in the interest of the ultimate owner or owners in equity, — the "beneficiaries." As early as the middle of the nineteenth century, this idea was used commercially in England for the management of investments.

Classes of Trusts. — Lawyers distinguish several classes of trusts: active and passive, simple and special, express and resultant, etc. The terms active and passive are self-explanatory. A "simple" trust is one established without any special instructions to the trustees, thus allowing great discretion on their part. An "express" trust is created by an instrument which designates directly and expressly the property, persons, and purposes of the trust; whereas a resultant trust is one which results from the construction put by the law upon some existing or past relation. Practically all business trusts may be classed as active express trusts; but, as it is next to impossible to define the duties and policies of trustees, they are all virtually "simple" trusts.

From the economic point of view, two classes of trusts are clearly distinguishable: (1) trusts of real estate, and (2) trusts of personal property. Personal property trusts, in turn, are of two kinds: (a) industrial trusts for carrying on some manufacturing, mercantile, or other business; and (b) securities-holding trusts, organized for investment in or control of corporations or joint-stock associations.

In Massachusetts, where the trust form is now most used, the State has for all practical purposes prohibited the use of corporations for developing, holding, and managing real estate. Therefore, the trust is largely used in this field, most of the real estate development of Boston being carried on in this way. The advantages of so doing have been stated in the following terms: —

> "The rights of shareholders, the terms of office of trustees, theit compensation, powers, duties and limitations are more satisfactorily regulated by the terms of the trust agreement which can be drawn to meet the special needs in each case than could be possible under the general corporation laws; and as the property under any specific trust is usually limited to one parcel and one set of shareholders, it seems wise to leave the management, as far as practicable, in the hands of trustees selected by the owners with their powers and duties carefully defined rather than to give over its supervision to the changing officials of the State."[70]

Industrial trusts are not nearly so common as real-estate trusts, and are generally small. Only one having over twenty shareholding beneficiaries existed in Massachusetts in 1912. The majority of such trusts appear to have been reorganized from corporations for the purpose of avoiding publicity, liability for the Federal income tax, and other corporation disadvantages. Here would come such cases as the McKay Sewing Machine Association;[71] inventors who assign inventions and patents to trustees;[72] "car trusts"; etc. Car trusts are organizations for supplying railway companies with cars. The trust, which is often formed by officers of the company, issues certificates to pay for the cars, which cars are leased to the company for a rental sufficient in amount to cover interest and to form a sinking fund for paying off the full price of the cars. These leases are held to form a conditional sale, as they are in the shape of contract of sale providing

that the title to the cars shall remain in the vendor until the purchase price is fully paid. The beneficiaries, or ultimate equity owners of the cars, are the manufacturers or original owners, and they are virtually selling the cars to the railway company on the installment plan through trustees, who issue trust certificates to them to represent their interests in the payable installments. These certificates are transferable; and the death or withdrawal of a member of the car trust does not dissolve the association. The members cannot be bound by the trustees on a contract entered into for a purpose which does not come within the objects of the trust, and they cannot make themselves liable on such a contract unless they unanimously authorize it.[73]

Securities-holding trusts have been formed of late years in some States which do not authorize corporations to hold the stocks of other corporations, especially where the law prohibits the consolidation of public-service corporations, — *e.g.*, Massachusetts electric railway companies and gas companies. Such organizations take us over into the field of "combination trusts," which are to be discussed later. The procedure is simply to put a majority of the stock of several companies into the hands of trustees, and these trustees then issue certificates in any amount desired.[74] In such cases, question of creating a monopoly can hardly exist; for such industries are naturally monopolistic. The chief trouble with such trusts has been that they have often been grossly overcapitalized. Also they have increased the extent of their monopoly by going into the business of furnishing the materials and supplies needed by the subsidiary companies.[75] They are virtually holding corporations, but are not subject to the laws regulating corporations. Their legality may be questioned. But there is a kind of holding trust in existence to-day, which, within certain limits, is entirely legal, however undesirable it may be. Such trusts are known as "voting trusts," and are sometimes called "stock pools." The voting trust is a kind of special express trust, which may be defined as a form of organization in which holdings of stock are combined by placing them in the hands of trustees to be voted in a stipulated manner. A voting-trust agreement is entered into; and the stocks are transferred to the trustees and taken out in their names, negotiable trustee receipts being given by them in exchange. They are authorized to collect dividends, and are bound to pay such dividends over to the holders of the trust receipts. Unified voting is the object in voting trusts, and the ownership of stocks is not vested in the trustees: they are trusts of management, not of property. This second class of holding trusts does not involve a combination of corporations, and is undoubtedly legitimate when used reasonably. It is often desirable to insure a uniform and undisturbed policy on the part of a whole corporation, or of a group of stockholders within the corporation, and by transferring a controlling amount of stock of the company, or all the stock of the group, to a board of trustees, with definite and binding instructions as to how to vote, this end may be secured. The trustee's receipts may be transferred without affecting the voting of the stock. In this way a dominant majority within a corporation may rest easy without fear of its holding being decreased, a minority may insure a united front upon all occasions, or a whole body of stockholders may prevent outside interests from buying in and manipulating their corporation. The voting trust, however, may be abused by majorities, and may be used to further manipulative plans. Its use should be carefully safeguarded by law.

The only limits to the legality of these voting trusts at present are that they must be for legal objects and not be discriminatory against other stockholders, they must be formed for a reasonable duration of time — probably not for a longer period than the life of a proxy — and they should be open to all stockholders desiring to enter. New York statutes specifically provide for voting trusts.

Advantages and Disadvantages of Trusts. — If this form is at hand for organizing business units, and has actually been used in not a few cases, one's next inquiry is: What are its potentialities? Why is it used at all? Why is it not more used? The answer to these questions involves a discussion of the advantages and disadvantages of the simple business trust.

Applying the six tests of efficiency of business organization, we note first that the trust is readily and

cheaply formed. It does not require the sanction of the State. In facility of formation, then, it is on a par with the partnership.

As to capital, the trust lies between the partnership, as ordinarily organized, and the corporation. The trustees issue certificates which accommodate a number of investors; but the character of the management makes it impossible to appeal to so wide a market as do the stocks of a corporation. Furthermore, the trust certificates can be sold or assigned only in States which authorize by statute the assignment of those rights to personal property which are contingent upon suit at law (*choses in action*). In other States the buyer may have to file a bill of equity to get the title.

The liability of the members of trusts is in practice handled very satisfactorily, from the point of view of the investor. It is common to make an agreement that neither the trustees nor the beneficiaries shall be liable for the debts of the trust, which provision is made a part of every contract entered into by the trustees. In a word, it is provided that the trust property alone shall be looked to for the satisfaction of debts. This leaves the beneficiaries in a more desirable state than even the stockholders of a corporation, as there would be no excess of par value of shares over value of property to be drawn upon. Unless some such agreement is made, it appears that the trustees are personally liable: trustees can be held personally for material ordered for a trust estate, and for contracts made.[76]

The foregoing tests, then, are met fairly well. Aside from questions of legality, the crucial test, therefore, comes in the efficiency of direction. Here we find that the *continuity* of management is excellent; for trustees are not likely to be changed. In this the trust has an advantage over the corporation for businesses in which continuity is highly desirable. It also appears that in practice trustees can handle business with more ease and dispatch than the average board of directors.[77] But the case is not so favorable on the important points of *motivation* and *flexibility.* True, the trustee is in equity bound to take such care of the trust estate as he would of his own property. That fact, however, can have but an uncertain and intermittent motive force, and can not adequately take the place of responsibility to shareholders. The beneficiaries have no power to remove trustee managers. They possess no remedy for unskillfulness on the part of trustees; and they can remove trustees who are guilty of fraudulent acts only by means of an uncertain bill in equity. As to *flexibility,* the trust is sadly deficient. The deed of trust once drawn up and put in force, its provisions are not subject to change except by the unanimous consent of all parties. The courts cannot change the powers of trustees, nor alter the terms of the trust agreement. And a trustee who has accepted a trust can neither renounce the duties and responsibilities of his office, nor delegate them to another. We must conclude that the trust will supply a safe and efficient instrument for direction only in case of businesses which are little subject to change, and which require relatively little discretionary action on the part of the managers. Such a business is the holding and managing of real estate.

Quite in accord with this conclusion is the fact that the trust is very stable and enduring. Trusts may be established for any reasonable time, and upon the death of a trustee his duty passes to his survivor or survivors. While a large percentage of the corporations formed each year soon pass out of existence, such business trusts as have been established have with few exceptions endured.

A final disadvantage of trusts lies in their doubtful legal status. As a general proposition, at common law, trusts are quite legal: any one who can enter into a contract, or make a will, or deal with legal title to property, may vest property in trustees. But, of course, this proposition is subject to the limitation set by public policy and by statute law. Trusts for combining corporations may be illegal as being the result of *ultra vires* acts by the corporations. New York and other States forbid trusts of real estate except in certain cases; and some States have abolished all trusts and uses except those which are established by will or deed.

But this is not all. It is not entirely clear whether trusts as forms of business organization will come

under the law of trusts or not. It appears that in Massachusetts the trend of the decisions has been toward regarding voluntary associations with a trust agreement as a form of partnership. In some cases, however, they have been brought under the law of trusts. It seems not unlikely that in other jurisdictions, business trusts having agreements which limit liability and vest all property rights in the trustees would be regarded as quasi-corporations. A recent Massachusetts case suggests that in the determination of this point the emphasis will be laid upon "the substantial purposes of the enterprise" rather than upon these forms and agreements."[78]

In addition to this element of uncertainty, there is the further fact that the public is inclined to be suspicious of any organization bearing the name "trust"; and even in Massachusetts, legislation restricting the use of simple business trusts has been proposed of late.

Trustees as Entrepreneurs. — How is the entrepreneur's function filled in the trust? What of the trustee's position as an entrepreneur? Under the common law, the situation is rather anomalous, being somewhat like that in a receivership. The trustee is neither a pure entrepreneur, nor a mere salaried employe. His risk is more like that of the entrepreneur, though it is modified by his right to reimbursment for losses incurred through acts performed in good faith. But his reward as trustee is in the nature of a stipulated commission, and he may not make a profit in his trustee capacity. His mixed status appears in the ownership of the trust property: The legal title is in the trustees; but in equity the beneficiaries are the owners, and the trustees are limited by the terms of the deed and by the principles of equity. Like the receiver, although to a less extent, the trustee is subject to considerable supervision by the courts.

As modified by special agreements, the business trust is made to partake largely of the nature of a corporation, except that the trustees may always be more independent of the shareholders than are directors. Agreements often specifically divest the beneficiaries of all title in or to the trust property, deprive them of the right to an accounting, and bestow upon the trustees all the powers of corporation directors. As already noted, too, such agreements generally provide that neither the beneficiaries nor the trustees shall be personally responsible for the debts of the trust.

Social Point of View. — Considered from a social standpoint, the business trust is so liable to abuse, and requires such safeguarding, that it may fairly be called a dangerous institution. It will be remembered that the idea of the trust developed from the need of a suitable agency to manage the estates of incompetent persons, not to conduct businesses for competent persons. We have seen that in its very origin the trust form savored of the evasion of law. It has appeared that the securities-holding form of trust has been used to evade corporation laws. In one case, the courts have held that "the originators of this scheme have endeavored to avail themselves of the advantages of a corporation, under an association as partners";[79] and again in *Hussey* v. *Arnold,* the Massachusetts court said: —

> "The agreement creating the trust has peculiar provisions. The object of it, apparently, was to obtain for the associates most of the advantages belonging to corporations, without the authority of any legislative act, and with freedom from the restrictions and regulations imposed by law upon corporations" (185 Mass. 203).

While these cases were decided in a State whose policy is to recognize no forms intermediate between the partnership and the corporation, they throw light on the general significance of the trust as a form of business organization.

In order to give the utmost reasonable safety to the use of business trusts, in the interest both of investors and of the public, it would seem to be the part of wisdom (1) somewhat to limit the field available for

them, and (2) to safeguard their form. Business trusts appear best adapted for the conduct of investments in real estate; and, to say the least, are not needed for ordinary manufacturing and mercantile business. Wherever used, the following restrictions should be adopted: Trusts should be limited to a reasonable term of years, — say ten. They should be formed only by means of a written deed of trust accessible to all beneficiaries. The beneficiaries should not surrender all title to the trust property; and the deed should empower them to withdraw their property upon reasonable notice. The same policy which is applied to the control of the capitalization of corporations ought also to be applied to the trust.

In conclusion, it may be said that the essence of the matter lies in the fact that the trust institution originated in the need of an organization for administering the property of those who were incapable of attending to it themselves, and consequently it is not *naturally* adapted to the needs of active and intelligent investors. While the trust supplies a stable and enduring organization, as used in business it almost of necessity places in the directors (trustees) a discretion which is out of all proportion to their actual responsibility. It is not a safe form, viewed from the standpoint of society.

Chapter IX: Combination Organization in General

Thus far we have examined organizations which may be called simple associations. In each of the forms discussed in the foregoing pages, the individual has been the constituent unit, and, in each case, the individuals as units have been simply and directly associated. Formally, at least, the natural persons who are the members have stood in an immediate relation to the direction of the management of the organization. The highest and most efficient form of organization by simple association is the corporation. Now, in just the same way that the powers of a single individual are limited in comparison with the powers of an association of individuals, so the powers of a simple association are more limited than those of larger and more complex aggregates. In political government, and especially in an immature and changing civilization, it would be deemed impossible to administer the affairs of a great continent directly, without the interposition of subordinate officials and local units having some discretionary powers; and, likewise, in business government, the extent of territory and amount of production that could be attended to by a simple direct association of business men is limited. If we call business "the market," we may conclude that with the growth of markets there would be a tendency to form larger business organizations, and that these larger organizations would necessarily be less simple and operate more indirectly. The natural thing to occur would be the combination of existing simple associations into large compound organizations.

Looking around us. to-day, what do we see? On all sides we behold complex organizations which indirectly, through sub-ordinate and simpler forms, deal with markets which are sometimes world-wide in extent. Of course, independent simple associations, such as partnerships and uncombined corporations, continue to exist, just as the single-individual organization does; and moreover, combinations were not unknown in earlier times; but a substantially accurate idea of the evolution of business organization will be gained if one thinks of a new cycle of development as opening about the time of the Civil War, or say 1870, and reaching a climax about 1898 — a cycle in which the constituent units more and more frequently became associations of individuals, and the resultant organizations were compound affairs or combinations. It may be said that artificial persons (corporations) more and more form the units of the later associations. For over a generation we have been growing more and more familiar with the rich terminology of combination. The columns of the press bristle with "combines," "trusts," "associations," "pools," "consolidations," "rings," "mergers," and what not. In the following chapter the object will be to straighten out this confusion of terms, to analyze the forces which gave rise to the new cycle in the evolution of business organization, and to prepare the way for later discussions by presenting some general principles of law as affecting combinations.

Classes of Combination Organization. — Few readers, or writers either, for that matter, discriminate carefully among the terms which indicate the various forms of combination; but there are as many different

kinds of combination as there are kinds of simple association, and in dealing with these different kinds it will be found conducive to clear thought to apply the various terms according to their logical denotation and best usage.

To combine is simply to become one of the parts of a whole, and a combination is merely a union of persons to make a whole or group for the prosecution of some common purpose. The idea of purpose is not separable from the meaning of the word as used to indicate unions of men, for men hardly unite without a common object in view; and it is significant that even the dictionaries use the word "confederacy" in defining human combinations. Aside from the idea of purpose, however, the word "combination" is properly used as the most general and colorless term to denote any sort of union of persons, and will generally be so used in the following pages. The law, with which we are constantly touching hands in this subject, recognizes two classes of persons, the natural and the artificial, or corporate; and generally, in present-day business, persons of the latter kind are the ones which are directly concerned in the formation of combinations. Indeed it would be well if the word "association" could be used to indicate direct unions of individuals or natural persons, for that word implies a personal relation, a linking together in fellowship, which is not found in the combination of artificial persons.[80] This is, perhaps, a refinement which cannot now be insisted upon, but it has been observed in these pages. When the term combination is used alone it will mean a compound combination, or combination of associations.

Next, the idea of "federation" should be brought in. Federation is alliance for mutual support, or a union by agreement of independent and autonomous powers for mutual benefit in relations external to any one member, and it implies that outside of such external relations the members retain their independence and autonomy. Thus a federation, both in political and business life, is a relatively loose form of combination based upon mutual consent.

Another general term is "consolidation." Consolidation, by the logic of words and by best usage, applies only to firm, compact alliances. It should, therefore, never be applied to federated organizations, but only to combinations in which the members are so compactly united as to lose a large measure of independent and autonomous existence. They are fused. For example, both the Southern Wholesale Grocers' Association and the United States Steel Corporation are combinations, but the former is a federation organization while the latter is a consolidation. The law recognizes the distinction between consolidation and mere combination, for the validity of consolidations, involving as they do a greater loss of individuality on the part of their members, depends upon statutory authority and not upon public policy; whereas combinations other than consolidations have their validity determined by public policy, and the laws rarely authorize but often forbid them.

A "merger," as the term clearly indicates, is a form of organization in which the identity of the parts is lost. The members are absorbed, as it were, into a common whole, and the merger is thus a complete and absolute consolidation. Though the term is loosely used, there is considerable legal authority for confining "merger" to consolidations in which one business organization absorbs another or others and continues to exist, as when a railway system absorbs a branch line. In view of this fact, it is logical to use another term, "amalgamation," to indicate a consolidation in which all the combining organizations give up their identities, become fused, and coalesce in a new organization.[81]

An outline classification of combinations, then, would run somewhat as the following: —

I. Simple Combinations:

1. Association (direct combination of natural persons as in partnerships).

II. Compound Combinations:

1. Association (the loosest agreements directly between individual members of different associations: trade “associations,” some simple “agreements,” etc.).

2. Federation (combination of organizations which remain separate and retain considerable autonomy: most simple “agreements” and pools).

3. Consolidation (combination of organizations in which, while members may remain nominally separate, direction of business is fused). a. Partial Consolidation:

(1) Securities holding (direction of business organizations consolidated through stock ownership, with separate existence formally maintained). b. Complete consolidation:

(1) *Merger* (complete consolidation, members of one business organization absorbed by another).

(2) *Amalgamation* (complete consolidation, members of two or more organizations coalesce to form a new organization).

In the preceding chapters, individual business organization and combinations of individuals into simple associations have been discussed; in succeeding chapters the compound forms of combination will come up, forms in which the preceding simple associations are combined, making combinations of combinations. We enter the new cycle in which the combining units are generally corporations.

From a more strictly economic point of view, all combinations may be classed as trade-combinations and industry-combinations. The trade-combination is a horizontal or parallel combination, as it were, for it reaches out and unites organizations which are competing on the same plane, or in the same trade, or which are in the same general line of business. This has been the most frequent type of combination and the one most inveighed against by the public. On the other hand, an industry-combination is a vertical or sequence combination in that it unites organizations which are on different planes and which represent the successive stages or “trades” within an industry. The organizations combined are not competing side by side, but stand end to end, the one receiving the products of the other as its own raw material. The suggestive term “integration” has recently come into use to indicate this type. The expression “industry-combination” is preferable, however, as setting it over against trade combinations. Moreover, it has none but economic implications, and it suggests more clearly the distinguishing characteristic of the combination involved, namely, its inclusion of all or a large part of the subdivided “industry.” A similar terminology is well established in the field of labor organization.

Cases of trade combination occur to one in plenty, — parallel railways, local coal dealers, the sugar refiners, and so on. Industry-combination rarely occurs alone, but it is strikingly apparent in the steel and tobacco industries. In the former, the whole scope of the industry, from ore to rail or wire, is combined under one management; and likewise in the tobacco industry, the growing, the curing, the manufacture of machinery used, the manufacture of snuff, chewing tobacco, cigars, and cigarettes, the manufacture of licorice, — to say nothing of tin foil and cans and packages, — and finally the retailing of the finished product, — all have been more or less combined. Obviously, this saves capital in the storage, selling, buying, inspection, and transportation of materials between the stages. End-to-end consolidation of railways, to form a single long line, also resembles industry-combination. Such combination is hardly possible except in very large-scale industry; and it is greatly facilitated by simplicity and uniformity in the product. To integrate the piano industry, for example, would require the control of so many industrial fields, — metal, wood, ivory, — that it is hardly practicable.

The question naturally occurs to one, does industry-combination (sequence combination) not ultimately tend to trade-combination (parallel combination) ? Such appears to be the case. The most obvious reason for this conclusion is the fact that the existence of industry-combination results in a more highly

concentrated and dangerous competition; for huger aggregations of capital are involved and the struggle affects a wider range of productive processes. Consequently it becomes very desirable to limit competition. The truth of this point is evidenced by the fact that the progress made in industry-combination in the iron and steel industry, together with threats of further steps along the same line, was largely instrumental in causing the United States Steel Corporation.

But more than this, the very purposes of industry-combination tend to drive the combining units to monopoly. If the object be to secure control of a market, how can it be effectively attained with strong competitors in the field? Or, if the end sought be control of sources of raw materials, ultimately we come to some limited natural resource, and monopoly becomes likely. So we conclude that the integration by any business organization of the various stages within an industry will generally mean a tendency towards combination with other parallel business organizations, — that, or the elimination of the non-integrated organizations from the field.

Occasions and Causes of the Recent Combination Movement. — The forces which called the combination movement — or "trust movement," as it is popularly called — into being must be of profound interest to economists and statesmen, and such attention has been devoted to them that the author could hope to add little knowledge concerning the subject. They will, however, bear further analysis and restatement. In any movement like this the forces and conditions may be divided into those which drive, those which beckon, and those which facilitate. The last ones may be called the occasions for the movement as distinguished from the causes.

First, then, the *driving forces.* Becoming clearly apparent about 1890, there was a marked decrease in the opportunity for speculative gains along the old lines. Formerly there had been a wide, uncertain field of natural resources to be exploited, and great prizes were drawn from physical environment. Now, this field has been narrowed down and become pretty definitely known. The tillable public lands are gone; the gold, coal, iron, and copper mines are exploited, and so with the forests; the railway map requires little revision. Consequently the old opportunities for great gains through exploiting such fields have rapidly diminished. This fact, when coupled with the desire for gain through the employment of a greatly increased fund of capital and a multiplied labor force, impelled industrial leaders to seek new fields, such as existed in control of manufacturing industry through combination.

At the same time, a development in the character of markets and business risks which had long been unfolding, came to a head. As markets became more truly continent-wide, or world-wide, that part of production which consists in moving goods from place to place and holding them from time to time became more important, and the conditions of exchange seemed to dominate the technical conditions of manufacture, etc. *Business* risks, arising from changes in expenses and prices, came to bulk larger in comparison with *technical* problems. Now the way to control the business situation, and reduce the risks of exchanges which involve widely separated places and times, is to combine the direction and management of the various producers. Installing new machinery and processes, or operating on a larger scale, might serve as a remedy for the technical troubles of growing and manufacturing things ("form utilities"); but unity in direction of management was needed in dealing with the risks involved in creating time and place utilities through buying and selling.

But doubtless the most active impelling force was the increasing severity of competition. In the days before the Civil War, business was on a relatively small scale. There was generally a close personal relation between producer and consumer, and less specialization existed. Capital, too, was relatively less important; and this was notably true of fixed and specialized capital, so that the danger of great loss was less. As a result of such conditions, competition was less *intense.* But with modern large-scale capitalistic production, com-

petition often becomes cut-throat and intensely wasteful. The reasons for this fact may be briefly stated. Take any non-monopolistic business employing a large amount of fixed capital; which is the case wherever machinery plays an important part quantitatively, and a large part of the expenses is fixed. This means that if the output can be increased with the same investment in plant, the net returns per unit will increase: the business is one of "increasing returns" or "decreasing costs." The moral would seem to be "increase your output." But what happens when this natural impulse is obeyed by competing producers? First, prices sooner or later fall as a result of increased supply, and a time comes when they fall faster than expenses. Then comes overproduction, which means producing more than can be sold at prices which will cover costs. And, finally, the producer realizes that he has on his hands a mass of capital which is so specialized that he cannot turn it into other industries and *is* so fixed that charges must accrue on it for a life period of considerable extent. He is without alternative and continues the struggle, selling for what he can get, until exhausted.

Transportation developments increased the intensity of competition by building up larger business units and then adding to the force of the clash between them. Those plants which furnished the largest and steadiest tonnage were favored by railway discriminations which need not be recounted here, with the result that small plants were driven out, and then the large plants were enabled to enter costly wars with one another by means of the same space-eliminating transportation facilities which had aided their upbuilding.

The severity of competition was increased by the fall in general prices which took place between 1875 and 1895. Largely because of a relative decrease in the supply of money, the value of a dollar was steadily increased and prices correspondingly reduced. The natural result was that between the beginning of an enterprise, when materials were bought, and the time when the finished product was sold, prices often fell considerably. Wages, too, fell more slowly than prices. Under such circumstances business profits were less certain and losses more common, a situation which greatly stimulated the desire of business men to get together for the purpose of reducing their risks.

All these conditions, it will be remembered, were brought to a focus in the crisis of 1893, and the ensuing years of industrial depression.

So much for the more important driving or impelling forces. On the other hand, certain conditions invited combination, the *beckoning conditions.* Thus, in the potential gains to be secured by regulating prices and trade conditions, the obverse of the driving force of intense competition was to be seen. Even at low prices, if the economies referred to in an earlier chapter could be effected, there was still an opportunity for gain. More particularly characteristic of the time, however, was an almost conscious realization of the possibilities of profits on a large-scale production of the common necessities of life, — coal, ice, lumber, nails, meat, salt, tobacco, sugar, etc. Captains of industry arose who saw, first, that great profits might be made by selling large quantities of such products even at a small gain per unit; and second, that in selling such things monopoly would have great power because the demand for them does not fall off rapidly when prices are raised or kept up.[82] Both of these visions were based on the width of the market or the inelastic character of the demand for such necessaries.

A distinct feature of this phase of the matter was formed by the tariff protection afforded to these industries. Though excepting his own industry, Mr. Havemeyer, of sugar-trust fame, testified before the Industrial Commission that the tariff had been the occasion for the formation of most of the large combinations prior to 1900.[83] It is. too obvious to need discussion that wherever a tariff wall is built the control of prices is made easier and combination is invited.

Another condition which invited the combination movement was the possibility of gain by overcapitalization. By watering stock and making two shares grow where one grew before, it was possible to reap large speculative profits, and such profits were reaped from bountiful crops. There is no doubt that

several large combinations have been promoted chiefly because the promoters believed that they could sell an increased capitalization for more money than they had to pay for the properties combined.

The foregoing conditions are well stated by a witness in the recent hearings before the Senate Committee on Interstate Commerce: "Then came years of financial panics — 1890, 1893 to 1897 — with complete dislocation of business. The old owners emerged from this period of stress worn out by superhuman exertions and profoundly discouraged, and were, many of them, glad to give, free of cost, options on their works, to sanguine trust promoters; and the people were ready for a bull market; whence the crop of trusts."[84]

But had these driving and beckoning conditions not operated in conjunction with *certain facilitating conditions,* the combination movement would not have come just when it did nor in just the same way. The tariff, for example, was such a condition. Under Republican administrations the principle of protection was more and more strongly applied, reaching a high point in the McKinley Tariff Act of 1890 and a climax in the Dingley Act of 1897. While it can hardly be maintained that tariffs *cause* trusts, they certainly facilitate their formation by raising a wall against foreign competition, and such cases as salt and sugar, rails and nails, paper and window glass, are evidence to the fact.

Last, but by no means least, the development of corporate organization was itself a factor in facilitating combination. Prior to 1850 the use of the corporation in business had not been great, and it was not until the seventies that the general corporation laws were much utilized. The result was that capital was limited in amount and combination difficult. Through the agency of joint-stock shares, control over a large number of business organizations may readily be concentrated in the hands of a few men. They have merely to purchase enough stock to control each corporation and vote that stock with a united policy, and to make the purchase they need only form a new corporation whose shares may be exchanged for the controlling holdings. By proceeding in this way they do not have to gain the consent of the organizations which they desire to combine, nor do they increase their financial liability. Such a means of combination sharpened one of the most effective weapons of the trust builder, — secret control of plants used locally to cut prices under those of particular competitors while keeping them up elsewhere. In so far as the corporate form could be used to minimize legal responsibility, it also facilitated combination.

Prerequisites for Effective Trade Combination.— Competition can lead to effective and enduring trade or parallel combination only under certain circumstances. When the number of competitors is large, combination cannot be close and so cannot be either efficient or stable. First, then, the competitors must be reduced to a manageable number. A corollary of this prerequisite is the fact that, where it is easy to establish a new business unit, competitors will spring up and effective combination be difficult. Again, where the competitors are of very unequal strength, combination is not generally effective. The weak members are dissatisfied and tend to undercut prices; the strong tend to gobble the weak. As an extreme illustration of this principle, it seems safe to say that the history of the United States Shipbuilding Company shows that where one member of a combination is stronger than all the others put together, no stability is possible. In this case, one concern, the Bethlehem Steel Company, had a majority of the votes and used them to its own advantage rather than for the good of the combination. From both these prerequisites it follows as a corollary that effective combinations are generally preceded by competitive struggles for survival. A third requirement is that where there are several trades or stages in an industry, like ore mining, smelting, and rolling, in the iron and steel industry, the members should hold similar positions as to the stage in which they operate; for if the business of some members includes more advanced stages of production than others their interests are double and may not lead them to maintain prices, etc., in the earlier stages. Where some producers combine several stages and others only one, that which is the raw material of those in the later stages is the finished product of the others, and consequently their interests as to prices may diverge.

Some General Principles of the Legality of Combinations.[85] — Combinations may exist between individuals or between corporations or between other forms of business organization, but the same general rules of public policy and the same statutes apply to all. In so far as the character of the parties is concerned, the chief difference among combinations lies in the limitations which may be placed on the powers and objects of corporations as preventing them from entering a legally binding union. Thus corporations cannot enter any agreement which transcends the powers granted them in their certificates, and in most States they cannot become members of a partnership. But, as just stated, in so far as the legality of objects and means is concerned, all combinations are on the same footing.

It needs but a cursory examination of the cases in which the legality of business combinations has been tried to see that three leading tests are applied, namely, monopoly, restraint of trade, and conspiracy. Two of these, restraint of trade and monopoly, rest upon the more fundamental rules of public policy, but for more immediate purposes, the general legal principles may be discussed under the three heads.

First, then, as to monopoly. Monopoly is control over price, based upon control over supply. The old legal concept of an exclusive grant from the sovereign no longer obtains. Monopoly, as such, is not illegal; that is, the test of legality is not monopoly but the results of monopoly. In a word, there might be lawful monopolies and unlawful monopolies. True, the courts to-day generally speak as though monopoly in itself and as such is illegal, but always there will be found that a major premise is implied which would run: "All monopolies are against public policy." The ultimate test, then, is public policy, not monopoly; and whenever it conies to be recognized that some monopolies may be necessary and according to sound public policy, then this tacitly assumed major premise will have to be modified. At the same time, the fact of monopoly will sink to its secondary and minor place. The sound logic would reason: (1) acts which are against public policy are unlawful; (2) some monopolies involve acts against public policy; (3) therefore, some monopolies are unlawful.

As yet, the prevailing doctrine is such that monopoly will generally be declared illegal without further analysis, both at common law and under anti-trust statutes; but, if a prediction may be hazarded, the time is coming, when, as the existence of "natural monopolies" is realized more fully, more discrimination will be used, and already we have many public-utility laws which authorize monopolies in the hands of public-service corporations on grounds of public policy. Other illustrations are furnished by patents and copyrights, which in themselves are legal and lawful monopolies and often furnish the basis for monopolistic business organizations. The time must come when the results of the monopoly as affecting public welfare in each case will be considered as the decisive element.

The case is similar with "restraint of trade," only here the common law has long been on a more rational basis. Any contract which limits freedom of exchange or restricts markets is in restraint of trade, thus making this idea broader than the idea of monopoly. Frequently such contracts appear as incidents to industrial combination, as when a retiring competitor agrees not to set up in the same line of business for a term of years; but this is over and above the act of combination and does not affect the legality of the combination as such. The question of restraint of trade, however, may concern the combination itself. In this case, we find the preceding reasoning on monopoly an accomplished fact, for the law recognizes reasonable as well as unreasonable restraints. At common law it has long been customary to inquire into the operation of the restraint upon public welfare, and, if it be found injurious, to declare it against public policy and consequently unlawful. And, *vice versa,* if found beneficial, restraints of trade may be held reasonable and lawful. It is only recently, however, that the provision of the Federal anti-trust law against restraint of trade has been subjected to this "rule of reason."

"Conspiracy" remains to be discussed. A conspiracy, by legal definition, is any combination "to do an

unlawful act, or a lawful act by unlawful means." The parties to the conspiracy may be individuals or corporations, — the law is the same. Two conditions are essential to conspiracy: (1) concerted action, and (2) unlawful intent, either to do unlawful acts or to use unlawful means. But when the question is raised as to what actions are unlawful in the sense here used the answer is not so clear. Often, courts appear to make the combination or concerted action the gist of the conspiracy, for acts otherwise lawful are declared unlawful when done by a combination. Thus an individual may lawfully refuse to buy of any dealer, but concerted action among a number of individuals so to refuse may be an unlawful conspiracy. Or any proposed restraint of trade, though it be in itself innocent, if it is to be accomplished by conspiracy is unlawful. The truth, however, appears to be that, of necessity, both the purpose and the results of the group's action will differ from those of the individual's, for in combining, a greater power is brought to bear, and this may be assumed to be known to the members. Therefore, the quality of intent that characterizes concerted action must be the basis. Again, if a monopoly or restraint of trade is unlawful, then *concerted* action to procure either would be conspiracy and so heighten the offense. Not that individual action by way of monopoly or restraint of trade would not be unlawful, too, but when there is concerted action a new offense in the eyes of the law is added, an offense which lies in the intent of the conspirators. Thus, the conspiracy proper lies in the intent to do an act forbidden by law or to do damage, expressed in some agreement. *Design in common* is the essence.

Organizations in the nature of business combinations are not often illegal as conspiracies, for the simple reason that their primary purpose is usually the benefit of their members, and, unless it can be proved that their intent is primarily to injure their competitors or others, or to do some unlawful act, they are not conspiracies. Even when they act with such an intent after the combination is formed, the original intent is considered in so far as the combination itself is concerned and the later act does not necessarily invalidate the combination as such. Most of the cases of conspiracy brought under the Federal anti-trust act have involved labor organizations, but not all; for in *Gibbs* v. *MacNealey* (102 Fed. Rep. 594) the court held the action of an association of manufacturers in adopting a resolution denouncing a dealer in their line of goods who was engaged in interstate trade, and in printing this resolution and mailing it to other manufacturers and to customers of the dealer, whereby his business was injured, constituted a conspiracy in restraint of trade under the anti-trust law.

The three foregoing points hark back to the more fundamental principles of public policy. The general statement of this principle laid down by Story is also accepted by Judge Noyes.[86] It runs as follows: "Whenever any contract conflicts with the morals of the time, and contravenes an established interest of society, it is void, as being against public policy." A more special statement of the principle, however, based upon an examination of the leading anti-combination decisions of the courts, may be hazarded. *Any combination, the object or necessary result of which is directly or indirectly to control prices or restrict freedom of exchange to the detriment of the public is unlawful as being against public policy; and this rule will be most strictly applied when necessaries of life or public utilities are concerned.* It must be admitted, however, that in one particular the courts follow a narrower and more superficial rule, for they still reason that contracts which create monopolies are null and void as contrary to public policy, without going back of the idea of monopoly to the reason. That there are difficulties in the way of deciding what things are necessaries of life, and even of determining what is on the whole detrimental to the public, goes without saying.

For the most part, the principle of public policy will be found precipitated and expressed in the various anti-trust statutes State and Federal. The Federal "Sherman Anti-trust Law," for instance, reads: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared illegal.... Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopo-

lize any part of such trade shall be guilty of a misdemeanor." However, some few States do not have such laws, and in any case the principle has some significance in interpreting the statutes.

At common law, mere agreements which restricted competition were only extra-legal and non-enforceable. A person injured by them had no ground of action against them. But the Federal statute makes them criminal, and provides that any person injured by the prohibited combinations may recover threefold damages (Sec. 7). Following this lead, the various State statutes generally make such combinations criminal, and their members liable for punitive damages.[87] Domestic corporations as members may have their certificates of incorporation forfeited, while foreign corporations may be ousted. Says a State court: "It makes no difference whether such acts if done by an individual not in the combination might have been lawful, and a person suffering therefrom would be without remedy. The same acts done by agreement or combination of several are made unlawful, and for that reason a right of action follows."[88]

By this time, the reader will have wondered what significance there is in the various forms of business organization from the standpoint of legality. In a general answer to such a query not much more is to be said than that the only significance of the form of combination, various types of which are to be studied next, is that it may throw some light on the intent of the combiners, and also upon what the necessary results of the combination will be. If the combination takes the form adopted by the Tobacco Trust the purpose is fairly obvious and the necessary result is clear. Outside of such indirect considerations, the matter of form is a mere question of corporation law.

Chapter X: Federation Organization: Simple "Agreements" and Price Combinations[89]

Definition and General Nature. — In passing over to the field of combination organization, we enter a region where forms are so complex, interrelated, and shifting, that accurate classification is difficult. Such was once the case with simple associations of individuals when in the sixteenth and seventeenth centuries various forms of partnership and joint-stock company, temporary and permanent, unincorporated and incorporated, were being tested by business men and lawyers. One result of this greater complexity is the loose terminology used by the press and popular writers on the subject of combinations. Naturally the looser forms of combination are treated most unsatisfactorily, and so a word about the meaning and classification of "agreements" and "pools" will not be amiss.

Both of these forms come under the idea of "federation," for both are alliances of separate and largely autonomous organizations for mutual benefit in relations which are largely external to themselves. The pool is the more highly developed form and is more easily defined. As its name indicates, the pool as a form of business organization involves the establishment of a common fund which is to be divided among the members on some agreed basis. This is the essential element; and income, output, or market may be thus "pooled" by any number of producers. The pool is thus a special kind of agreement and generally involves a considerable amount of organization for its maintenance.

The "simple agreement," various forms of which are to be discussed in this chapter, is a less highly organized and compact form of federation among business organizations. In most general terms, an agreement is simply an express understanding concerning business affairs, and so would embrace pools. A pool is a sort of agreement. But the latter term has come to have a more limited and special meaning, and that class of agreements in the general sense which concerns pooling is excluded from "simple agreements" in the special sense. The term "simple agreement" will be used to cover *all express understandings between separate business units in so far as they do not concern any collective control of the quantity of output to be marketed.* Such understandings concern prices or trade conditions directly and immediately, and do not seek to restrict supply or demand, — the price-making conditions. The "agreement," then, is to be taken to mean the looser forms of business organization, such as are variously called "working agreements," "price combinations," "gentlemen's agreements," "associations," etc.

In 1776 Adam Smith wrote: "People of the same trade hardly meet together even for merriment or diversion but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." Over one hundred years later, Mr. C. M. Schwab, the steel magnate, when asked if there had been pooling agreements in the steel industry before the trust, replied: "Yes; in all lines of business, not only in

steel, but in everything else. There were similar agreements, known as joint agreements, to maintain prices. They have existed in all lines of business as long as I can remember."[90] And undoubtedly as long as there have been groups of business men engaged in the same industry, among whom communication has existed, such agreements have been made. The period in which they came into special prominence as a means of federating important business organizations, however, may be said to extend from the Civil War time till 1875 or thereabouts. Then, "big business" was only just developing in this country, and the agreement was naturally the first recourse under the new circumstances. To-day, however, agreements may be found everywhere. In all trades there are wholesalers' or retailers' "associations," often organized into national and local branches, which loosely federate business organizations. Conventions are held at which trade conditions are discussed and steps taken to secure the advancement of the business. "Unfair" competition is ventilated and decried. Moreover, the members of such organizations sometimes prepare catalogues or price lists of standard articles, the understanding being that the terms thus circulated will be observed.

Not so extensive, but much more effective, are the numerous little groups of "magnates" whose agreements occasionally come to light. Thus there were the notorious "Gary dinners" of steel manufacturers, at which "there were no understandings reached to maintain prices, but the general effect was that prices were maintained."[91] There is the Bridge Builders' Society formed "to establish perfect frankness as to furnishing such information as to bids, terms, prices, and tonnage as may reasonably be required," but whose members maintain that they are in active competition with one another. For years, without any formal organization, the price of anthracite coal has been regulated effectively by obvious agreement among a small group of mine owners. The various railway traffic associations bring agreement concerning rate schedules, as every one knows, without any consolidation or pooling organization. And recently the limelight has been turned upon the secret meetings of the "big six" among the packers, who each week came to an informal agreement on prices and margins. As they also regulated output after the manner of pools, this agreement shaded into pooling. In fact, few if any outsiders know the exact scope of these secret agreements, and several of those mentioned may embrace pooling features.

Illustrations of Various Kinds of "Agreements."[92] — From the formal point of view, two broad types of "simple agreement" organization exist: those which trust to the spoken word of the parties for the enforcement of their terms; and those which seek to secure more binding results through written contracts, penalties, or other devices for compulsion. The former type embraces the so-called "gentlemen's agreements." Such organizations are numerous and widespread. Their effectiveness depends entirely upon the honor and faithfulness of the members in holding fast to their informal word, but they are often more effective and more strictly observed than more formal contract agreements. They include no formal organization for regulating output or maintaining prices. While the other type is not necessarily, *per contra,* a rascal's agreement, it depends less upon the honor of the parties, and forfeits are provided in case of infraction. Such agreements are described in the pages which follow.

Within each of these types several different classes of agreements might be distinguished. Some are loose and secret; others are more open and have written by-laws. Some concern the conditions under which business is transacted; others concern the prices charged for products; still others go further and include an agreement concerning the output. It is the purpose of this chapter to examine in outline the more important forms of "agreement." As descriptions of them are not readily obtained, it has seemed best to include brief accounts of numerous agreements, even at the risk of confusing the reader; but, as such a variety exists, after all the confused picture will be the truer likeness.

1. *Trade-conditions Agreements.* — Most simple agreements of the present time concern prices; but many do not have the fixation of prices as their direct and primary object, and some do not relate to prices at

all. As such agreements concern various conditions of trade, such as terms of credit, methods of packing and shipping, dealing with competitive products, advertising, transportation, and labor supply, they may well be called “trade-conditions agreements.”

One great branch of trade-conditions agreements is formed by the commercial organizations of cities and towns which are variously known as “chambers of commerce,” “boards of trade,” “commercial clubs,” etc.[93] These organizations are characterized by the fact that (1) they are based on locality; (2) they may embrace any number of different industries; and (3) they have little if any effect upon the independence of their members. They are organized for the general civic, commercial, and industrial development of the community concerned; and to this end they perform one or more of such services as the following: they furnish quotations of current prices, and inspect shipments; they send out trade embassies and advertising material, furnish information concerning business openings, and hold conventions; they help secure economical transportation arrangements; they encourage industry through financing schemes, and by furnishing land and factory buildings; and in many other ways they bring the business men of a community into cooperation. Usually a salaried secretary or a central board or committee conducts their operations, and expenses are paid from membership dues and voluntary contributions.

The branch of trade-conditions agreements, however, with which a book on business organization is most immediately and directly concerned, embraces those organizations which have no necessary connection with any locality, which embrace but a single trade or industry, — or at most a group of closely related industries, — and which generally exert a somewhat greater effect upon the business conduct of their members than do the commercial organizations referred to in the preceding paragraph. They do not have the quasi-public aspect which is found in the local commercial organizations, and their objects are generally narrower.

In England, for example, “the sale note adopted by the National Association of Millers prescribes the terms of delivery, the duration of the contract, the date of payment, and the adjudication of disputes. The charter party or contract for hire of a vessel adopted for various trades by Chambers of Shipping contains stipulations as to loading, conduct of the voyage, and method of payment. The primary object of these agreements is the avoidance of disputes by the transaction of business according to settled forms, but they also ensure that competition shall take place in the open without secret rebates.”[94] According to Judge Gary himself, the American Iron and Steel Institute, which succeeded the “Gary dinners,” deals only with methods of operation, technical questions, welfare of employees, and “various other questions.”

A clear but peculiar case of such an agreement organization is the American Baking Powder Association formed in 1899. It included most of the manufacturers of alum baking powders and was established to defend the industry against the competition of the cream-of-tartar baking powder producers, headed by the Royal Company. The association has a constitution and by-laws, in which its objects are stated to be “by bringing together all business firms using exsiccated alum in the manufacture of baking powder, to stimulate a spirit of fraternity and cooperation for mutual advantage and protection,” and to disseminate information and improve trade conditions.[95] Dues, assessments, and regular annual meetings as well as special meetings, are provided for. The main idea seems to have been to raise a fund to offset the Royal’s anti-alum war.

Another instance of trade-conditions agreement, but one which illustrates the difficulty of classification, is the Cordage Manufacturers’ Association of the United States which was formed after the dissolution of the National Cordage Company in 1893. The competing and disorganized manufacturers met first at a dinner in New York, and agreed to form an association for the purpose of a better understanding and the elimination of trade abuses. The association, which embraced not all, but a majority of the manufacturers, had no constitution or by-laws, nor any officers save a secretary. Upon request by any member the secretary

would send out word that "So-and-so would like to have a meeting," and ask, "What do you think?" Some three or four meetings per year were held, at which any questions of general interest to the trade were discussed: the hemp situation and prices; and different trade abuses, such as allowing too much time, too large discounts for cash, and lack of uniformity in materials. There was no agreement to main-tain prices, but "card prices" were issued, which, though not uniform, had a natural result in uniformity as far as the trade was concerned. "At these meetings the question will be discussed. One will say, 'I am going to put up my price.' Some one else will say that he will do the same thing; and perhaps they will all do it — they will all put up their prices. But there is no agreement to follow those prices."[96] The Cordage Association, then, is a pretty informal agreement organization which primarily concerns trade conditions, but also exerts some influence on prices.

Here, too, might be mentioned those fruit growers' "exchanges" and other produce-selling organizations, which, while in the interest of higher or more regular prices, confine their operations to the inspection, packing, storing, and shipping of the produce, and seek to get rid of speculators and middlemen.[97] The Southern Texas Truck Growers' Association, as at first conducted, and the Fruit Growers' Association of California are examples.

From these mixed trade-conditions and price agreements, we may pass to an examination of some which center in price control.

2. *Price Agreements.*[98] — "Price combinations" are numerous, and, in addition to prices, frequently cover trade conditions. Broadly speaking, two groups of price agreements may be distinguished, and if one be called *industrial agreements* the other may be named *speculation agreements.* We may dismiss the latter group with a word. By "speculation agreements" we mean such understandings among dealers as aim temporarily to affect the price of some commodity or security in order that the parties to the agreement may gain financially thereby. Generally the commodity must be one that is regularly subject to speculation; and the dealers concerned generally seek to gain a monopoly of it for the sake of raising the price. Such agreements are illustrated by "corners." A corner is an organization of speculators which seeks a temporary monopoly of the market by gaining control over the available supply of a commodity or a security. Agreements of this class do not seek to affect the technical processes of production such as manufacturing and transportation; and rarely, if ever, are productive of any net gain to society. They may well be thought of as abnormal forms of business organization. Hereafter, then, in speaking of agreements, we will not include "speculative agreements."

Industrial price agreements, on the other hand, do concern the technical processes of production, and seek to maintain a level of prices which is not too far above expense to be practicable. They may operate over long periods of time, and need not be abnormal. Such price agreements may be loose and informal, as in the case of the old Chicago Lumbermen's Exchange, which in the early eighties used to hold monthly banquets, when, on the basis of reports from dealers, "honest" prices were agreed upon and undercutting by discount was prevented. Or they may be closely and formally organized with by-laws and forfeits, as in the case of the tile dealers to be described shortly. They may operate through sales associations or not. From another point of view, they may be divided into sellers' agreements and buyers' agreements. And either class may be local, national, or international in extent. Of course, the machinery for enforcing such agreements will vary with the scope of the agreement and the nature of the industry concerned.

Industrial Price Agreements without Sales Association. — Local price agreements are notably common among coal, ice, and lumber dealers. But they are found in a great variety of other businesses, it even being true in some cases that local bar associations regulate the fees of lawyers. Probably there are lew lines of business in which the dealers in staple articles do not have some understanding which limits competition

in prices, though most of these "understandings" are not so developed as to merit the term "organization." The Gunpowder Trade Association of the United States furnishes a fine illustration of an early national price agreement among sellers.[99] This federation was organized in 1872 to ensure "an equitable adjustment of prices and terms for sales of powder throughout the United States." Any powder manufacturer, by indicating in writing to the president his desire to join, might be admitted to membership. The voting power of members varied according to the size of their businesses. Regular quarterly meetings were provided for; but a "council" of five was elected which met weekly, or oftener, at the call of its chairman, and to it were referred questions of price discrepancies, discriminations, and complaints of violations of the agreement. A schedule of prices was unanimously adopted and doubtless the chief function of the council was to maintain the observance of these prices. A few years later a competitor was forced to come in, and it was agreed that there should be a penalty of one dollar a keg on selling powder below the agreed minimum price. Partly on account of the relatively small number of the members, and their closely related interests, this was an unusually stable and well-organized agreement. It had no common sales association.

Another formal price-agreement organization on a large scale is found in the case of the Tile, Mantel, and Grate Association of California, formed in 1898 and declared illegal under the Sherman Anti-trust Act in 1904.[100] The monopoly element was prominent here. The purpose of the association as set forth in its constitution and by-laws was "to unite all acceptable dealers in tiles, fireplace fixtures, and mantels in San Francisco and vicinity (within a radius of two hundred miles), and all American manufacturers of tiles, and by frequent interchange of ideas advance and promote the mutual welfare of its members." Thus its membership was of two classes, dealers in tiles, mantels, etc., and the manufacturers of the same products. The conditions of membership were rather strict: on the dealer's side, any individual, corporation, or firm engaged in the business in San Francisco or vicinity and carrying a stock worth at least $3000 was eligible; but to become a member one had to be proposed by a member in good standing, be unanimously elected, sign the constitution and by-laws, and pay a fee of $10. Any manufacturer might become a member. Signing the constitution and by-laws committed one to an agreement not to buy from any manufacturer not a member nor to "sell or dispose of, directly or indirectly, any unset tile for less than list price to any person or persons not a member of this association, under penalty of expulsion from the association." The prices charged to members were 50 per cent less than the list prices.

Local retailers' associations are sometimes federated into national associations, and combined with wholesalers for maintaining prices. Take the drug business for example. Besides the Proprietory Association (patent medicines) and the National Wholesale Druggists' Association, there is a National Association of Retail Druggists. This is an unincorporated association having a membership composed of local associations which embrace about 90 per cent of the retail druggists in the localities organized. The headquarters have been at Chicago and the local associations are represented by delegates periodically chosen for that purpose. In the well-known case of *Loder* v. *Jayne* (142 Fed. Rep. 1010) the court made the following statement of fact which describes the methods of the association: —

> "... that the National Association of Retail Druggists had its central office in Chicago, and received financial support from all the other associations and many of the members belonging to them; that from this central point organizers were sent out for the purpose of bringing the local retail dealers into associations, and, as a result, Philadelphia retailers were organized into an incorporated association known as the Philadelphia Association of Retail Druggists. In accordance with the plans suggested by the organizers sent from Chicago, the Philadelphia retail druggists working with the organizers secured a consensus of opinion of the retailers here from which they fixed the minimum rate at which drugs should be sold.... All the retail dealers were then notified

> of this minimum rate, and in case the retailer cut below the price so fixed, his name, with this information was sent to the National Association of Retail Druggists at Chicago, and the Secretary, Mr. Wooten, then placed the name of this retail druggist upon what was known as an 'aggressive cutter's' list...."

This aggressive cutter's list was sent to all manufacturers of patent medicines and wholesale druggists who were members of their respective associations, with the request that they refuse to sell to the aggressive firm. In case they refused to act favorably upon the request, the "pink slip" was evoked, that is, the recalcitrant wholesaler's name was sent to all members of the retailers' association with the request that they have no further dealings with him. "Pink slip" was likely to spell "boycott."

Industrial Price Agreements with Sales Association. — A good illustration of a strong local sellers' agreement organization with a sales association is furnished by the lumber com-panics of Portland, Oregon. In 1902 they agreed to operate in harmony for the sake of controlling the market and securing higher prices. To this end, they organized the City Retail Lumber Company and agreed to sell lumber in the Portland market only through that agency, and at prices to be fixed by it. Further, the agreement provided for inspectors of building operations who reported when local contractors purchased lumber outside the city, in which event the Portland lumber companies refused to deal with them.[101]

The Southern Truck Growers' Association is an example of a sectional price agreement operating through a sales association. The sales association in this case is an incorporated concern, formed for the purpose of "protecting" farmers "in the sale, inspection, and distribution" of their crops. Membership is obtained and indicated by holding stock in the association. A sales manager is at the head of the operations, and he must market all cars of truck offered by the members in the order received. Expenses are paid by levying a uniform handling charge on produce marketed; and, as any shipment not marketed through the sales manager must also pay the handling charge, members are practically compelled to sell their produce through the association. The great majority of the business is carried on by means of a "daily local pool"; that is, every grower loading in a given locality receives on the same day the same price for the same grade of produce. The records of the association show that members who sell in this way have received a higher average price than those who sell outside the so-called daily "pool."[102]

It will be observed that sales-association *agreements* necessarily involve no restriction of the aggregate output, and no apportionment of that output among the members. Merely, the output is turned over to a sales manager who disposes of the whole. The income is distributed through the common sales agency according to the unrestricted outputs of the individual members. While there is a semblance of pooling, — which might be called "marketing pooling," — there is none of the control over supply which characterizes the true industrial pool.

Price Agreements Enforced by Patent Control; and Factors' Agreements. — The recent prosecution of the so-called Bathtub Trust has thrown light upon another means of organizing and enforcing a price agreement.[103] In 1909 a "Sanitary Enameled Ware Association" had been formed with a certain Mr. Wayman as "commissioner." This preliminary organization attempted to maintain prices, but large and irregular discounts were made and the trade was much demoralized. Accordingly a more effective agreement was devised, and entered into by sixteen of the largest manufacturers of enameled iron ware and nearly four hundred jobbers in the same trade. To Wayman, important patented devices and processes were assigned, and each of the sixteen manufacturers then entered into an agreement with him which was in the nature of a license to use the patents upon certain conditions. Each licensee was to sell only a specified quality of goods, to sell only to jobbers who made a certain resale agreement, and to observe the prices fixed; and to insure

observance, a royalty of $5 a day was paid for each furnace used, with an 80-per-cent refund in case of good conduct. The jobbers, on their part, contracted to buy exclusively of the sixteen manufacturers and to observe the prices set down in a jobbers' list that was issued by the manufacturers' organization. A "blue book" of eligible jobbers was maintained. To hold the jobber to his agreement, he was required to pay 5 per cent more than the net price, and if he lived up to his contract this extra 5 per cent was refunded at the end of the year. This agreement might be classed as being to a small extent a pooling agreement; but, in any case, it well illustrates an unusually rigid and binding price agreement embracing manufacturers and jobbers, the backbone of which was control over patented devices.

Such organizations shade down all the way to agreements which concern but one item in the jobber's stock, and contain but a faint shadow of the patent control — or none at all. Thus, the government has recently begun suit against the notorious control exerted by the Kellogg Toasted Corn Flakes Company. That concern sells only to dealers who agree to maintain a minimum price per package set by it, and re-enforces its control by means of a patent held on the carton in which its product is packed. Aside from the small infusion of patent control, this is a typical example of the "factor system" which has become so common. The factor's agreement always lies between different stages in the marketing of a product, — *e.g.*, manufacturing and jobbing, or wholesaling and retailing,— and consequently is a sort of "industry-combination," or sequence agreement.[104] The classical case is the agreement between the American Sugar Refining Company and the Wholesale Grocers' Association, which has lasted from 1889 well down to the present time. So keen was the competition between the wholesale grocers that sugar was regularly being sold at cost or below; and, in order to restore a more reasonable condition of affairs, they sought and obtained from the refining company an agreement under which sugar was bought and sold by wholesalers at a uniform price per pound, with a rebate to all who maintained that price. This rebate assured to each a small uniform profit. Such agreements may, if open, be quite reasonable and beneficial; but they are likely to be abused. They may be made the means of discrimination, — as when a condition of the agreement is that only the goods of a certain manufacturer may be handled, — and of maintaining extortionate prices.

Buyers' Price Agreements. — Finally, there are agreements which have as their chief feature the control of the price of raw material purchased by producers. These are buyers' agreements. One illustration will suffice. It is a matter of general belief, if not an established fact, that various cotton-oil mills in Mississippi, Louisiana, and Tennessee are parties to an agreement according to which they keep up a uniform rate on cotton seed. To this end they communicate to one another the prices they pay or intend to pay for seed, and have some understanding of a relation between the price they will pay and the New Orleans and Memphis markets. Moreover, they do not invade one another's territory in purchasing seed.

General Characteristics. — A little reflection upon the foregoing illustrations leads one to conclude that, as contrasted with the closer corporate combinations or consolidations which are to be discussed later, some of the more notable characteristics of simple-agreement combinations are: the members retain a larger measure of individual identity; the union is weaker and liable to be temporary; the object is more generally merely to restrict competition rather than to secure economies in production; in fact the combination is not close enough to effect such economies. When coupled with a sales association, however, the agreement may be enduring and effective. On the side of public policy, it is to be observed that publicity is less likely, and consequently regulation is more difficult. The most effective remedy for abuse of power is dissolution, any other procedure being very difficult; and dissolution does not as a rule work such hardship as in the case of corporate combinations, as the separate ownership and management of the properties is little affected by the agreement.

Advantages and Disadvantages. — The advantages of the agreement as a form of business organiza-

tion are fairly patent. It is formed with great facility. A dinner is arranged for, and with their feet under the same table the competitors reach a general understanding concerning the particular problem, together with a more or less informal arrangement for future cooperation. The more detailed and comprehensive the arrangement, the less true is this picture. But, in any case, there is no certificate of incorporation to secure, and no taxes to pay. As to financial liability, it, of course, is not increased by becoming a party to a price agreement.

On the score of direction of management, much is to be said for the simple agreement in certain cases. It is very flexible and readily adjusted to changing or complex conditions. When, therefore, the industry is in rapid transition or trade conditions are very complex, such a loose temporary organization as the agreement appears very desirable. It will be observed that of all forms of combination organization it probably leaves the largest measure of autonomy with its members, for the management of plants is entirely in the hands of their owners. This not only leaves them free to tackle local problems in their own way, but it makes it possible to retain undisturbed the motivating forces of the component establishments. That the agreement may readily be kept secret for a time is apparent, and this may be an advantage to the business from the individual standpoint.

Another point which may prove of considerable importance lies in the fact that through simple agreements groups of independent producers may be able to secure such economies in buying and in marketing as will make it possible for them to exist alongside of large "trusts," thus keeping alive a personal direction of plants and some degree of competition.

But agreements are notably unstable and temporary. They are not based upon a perfect association, for with the retention of autonomy by the members there goes a retention of separate interests which may be divergent; and little compulsion can be brought to bear upon them in a legal way. From this point of view we can discern five or six classes of agreements among the illustrations given above, (1) Oral agreement, without forfeit; (2) written agreement, without forfeit; (3) agreements with provision for refusing to sell to violators, or for boycotting them; (4) agreements with fines for violations; (5) agreements with a pledge to be forfeited by violators; (6) agreements enforced by control of patents. These various devices, however, may not prove so effective as a gentlemen's agreement among a few closely allied producers.

The majority of "simple agreements" are of the price-combination sort, and these have the great weakness of not controlling supply. They do well enough at times when prices are going up, and they may themselves raise prices for a while; but each producer tends to put all he can on the market in order to profit by the high prices, with the result that the market is overstocked for sale at profitable prices, and when the break comes the agreement is futile. This difficulty may be partly met by including a regulation of output in the price agreement, but the tendency to violate such a regulation is strong.

Moreover, in the United States, most price agreements will be found to be illegal under the State or Federal anti-trust laws, and there is no question that the monopolistic agreement under the present conditions should be illegal as being a limitation upon freedom of exchange. It will frequently be found impossible to enforce the terms of the agreement in the courts, which greatly limits the usefulness of this form of organization,

Social Point of View. — From the social point of view, simple agreements and pools have so many points in common that no extended discussion is needed here, and the reader is referred to the concluding section of the second chapter below. One notes that the price agreement is the least highly organized and stable form of organization for affecting prices, and therefore brings the least danger of a great or permanent injury to consumers. Also, it allows so much independence among its constituent organizations — they are so loosely federated — that overgrown and wasteful compound units are not likely to be built up. Of course,

the creation of no new corporate organization is involved, and the uncertain life of the agreement makes the capitalization of increased earnings by its members impossible; therefore, this form does not facilitate or stimulate overcapitalization. Furthermore, agreement organizations are so loose in their nature that they are ill adapted to gain control of the great natural monopolies of the country, such as coal and water power, and consequently are free from what is often a sinister feature of corporate combinations.

Secret monopoly, however, is the danger of the price agreement. It will have been observed that some of the agreements described in the foregoing pages were bent upon gaining and maintaining exclusive control of the market, as in the cases of the tile dealers and the "Bathtub Trust." Others were open to all comers, seeking merely to maintain a uniform price, as did the Druggists' Association. Again, some agreements work by the most secret and devious means; others have unconcealed constitutions and by-laws, and, being open in membership, do not maintain much secrecy.

Thus agreements run all the way from the very undesirable to the very desirable. At the bottom of the list stand those price agreements which are monopolistic, close, secret, and with members some of whom are forced to join against their will; while at the top come the voluntary agreements concerning trade conditions which are never monopolistic, are open, and public. These agreements, desirable and undesirable, may exert considerable influence, and the only way to insure their responsible use of power is to make their existence, purpose, and methods known. It goes without saying that methods of terrorism and discrimination used to compel membership in an agreement are intolerable.

In very general terms, may it not be concluded that it would be desirable to have all agreements subject to publicity? Yet this result can never be even approximated as long as the public displays hostility to such organizations in the present undis-criminating way. That there are reasonable and unreasonable agreements, just as there are reasonable and unreasonable restraints of trade, must be remembered. The goal of public policy should be to bring to pass a condition in which business men would not fear to form any socially beneficial agreement organization, a situation in which business practices could be standardized, and cut-throat, unstable prices be eliminated. That necessary agreements concerning business methods and prices will be made is indicated by the futile attempt to stamp out railway rate agreements. The certain conclusion is that provision should be made for the registration of legitimate agreements, bringing them within the pale of the law.

Chapter XI: Federation Organization: Pools

Agreements as to conditions of doing business, lying as they do outside the realm of value, are quite inadequate to meet the desires of those business men whose ultimate object is profit; while the mere price agreement was soon found to be too loose and superficial to accomplish with any certainty the objects sought. The necessity for controlling the factors that determine price was seen. Business men, feeling the need of combination, and still being loath to give up the sovereignty of their establishments, turned to closer and more thorough means of federation. This means they found in various kinds of pooling agreements.

As just implied, a "pool," in the business sense, is a form of agreement organization; that is, it is based upon the federation of members who by mutual consent combine for certain purposes, and retain a large measure of authority over their separate units. Mere agreements shade into pooling agreements, and pools frequently, if not usually, include agreements as to conditions and prices. Nevertheless, the pool is a separate and distinct form of organization with a characteristic element that allows exact classification. This element springs from the closer association sought in the pool. Briefly, it is this. Some material factor in the price-determining process is taken as the most readily ascertainable or easily controllable one common to a number of business units. This factor may immediately be on the supply side (the output or an element in it), on the demand side (the market), or it may be the income which arises from these factors ("profits"). Acting in concert, these business units combine to the extent of merging this material factor in a common aggregate or "pool." Thus they are federated and bound together in so far as this factor is concerned. And if the factor is a controlling one, the object in view is gained as long as the pool lasts and contains a determining proportion of the pooled factor. On the contrary if the factor pooled is not a controlling one, or if the pool is too small, the organization is ineffectual. Ultimately, the activities of the pool find expression in a collective control of the quantity of output marketed by the members. It is a necessary corollary of such an organization that the pool is divided among the various members upon some agreed basis, to the end that while retaining their separate existences they may share in the benefits gained. *An industrial pool, then, is a form of business organization established through federation of business units whose members seek a degree of control over price by combining some factor in the price-making process in a common aggregate and apportioning that aggregate among the units.* Always some degree of control over supply is involved, and is exerted more or less directly according to the type of pool.

The "pool" is a more definite and highly developed combination than the "agreement." The pool is generally accompanied by an agreement as to price, but it undertakes to go back of price and control price making: the "price combination" merely names the price and seeks to maintain it by an agreement not to sell for less, whereas *the pool undertakes to provide machinery for controlling prices.* This involves a more thorough and complex organization. One result is that it is possible to treat the latter kind of organization in

a more clear-cut fashion than could be pursued in discussing the former.

Just as the agreement was the typical form of combination from 1865 to 1875, so the pool was the typical form from 1875 to 1895, if, for the moment, we overlook the short period of "trust" organization to be described in a following chapter. Certainly this is true for the more highly developed industries. Pools became common in the seventies, while in the steel industry and elsewhere "in the latter part of 1896, and the early part of 1897 in particular, there was a rather general abandonment of such combinations."[105] The beginning came as a result of the need for controlling larger business units operating under highly competitive conditions. Thus the crisis of 1873 and the cutthroat rate wars of the years following gave rise to the first great railway pools in 1877. As early as 1870, however, there was an important railway pool between Chicago and Omaha. The end came with hostile legal developments and the discovery of more effective devices. As a standard journal puts it: "The collapse of these pools showed very conclusively that pools, even where there were penalties involved, were not always successful, and another method of controlling certain lines of manufacture had to be tried."[106] Of course pools continue to exist to this day and are perhaps more numerous than ever, but they can no longer be called the typical form of combined business organization.

Main Types of Pooling Agreement. — The reader will have observed that the definition of pooling here used is to be applied to "industrial pools." This is as much as to say that "speculative pools" are not included in the discussion. Those manipulative pooling agreements which throw stocks into a common fund for the purpose of speculative operations on the exchanges, and whose members share the pecuniary gains of these operations according to an agreed per cent, are too temporary and too exclusively concerned with profits won by artificial modifications of supply to deserve discussion here. They have no necessary effect upon the functioning of concrete capital goods, such as machinery, locomotives, business buildings, and stores of goods.

Three main types of industrial pool are clearly distinguishable: (1) Output or traffic pools, (2) territory or market pools, and (3) income pools. In income pools either gross or net earnings may be pooled, and in the latter case the organization may be called a profits pool. This classification is based upon the essential feature of pooling organization and will be followed in the illustrations presented below. From other points of view, however, we may distinguish voluntary and involuntary pooling agreements. All pools might be classed according as they restrict the aggregate output or not, a point of great importance when the public interest is concerned. Again, there are local, State or national, and international pools. In more recent times it has become common to organize a separate selling agency to handle the output of a pool's members, and this kind of pool is called a "sales association" or "cartell." Accordingly, pools might be divided into two classes on this basis. Generally the sales association is connected with the pooling of profits. The reader will find most of these types illustrated in the following pages.

1. *Output or Traffic Pools.* —As the name indicates, an output pool is one in which the members combine to the extent of making their outputs — or traffic, in the case of railways — form an imaginary aggregate fund or pool, and then divide that pool among themselves according to some agreed basis. This kind of pool operates on the supply side of the market, seeking to control competition in producing quantities of goods, and sometimes goes so far as to restrict aggregate output. This is the rock upon which many a price agreement has split, — how can prices be maintained or raised if it remains to the advantage of the individual members to increase output and they are left free to do so? The output pool is adopted primarily to avoid the rock of "overproduction."

The first pool to be considered here is an agreement that was entered into in 1886 by the chief powder concerns in the United States, and was designed to last for three years.[107] It was an output pool, combined with a price agreement, but without any restriction on maximum aggregate output. It was formed "for the

purpose of avoiding unnecessary loss in the sale and disposition of powder by ill-regulated or unauthorized competition and underbidding by the agents of the parties hereto." The powder manufacturers were divided into two groups, one consisting of three companies (including the du Pont de Nemours concern) and the other of nine. The nine companies were arbitrarily allotted an output of so many thousand kegs of powder per year. In case they should exceed this allotment, they agreed to purchase enough powder from the three companies to make up the difference, paying from three fourths to five sixths of the established sale price according to the kind of powder. On the other hand, the three companies, in case they increased their average yearly sales beyond the average for the years 1882, 1883, and 1884, agreed that the nine companies might increase their allotted output in proportion. Accordingly, the three companies were free to sell all the powder they could, for there was no restriction save that when they increased their sales the nine companies might do likewise. So also the nine companies were free to sell as long as they maintained prices; for the only penalty was that when they exceeded their allotment, allowing for any increases due to increased sales by the three companies, they had to purchase enough powder at a fixed percentage of the agreed price to readjust the situation.

This pooling agreement provided for a "Board of Arbitration" of the members which was to pass upon all disputed points and whose decisions were to be final. As a result of its operation, prices were raised and maintained.

Next it will be well to examine an output pool which included no formal price agreement but which restricted the total production of the members. Such an organization was the famous steel-rail pool which was first organized in 1887, and which, with some lapses, has continued in one form or another down to the present time. The various firms and corporations which combined to form the pool agreed to restrict their sales and production of steel rails according to the following allotment: For the year 1888 the market was estimated at a minimum of 1,050,000 tons of rails, and of this amount 800,000 tons were divided among the members in proportions running from 1.4 per cent for the Worcester Steel Works to 13.5 per cent for the Carnegie companies. The remaining 250,000 tons were placed at the disposal of a Board of Control to be apportioned by it "as and to whom it may deem it equitable, in the adjustment of any differences that may arise." More than this, the board was directed three times a year to take away parts of the allotment shares which it might deem any member could not make in due time and transfer the same to any other member. The board was further empowered to make such allotments in addition to the 1,050,000 tons as might be necessary to keep the unsold allotments 200,000 tons in excess of the total current sales. Any changes outside of this required the written consent of 75 per cent of allotment percentages. Thus the output was limited and divided, but some elasticity was provided for both in the aggregate amount and its division among the members. And a safe working margin was maintained.

The Board of Control referred to was composed of three men named in the pooling agreement who were empowered to employ a paid secretary and treasurer. They could call special meetings when they judged it expedient, and could levy assessments to meet the expenses necessary to carrying out the agreement, such assessments to be levied *pro rata* to the tonnage allotments.

To this board all members bound themselves to report each month their contracts and shipments of rails, together with a statement of the tonnage on hand at the beginning of the year.

Though not expressed in the agreement of 1887, there was a penalty of from $1.50 to $2.50 per ton for each ton produced in excess of the allotted amount.

Prices, too, were not fixed in the formal written agreement, but were left to an informal arrangement which on the whole was fairly effective as backed by the output pool.

This famous pool was broken up by the panic of 1893 and attendant disagreements over the allotment

of tonnage, but was reformed in 1894 and lasted till 1897. Somewhat later it was again revived. During the years of depression it maintained its existence with great difficulty and large sums were expended in buying off or subsidizing outside producers.

Output pools, or "traffic pools," as they are generally called in this case, have been common in the railway business and still exist, notably in the case of export and import traffic moving via Atlantic ports. One simple illustration will suffice. At a meeting held in New Orleans in 1898, at which a chairman and secretary were elected, all the railways carrying cotton out of Memphis, Term., entered into a pooling agreement. Each road bound itself to observe rates as they might be adjusted by its agent from day to day, to furnish daily information as to the lowest ocean rates from the ports which it served, and to control the routing of cotton. An official acting for all the roads issued a daily rate bulletin for all ports, the rates being made up of the domestic rail rate plus the ocean rate. That combination which gave the lowest total through rate automatically became the rate over all the roads and via all the ports. If the through rail-water rate over the Southern Railway via Norfolk was 65 cents a hundred, while it was 70 cents over the other roads, 65 cents became the general rate. But this rate basis could hardly have been maintained without the pool. The roads concerned agreed to accept tonnage at the rate so fixed and to distribute the total in certain fixed percentages. Thus, at the New Orleans meeting referred to, the Southern Railway was to have not over 13.4 per cent, the Illinois Central and Yazoo and Mississippi Valley roads not over 42.8 per cent, the Louisville and Nashville not over 13.4 per cent, the Nashville, Chattanooga, and St. Louis not over 7.9 per cent, and the Memphis and Cincinnati Packet Company not over 6.5 per cent. Clearly the object of the pool was to maintain stable and profitable rates.

This Memphis cotton pool was attacked at law and in 1899 the Supreme Court of Tennessee gave it some sanction, though the case went off on the question of the right of a shipper to route his shipment.[108]

2. *Territorial Allotments or Market Pools.* — Another way of maintaining prices is to pool the market and divide it among the members of the combination. From one point of view, this insures a certain demand to each member, and so this form of pool may be thought of as seeking to influence the demand side of price determination. But a part of the object may be to restrict the supply in certain sections by keeping the members from other sections in their own fields. It is not usual to find this kind of pooling agreement alone, for it is generally associated with some understanding as to a division of output or traffic. As will appear below, the pooling of territory or market may be secured by direct specification or by indirect means. Also these pools may readily be international in scope.

The desirability of territory agreements comes from an endeavor to maintain prices above the competitive level. A business organization, usually a combination, in seeking to secure the highest net returns from the sale of its products, maintains prices at a relatively high level in the market in which it has the greatest advantage, which involves a limitation of supply. Its plant, then, is not running at full capacity. Thus it also seeks to make a larger output and to dispose of the surplus at what it will bring in some other market. But here it meets a competitor, who, if not already doing so, may retaliate by invading its sphere. Thus wars arise, as in the tobacco industry, and if both parties are of similar strength, an apportionment of the field is the result. Sometimes a "free" or neutral region is provided for, within which either concern may sell for what it can get. Of course, if one contestant is greatly superior in strength to the others, that one may swallow the others and virtually dominate the whole field, a possibility almost if not quite illustrated in the oil business within the United States. The agreements to be next described, then, are characteristic of a situation in which local combinations or mergers have gained control of certain territories and then are led to enter into what may be likened to protective tariff treaties made by the mutual agreement of the contiguous powers. Thus the home market at least is insured.

In 1875 the powder pool described above began active competition with a Pacific Coast company. As a result the rival company was forced to sell some of its, stock to a member of the original pool, and a "neutral belt" territory was agreed upon consisting of Utah, Wyoming, Montana, Colorado, and New Mexico. In this territory rates were fixed by the pool. When the agreement was renewed in 1880, the neutral belt was retained and the eastern members agreed not to ship powder into California, Oregon, Nevada, Arizona, etc., with the understanding that their territory would be free from invasion by the western concern. In a more highly developed and comprehensive pooling agreement made in 1889, the whole country was divided into seven "districts."

A very famous pool which had as an important essential feature a marked allotment of territory was the Associated Pipe Works which embraced six southern manufacturers of cast-iron pipe. This is the pool that figured in the celebrated Addyston Pipe Company Case in 1897–1899.[109] The avowed object of the pool was to regulate prices, and its chief means lay in a pooling of the incomes which will be described briefly below, but half the story hangs upon its division of territory. In the first place the United States was divided into two great territories, known as "pay territory" and "free territory." It must not be supposed that pipe was free in the latter region. It was merely the territory in which the members of the pool were free to sell on such terms as they chose without paying anything into the pool. "Pay territory," on the other hand, embraced the States in which, for every sale made, a "bonus" had to be paid into the pool. There were thirty-six such States, Virginia and her sister commonwealths to the north and east being "free." The fixed bonuses ran from $1 to $4 per ton according to State.

Besides this territorial arrangement a system of "reserved cities" was evolved. Thus a resolution of 1894 provided that "The Addyston Pipe and Steel Company shall handle the business of the Gas and Water companies of Cincinnati, Ohio, Covington and Newport, and pay the bonus heretofore mentioned, and the balance of the parties to this agreement shall bid on such work at such reasonable prices as they shall dictate." "Dennis Long and Company of Louisville, Ky., shall handle Louisville, Ky., Jeffersonville, Ind., and New Albany, Ind., furnishing all the pipe for Gas and Water works in above named cities," and so on for each member. Clearly a prominent feature of this agreement was a pooling of the market.

The tobacco consumers of the world have been pooled. In 1902 the Imperial Tobacco Company (Great Britain) and the American Tobacco Company (United States) made an agreement under which the former was to have exclusive control in Great Britain and Ireland and the Isle of Man; the latter was to have exclusive possession of the United States, Cuba, Porto Rico, Hawaii, and the Philippines.[110] A new corporation known as the British-American Tobacco Company (Limited), was established to handle the export business in the balance of the earth. Like Caesar's Gaul, the earth was divided in *partes tres.* The Imperial Company bound itself not to engage in the tobacco business in the United States unless through the American Company or its allies, except that it retained the right to buy and treat tobacco in that country for the purpose of its business in the United Kingdom; and the American made a similar agreement with regard to its former competitor's business. Each party was to sell to no one in the other's territory except that other, and goods sold to each other were to be paid for at a fixed rate of 10 per cent above cost. The Imperial Company was to act as sole agent for Havana and Porto Rican cigars and cigarettes in the United Kingdom and was to handle none but the goods of the American Company. This territorial pool was in operation at the time of the recent dissolution of the "Tobacco Trust."[111]

Territory pooling could not be completely described without some account of indirect means of dividing the market, such as the basing point system of prices affords. Take the old wire-nail pool for example. The territory was roughly divided by so fixing prices that the manufacturers nearest given points would have an advantage in selling there. Pittsburgh was made the "basing point." The price at any other point was fixed

at a figure which equaled the Pittsburgh price plus the freight rate from Pittsburgh to that point. Thus the closer the mill to the point in question, the greater its profit; while mills farther removed than Pittsburgh could not afford to sell to this point at all. If the cost price of a keg of nails at Pittsburgh is $1.20 and the freight rate to some point in Iowa is 60 cents, the price from any mill is fixed at $1.80, and Chicago will automatically hold the Iowa trade as against Pittsburgh, — as long as the basing point price is maintained.

3. *Income and Profits Pools.* —The Associated Pipe Works pool whose territory arrangements were described above makes a good illustration of an income or profits pool. Competition was confined to bids within the pool before contracts were let. It was managed as follows. A central board was created to represent the members and to it were referred all requests for bids coming from pay territory. The board then fixed the price that would be charged, and, having fixed it, the several pipe works were asked to bid for the contract. To the one which offered the most, the work was assigned. This was called “buying the job.” Those of the members who had been asked to do so then “went through the motions” of submitting bids to the real purchaser, but these bids were always made higher than the price fixed, leaving the work to the one who had bought the job. So much for the price-fixing aspect. On each shipment of pipe a certain sum of money was paid into the pool. This payment was called a “bonus.” The members regarded these bonus payments as temporary deductions from the price received in the nature of a penalty upon efforts to get all the business possible even at low rates. For, if they lived up to the terms of the agreement, the bonuses were distributed periodically among the several pipe works on the basis of their total yearly shipments into pay territory. At first the bonus was fixed at a certain rate per ton. This was not found to maintain prices at the desired level, and in 1895 it was agreed that prices and bonusses should be fixed at regular or called meetings of the principals. The following excerpt from the minutes of such a meeting will illustrate the nature of the transaction. (Anniston and Bessemer were two of the pipe works.)

> “It was moved to sell the 519 pieces of 20" pipe from Omaha, Neb., for $23.40, delivered. Carried. It was moved that Anniston participate in the bonus and the job be sold over the table. Carried. Pursuant to the motion, the 519 pieces of 20" pipe for Omaha was sold to Bessemer at a premium of $8.”
>
> “Moved that ‘bonus’ on Anniston’s Atlanta water works contract be fixed at $7.10, provided freight is $1.60 per ton. Carried.”

The long and short of it is that on every shipment each member paid a sum presumably bearing some relation to the profit that was expected, to the pool, and the total was divided according to the shipments. This arrangement was enjoined by the Supreme Court in 1899.

Sometimes more direct and definite steps are taken to insure that each member retains at least his expenses and that only the surplus above average expense, or profits, is pooled. The wire-nail association (1895–1896) did so. This association agreed upon prices and output, fixing them in advance, month by month. Production was allotted among the members, and all income above a fixed “cost price” was turned into the pool. Then the expenses of maintaining the pooling organization, which, in this case, were heavy, were deducted, and the balance was divided according to allotted output. Each mill marketed its output independently, but an inspector was maintained in each to keep tab on books, correspondence, etc. The nail pool, then, differs from the pipe pool, among other things, in that the proportion of gross income to be pooled was stipulated directly, and not left to competitive bidding among the members.

The foregoing comprises the ordinary features of a “profits pool.” Directly or indirectly, a “base price” sufficient to cover expenses of production is retained by the members and the difference between this and the selling price is paid into the pool. Indirectly this tends to prevent overproduction, for generally each

member shares in the pool on a fixed basis, and if he increases his sales beyond the agreed amount he receives no proportionate increase in profits.[112] Thus output, or supply, is the ultimate basis of control, even in income pools.

Obviously the effectiveness of such an arrangement may depend upon the percentage of the income that is put in the common fund, for if only a small percentage is pooled, it may still remain profitable for a member to take more than his share of the business. It was once found necessary in the old Southern Railway and Steamship Association (1875–1887), for instance, to require that as much as 80 per cent of the gross earnings from the through freight tonnage be pooled. In such cases as these, one can hardly speak of a "profits" pool, for far more than the profits are concerned. It is necessary, then, to distinguish two kinds of pools among those which involve the proceeds of the business, and this is the reason for the double heading of this section: "Income and Profits Pools." When, as was the case with the railway pooling organization just mentioned, a large part of gross earnings is thrown into the common fund for distribution on the agreed basis, we have what may best be called an "income pool." Where only the net earnings above expenses are so treated there is a "profits pool." Both classes may be called "money pools" to distinguish them from output (or traffic) pools and territory pools.

Chapter XII: Federation Organization: Pools (*Continued*)

Sales Associations. — The great weakness of output and traffic pools is the fact that the members are tempted to increase their sales beyond the allotted amount. This temptation the ordinary profits pool meets somewhat, but not perfectly. 'To obviate the difficulty, the various forms of sales associations, or pools which leave none of the marketing of their products to the individual members, have been devised. The sales association, then, may be defined as a joint output and profits pool which sells the combined outputs of the members through a common sales agency. Such an association is called a *cartel* on the continent of Europe. It is the most highly developed and stable form of pool, and may be said to date from the period of the later nineties. Indeed, to describe it here is to step somewhat out of historical order in the evolution of business organization, as in the United States the sales association was fully developed after the trust and merger forms which are to be discussed later had been tried. Some writers have even thought that it may prove the most advantageous form for combination organization in the future.

A short-lived but instructive experiment with sales association pooling is furnished by the Chesapeake & Ohio Coal Association.[113] This association was formed in December, 1897, by fourteen coal and coke producers located on the line of the Chesapeake & Ohio Railway Company in West Virginia. For the purpose of pooling their sales they organized the Chesapeake & Ohio Fuel Company under the laws of West Virginia and agreed with that company to sell their coal and coke for western shipment to it exclusively for a period of five years. The fuel company, in its turn, agreed to handle none but the products of the coal association, except in case of extreme emergency.

Each party to these agreements had an "executive committee" of three, which committees were endowed with great powers. It was provided that one member of the fuel company's committee should be a member of the coal association.

The association's executive committee was empowered to fix a minimum price free on board the cars at the mines, though it was stipulated that they were to act in consultation with the fuel company's representatives; and the said fuel company agreed not to sell below this minimum price, and to try to get as much more as possible.

Furthermore, the fuel company bound itself to take not less than 600,000 tons of coal and 75,000 tons of coke per year at the minimum price, providing that if it should prove impossible to market as much at this price, the quantities might be somewhat reduced.

The mode of operation was as follows. The executive committee of the coal association made a monthly apportionment of the output and this apportionment was reported to the general manager of the fuel company who was to distribute all orders to be shipped by rail among the members of the association "according to such apportionments." It appears, however, that the coal and coke producers themselves employed an

official known as an “equalizer” to make a distribution of orders and cars among the shippers. In case any member might not be able or desirous of contributing his entire allotted share, the surplus was redistributed among the others on the same basis as the original apportionment.

The fuel company agreed to make periodic reports on tonnage, sales, and prices. To quote the language of the agreement: —

> “(6) The said Fuel company shall make and render to the members of the Coal Association accurate and complete reports.... and upon the sale after the end of each month of any coal or coke shipped and weighed, or weighed but not sold during such month, the surplus, if any, arising after deducting from the actual price received the minimum price for such kind and grade of coal or coke for such month and, profit shall be paid forthwith to the shippers... according to their tonnage of such kind or grade of coal or coke for such month.”

The agreement then went on to provide for a compensation to the fuel company as follows: —

> “(9)... the Fuel Company shall get its profit [not to exceed ten cents per ton] over and above the net minimum price of said coal and coke f.o.b. mines as hereinbefore fixed, and, if the price at which said coal and coke is sold by said Fuel Co. shall be sufficient to yield a sum exceeding said minimum price and gross profit of ten (10) cents per ton as aforesaid, then the difference shall be paid over to the members of said association... as they may be entitled under this agreement, as part of the purchase price to be paid for coal and coke by said Fuel Co.”

The gist of the matter is this: an agreed minimum or base price — presumably about sufficient to cover cost of mining or coking — was guaranteed to the coal operators; and in addition they shared such profits as might be left, after an amount sufficient to pay ten cents a ton to their selling agency had been deducted, according to the tonnage allotted to them by the “equalizer.” Of course, to the extent that they were interested in the fuel company, the amount paid to it for handling their output might also be regarded as pooled.

Another point of interest in the agreement is its provision of a committee of arbitration and of elaborate rules for the procedure of that committee. In case of any controversy arising under any terms of the agreement, any party thereto might submit his contention to arbitration by this committee.

In 1900 this agreement and the organizations which were parties to it were declared illegal as being in restraint of trade and in violation of the Sherman Anti-trust Law, and the combination was dissolved.

An excellent recent example of the sales association is found in the paper industry. On May 26, 1900, some fourteen manufacturers of manilla and fiber papers organized a corporation known as the General Paper Company. This corporation was organized under the laws of the State of Wisconsin for the purpose of acting as exclusive sales agent for the product of the fourteen manufacturers, and in July its members all entered into contracts with the agency to sell to it alone. The number of members was later increased to twenty-one and altogether produced about 90 per cent of the paper and paper products manufactured west of the Alleghany Mountains. But the corporation was more than a mere salesman; it was the visible symbol of a combination among the twenty-one manufacturers for pooling purposes. Under its certificate of incorporation the General Paper Company was authorized not only to become the agent for marketing all their output, but virtually to regulate the output of their mills, fix the price of their products, and divide the market among them.

The corporation was capitalized at $100,000 and its shares were distributed among the twenty-one mill owners, in proportion to their average daily output. Of course its board of directors consisted of representa-

tives of the mill owners.

The Imperial Window Glass Company formed in 1909 was purely a selling agency for about fifty manufacturers who subscribed for the stock and agreed to sell no glass except to this company. Among other instances, sales associations have occurred in the salt business,[114] in the shade-roller business,[115] in the blue stone ware business,[116] and in the manufacture of wooden dishes.[117]

Characteristics of Successful Pools. — What now are the characteristics of the successful pool, and under what conditions will it succeed best? A study of numerous cases must lead to the conclusion that the more successful pools have been organized on the basis of *a definite allotment of tonnage or business, maintained by penalties for violation.* As in the case of the steel-rail pool, provision should be made for considerable elasticity in the aggregate output; and the exaction of penalties for excess production may well be accompanied by allowances to members falling below their allotted share. Of course, the penalty need not be in the nature of a fine, for the mere pooling of income makes the exceeding of one's allotment unprofitable, as is illustrated by the pipe-works pool.

As to conditions other than the form of the organization, much depends on the number of plants and the amount of capital required to start in the business. Where the number of concerns is small a compact organization embracing a high percentage of the total output is easier, and these features are important. Where large capital is required there is apt to be a smaller number of plants, so that it is easier to make arrangements and hold the members to them. Also a less complicated and expensive organization is necessary. Above all, competition is less likely to spring up: where one can start in business on a capital of but $10,000, no pool can long maintain prices when profits are good, for competitors will flock to the chance for gain.

Another condition of greatest success is that there should be a certain degree of uniformity among the members, first as to size or strength, and second as to kind of business. Where weak and strong, big and little, are combined, dissatisfaction is more apt to arise. Where some members are engaged in producing a more advanced stage of the article whose output is concerned in the pool than are others, difficulties arise. Thus, if the manufacture of steel billets is pooled, and a few members of the pool not only produce billets, but also go on to manufacture finished shapes, these members on the strength of their gain on billets may take it into their heads to sell the finished product at lower rates than their competitors and so spoil the market for the billets produced by their fellows in the pool, who, of course, are dependent upon these same competitors for sales.

The organization of a sales agency adds the finishing touch in making a pool stable, for it means a pooling of the marketing function as well as income.

Advantages and Disadvantages. — It is of no mere academic interest to discuss the advantages and disadvantages of pooling agreements, for, though illegal, they exist, and it has long been a live question whether or not the fact should not be recognized by the law and pools be legalized. Probably pools are more numerous and varied than ever before, and they have even become international in scope. Naturally much that was written concerning the advantages of mere "agreements" applies equally well to pooling agreements, but not all, and the possibilities of the more stable forms of pools makes a rather more extended discussion desirable. One difficulty in the way is the fact of a variety of forms which renders it difficult to make sweeping generalizations.

Like agreements, pools may be formed with great facility. They may spring up over night. As with all organizations depending solely upon contract, the ease of formation is in some proportion to the readiness of the parties. But in the pool there is a closer combination of members and more powers are delegated to its "federal" authorities, with the result that the stronger business units may be more loath to join in a pool which requires forfeits; and the difficulty of arriving at mutually satisfactory apportionments of output is

sometimes insuperable. On the other hand, the very fact that the pool affords an opportunity for more binding federation may make it more attractive, and it affords an opportunity for effective monopoly which beckons seductively. Needless to say, the facts that no corporate charter is necessarily involved and that taxes and fees are not increased, are also to be considered in this connection.

Not being a separate entity nor having any formal separate existence, the pool does not concern itself directly with any increase in capital and the test of ability to raise capital does not apply in the ordinary way. But the capitals of the members are combined for the limited purposes of the federation, so, in that sense, the question does present itself. It is to be noted, then, that pooling, as such, does not alter the financial liability of members, there being no change in corporate organization or capitalization. Some doubt has existed as to whether a partnership relation is established and in some pooling agreements the precaution has been taken to specify that such a relation is not to be created. Where the members are corporations, however, the partnership question has little bearing, and this is now generally the case. We may conclude that the pool furnishes a ready means of bringing large capital to bear on a combined object, but that the aggregation is unstable.

As remarked in the preceding paragraph, the pool is not concerned with raising capital, and by the same token it does not cause overcapitalization in any direct way. The formation of a pool involves the flotation of the stock issues of no new corporation. One result is the advantage that speculative mismanagement is not so apt to come from pooling as from corporate combination.

Pooling, of course, only concerns output, its amount and sale, and the division of the proceeds. Therefore, the direction of the technical processes of production remains or may remain undisturbed. The motivation of industry, however, is undoubtedly somewhat affected, and the spur of profits can hardly work in the same way as before when the very object of the pool is to modify competition among its members by regulating their sales. It is not to be concluded, however, that this means a destruction of motivation, for the producer still knows that by perfecting his methods and reducing his costs he may increase the margin between his expenses and the income assured him by the pool, and so get a larger net gain. Considerable benefit, too, may accrue to all concerned through a stability in prices and in trade conditions. Pooling agreements often provide for inspection of the product to insure a good, uniform quality, which is an advantage to the strong and honest producer. They also furnish a form of combination which is very flexible, being readily adjustable to varying conditions of territory, membership, and business. Thus there is something to be said in favor of the pool on the score of administration or direction, and, as was remarked with reference to agreements, the advantages thus indicated are especially prominent where the industry concerned is in rapid transition or trade conditions are very complex.

To sum the whole matter up: the object in view is always to check competition, and so maintain or increase the margin between expenses and income; and the pool supplies an easy and secret means of combining temporarily for this purpose.

But, on the whole, the foregoing advantages for direction are only offsetting or counterbalancing points, and apply only in comparison with other forms of combination. On the straight question of motivation, it can hardly be maintained that the intensity of stimulus to produce is as great in a pool as outside. This is due to the simple fact that during the life of the pool the struggle for survival is softened, the members do not have to seek more efficient means and broader markets, and the less energetic among them will not put forth so great an effort along these lines. Moreover, weak and inefficient producers are not infrequently taken into the pool and supported by it, in order to remove them as a disturbing element.

The great disadvantage of pools from the private point of view is their lack of stability and endurance. In most general terms, this is due to their lack of perfect and complete combination, as seen in the retention

of a large amount of autonomy by the individual members, whose separate interests may lead them to disrupt the organization at any time. The obstacle which has wrecked many a pool is the shortsighted tendency to raise prices too high, with the result that the output cannot be disposed of, there is a slump in the market, and the last demoralized state is worse than the first. But regardless of artificial prices, the difficulty is inherent. Business has its ups and downs — no matter why — whereas the output capacity of the pool's plants is fixed and probably at least equals the maximum demand. All goes well during the ups, but not so during the downs. To reduce output means waste capacity and a larger per cent of fixed charges, so each member is tempted to sell more than his share, and that means lower prices. Even if the pool is maintained there is constant difficulty in agreeing upon the division of the pooled factor, involving frequent readjustments with a new chance for dissatisfaction on each occasion. Or, if it is not the discontent of old members, there are new competitors springing up to be taken in and provided for. Pools, in common with all combinations, have ever to face the fact that any improvement they make in the price situation not only tempts their members to overstep the bounds of their allotment, but also encourages outsiders and the formation of new organizations. The further the division of the pool departs from the normal relative power of the members the more difficult will it be to maintain the agreement, for not only will discontent exist, but there will be an increase in the tendency to exceed one's share to the end that the larger showing may be used as an argument for a larger apportionment in the pool at the next time of adjustment.

For a striking example of the foregoing weakness of pooling agreements, and at the same time of their facility of formation and flexibility, one need go no further than the early days of the whisky combination. Beginning with a situation in which there was a glutted market and prices standing below cost, there were some earlier agreements, but it was in 1881 that the Western Export Association was formed. Its immediate object was to export the surplus product so as to keep up domestic prices, and to this end a monthly assessment was levied on members according to the amount of grain mashed. This organization split up in the following year, 1882. In this same year, another pool was entered for the purpose of restricting output, but it accomplished little. New pools were formed nearly every year till 1888,[118] when a closer organization was established. Sometimes they sought a limited output, leaving marketing to the individual distillers; sometimes they merely exported the surplus over a certain amount; but always the pools were soon disrupted and generally because the members exceeded their allotted output.

Another disadvantage, which has been notably prominent in the case of railway traffic pools, lies in the objection sometimes raised by customers or shippers to any diversion of their orders or shipments. Here the profits pool has the advantage. In order to maintain the agreed output or traffic apportionment the output pools sometimes divert business from one plant or line to another, and customers may prefer the company from which the business is diverted. Several important suits have been brought by railway shippers against the diversion of freight, among which is the case of the Memphis cotton pool described above. On the whole these cases have favored the shipper. As a result, railways voluntarily abandoned traffic pooling to a large extent in favor of money or profits pools. The difficulty is generally met in the case of industrial output pools by levying assessments on those plants which exceed their allotment for the benefit of those which fall short of it, thus making it unnecessary to divert business.

It remains to apply the test of legality to the pool, and here we find a woeful deficiency. Always formed by combining previously competing plants with the object of restricting competition, pools are visited with the full wrath of the laws against combinations. At common law, all pooling agreements being regarded as in restraint of trade are unlawful in a negative sense, that is, they are not enforceable in the courts. But in 1887 the Interstate Commerce Act positively forbade railway pooling, and, under the Sherman Anti-trust Act of 1890, industrial pools of all sorts became positively unlawful. Though not so intended by its framers, this

latter act was applied by the courts to labor combinations and to railways (1897), and so reenforced the previous law in the field of transportation. Thus, between 1887 and 1897 railways entered into rate agreements which were nominally, at least, different from pools, but in the latter year, when the Sherman Act was applied to the Trans-Missouri Freight Association, any form of concerted action became unlawful. Since 1890, the majority of the States have passed anti-trust acts which generally expressly prohibit pools The result is that these federations have been forced to take one of two courses: either they resort to secrecy and evasion, or they seek some other form of organization through which their ends may be gained.

Social Point of View. — The advantages of the pool, when regarded from the social viewpoint, are similar to those of the simple price agreement, but are reenforced on the positive side by the more efficient organization of the former. Pools and most cartels supply a facile means for minimizing industrial fluctuations and risks, and enable producers to cooperate with considerable unity without subordinating their individual methods to a central corporation. And these things may all be socially desirable. On the negative side, too, pooling, like simple agreement, does not lead to overcapitalization or stock watering; nor does it establish an organization sufficiently consolidated to seize permanent hold upon the great limited natural resources and thereby become entrenched as a natural monopoly. Surely the interests of society are more seriously threatened when a member of the United States Steel Corporation (a consolidation) secures certain ore lands than would be the case if the owner were merely a member of a pool, say the steel-rail pool.

From the standpoint of society, however, several objections might be raised against pooling. In the first place, there are certain objections which lie not against pooling in general but against special kinds of pool. Thus income pools are liable to the social abuse of being used to subsidize the weak and unprofitable plants. An inefficient railway or mill may be able to do great harm by cutting in and selling below cost, or the interests owning efficient plants may also own inefficient ones, which they insist on having recognized in sharing income. In such cases society is forced to pay interest on idle and inefficient capital. Again, pools which are managed in a shortsighted way so that prices are sent sky-high, only to fall with a demoralizing thud, are obviously undesirable.

More than this, if we must *assume the existing state of the law of combinations,* pooling in general is undesirable from the social point of view. Of necessity it works secretly by devious ways, and so begets evasion and crookedness. Moreover, under such circumstances, an anomalous and ill-defined status is given to co-operation in business, and a situation is created in which power and responsibility are not correlated: business men seek the power of concerted action without a proportional responsibility for their actions. Inasmuch as it has so far proved impossible to prevent such combinations and concerted action, it would seem worth while to try the experiment of removing the taboo and encouraging open pooling arrangements under legal sanction and regulation. Any tendency to distinguish rationally between socially reasonable and socially unreasonable combination in the shape of pooling agreements is to be welcomed as a step in this direction.

But, some one asks, is pooling not monopoly, and is monopoly, then, not socially undesirable? No and no, — that is, not necessarily nor always. In the first place, pooling does not necessarily mean monopoly and high prices. The author is not one of those who would minimize the effect of pools on prices, for it seems clear that they find their reason for existence in a desire to affect the margin between price and expense. Certainly it is too naive to argue as some do that traffic and output pools seek merely to divide business on the basis of the rates determined by preexisting economic forces, when (1) they remove that sort of competition which leads business organizations to attract trade by reducing prices, and (2) they generally involve some restriction of output. Nevertheless, pools do not always operate to advance prices. Take, for example, those pools which embrace businesses in which competition is normally impossible, that is, businesses

which are characterized by large fixed charges and increasing returns. In such cases it is a shortsighted person who concludes that because a pooling agreement will prevent price or rate cutting it will therefore cause higher prices than would exist without the pool; for, though the cutting of prices means low rates part of the time, at other times rates must be raised to cover deficits created during the cutting process, and the average rate over a period of years will be high. The net long-time result of rate wars, cutthroat competition, and the attendant unstable conditions, may be a higher average price than would exist if competition were restrained and prices maintained at a level somewhat above the lowest competitive basis.

Furthermore, pooling agreements may be the means of enabling small plants to compete with a great consolidation. By banding together to buy and sell in common, with pooling arrangements to give the agreement a degree of binding force, a number of "independent" concerns may exist outside of a "trust." This may be desirable, if properly controlled, for the reason that (1) it retains personal supervision of plants, (2) it can be readily dissolved, and (3) it cannot gain permanent control of natural resources. As in the case of price agreements, the danger of monopoly based upon control of limited sources of raw materials appears to be small in so far as pools are concerned.

Again, if we admit that pools may be monopolistic, we must not forget that monopolies may be partial and limited, or complete and general. Pools when monopolistic are generally of the former class. We must remember that the members of the pool retain their separate individualities and have an interest in securing as favorable terms of membership as possible. These can only be secured, as a rule, by gaining larger shares of the business. To the same effect is the fact that pools, in permitting the existence of numerous separate business units, allow a condition in which seeds of competition remain; whereas consolidation, which, as will be indicated in a moment, is the alternative, reduces the number of units and the likelihood of competition.

It is a demonstrable fact that the effort to maintain a low level of prices through sharp price competition and to prohibit agreements which limit such competition defeats its own. purpose by hastening the formation of more highly developed and powerful forms of combination. It is a matter of commonplace knowledge that the statutes against railway pooling have furthered consolidation into the great "systems" which now parcel out the regions of the continent among themselves. The recent history of the evolution of business organization shows no clearer lesson than that as the law has cut off one form of combination another has taken its place, and in following the line of least resistance each form has either been more secret or more compact than its predecessor. As agreements and pools have been made illegal, community-of-interest organizations, mergers, and holding companies have sprung up. These forms may or may not be worse than the pool. That is not the point here. The point is that anti-pooling laws tend to freeze the pools, as it were, into solid masses which fill the same beds that the pools occupied.

But, in the second place, it is not true that monopoly is always bad. This subject has already been touched upon in discussing the legality of combination in general, and will be mentioned again. Most thoughtful economists now are agreed that the wastes of unrestrained competition may outweigh the dangers of regulated monopoly *in certain cases,* and here monopoly, under governmental supervision, is good.

The foregoing point leads naturally to a final observation on pooling from the public point of view. Among the wastes of competition is a fluctuating and unstable condition of prices accompanied by unjust discriminations. Unstable and fluctuating prices mean greater risk, higher interest and insurance rates, and retarded industrial plans, and in this way they constitute a social evil.[119] Not only this, but the door is open to all sorts of unjust discrimination and favoritism and industrial terrorism. It is now a veritable commonplace to state that the railways are placed at the mercy of large shippers when they are not banded together so as to enable them to turn down requests for special favors, strong in the knowledge that the rival carrier is bound

to do likewise. Pooling, in addition to maintaining a level of prices which may be lower than the average of fluctuating prices, affords a distinct benefit by merely making prices stable. Mere price agreements tend to do the same thing, but are not sufficiently enduring. Pools also lack the permanence necessary to secure the best results on this score; but they have often met a temporary need successfully, and in their better organized forms have lasted for years. If legalized and regulated they could do the work. And, in addition, they would enable the honest producer to maintain reasonable trade conditions and prices against the undercutting of weak or dishonest competitors.

After all has been said, however, it must be agreed that pooling agreements are dangerous to the best interests of society unless prices or the price-determining conditions are under some sort of public supervision. Is it safe to allow pooling when monopolistic and extortionate prices may be charged? And is the mere right to sue for damages in the courts an adequate safeguard against extortion? Since the Interstate Commerce Commission secured power over railway rates, the benefits which might be expected from railway pools may be said to outweigh the dangers, and sound public policy would lead to a legal recognition of the railway pool as is the case in European countries. In manufacturing industry, however, the case is not so clear. Here, as already indicated, reasonable pooling agreements may do great good, especially in large fixed-capital industries; but the public hardly has an adequate protection against monopoly prices which *might* be set. In another connection, the author has concluded "that, though a pooling agreement does not primarily concern rates, under private ownership the rate is the center of the problem; if pooling is to be allowed, then rates should be regulated to safeguard public interests";[120] and a similar conclusion has some bearing to-day upon industrial pools. Is the inference not clear that, as with railways, so with manufactures we need administrative control — a commission under whose supervision legalized pooling agreements may be established? Probably no attempt should be made to regulate prices now, but any pool would have to be open to any plant which might desire to enter, its existence should be limited to some short period of time, and its agreements and proceedings should be filed with the commission just mentioned. And until we have these things the status of industrial pooling must be doubtful. Meanwhile, the courts may make some progress through establishing the principles that should distinguish the reasonable from the unreasonable pooling agreement.

Chapter XIII: Combination Trusts

Trust combinations grew out of the weaknesses of pooling agreements. The latter form of business organization, while possessing several advantages over closer combinations, had the great disadvantages of instability and imperfect centralization of direction and management. This weakness of management was apparent in the existence of numerous plants with a capacity far in excess of the market for products at paying prices. Some pools were more successful than others, but on the whole such agreements came and went without permanently improving the situation. When the Whisky Trust was formed in 1887 at the end of years of nearly futile pooling agreements, it immediately shut down sixty-eight out of eighty distilleries and was soon producing as much of the fiery fluid as ever with the twelve remaining plants. This spelled economy. A similar situation existed in the sugar- and petroleum-refining industries. Trust organization, then, was divised to meet the weaknesses of the less centralized federation forms.

The trust to be discussed in this chapter is a very different affair from some of the organizations to which the term is popularly applied — different in form, though not, perhaps, in purpose. Popularly, the "trust" is any big monopolistic combination; but as a specific business form it has a more definite meaning. The somewhat cumbrous definition which is necessary adequately to distinguish it is as follows: A combination trust is *a form of business organization established through temporary consolidation, in which the stockholders of the constituent organizations under a trust agreement transfer a controlling amount of their stock to a board of trustees in exchange for trust certificates. These certificates show their equitable interest in the income of the combination.* Obviously the trust thus defined differs from the corporation in that it is necessarily a combination of business units. But, more than that, its legal attributes are quite different from those of a corporate combination. Trustees are not as directors, the paid servants for the stockholders; nor are they mere agents. They act as principals, making contracts for themselves and being able to sue and be sued. Under the unmodified common-law organization, the debts of the trust are not those of the beneficiaries, but are the personal debts of the trustees.

In some respects the combination trust is like a stable pool, even in method of organization and in form. For one thing, it is based upon the mutual consent of the members who sign a "trust agreement." Thus, a contractual relationship is involved, which differentiates it from the forms to be discussed later. Again, the net income of the constituent organizations available for dividends is virtually pooled, for the dividends declared by the combined corporations on the stock transferred to the trustees all flow into a common fund in their hands. This dividend fund, or pool, is then paid out to the certificate holders in proportion to their interests therein as evidenced by the certificates.

But here the likeness ceases. The trust involves a great deal more than a mere pooling of dividends. There is a transfer of the legal title to stock in the constituent concerns, which is in the nature of a deed of

trust. The rights of the members are defined in a "trust agreement," and a formal organization is provided for with an assured succession of trustees. Above all, however, the trust is no mere federation but is a consolidation of interests. The agreement provides that the trustees vote the stock transferred to them, thus giving them power to elect the directors of the constituent companies and so control their policies. Through common ownership of stock and direction of management the various units embraced are closely combined. They lose the large measure of independence which is retained in the pool, and may remain separate only in name.

Classes of Combination Trust. — As observed in an earlier chapter on the simple business trust, the law recognizes several classes of trust, and in terms of these classifications it may be said that practically all business trusts are active express trusts. At this point, however, a further step in classification becomes necessary. Some trusts are formed by groups of individuals or corporations for the purpose of vesting in trustees the administration of property for the common benefit; and such trusts might be called *association trusts,* or trusts of property. Others, however, are formed by business units for the purpose of combination, and they delegate the control of the units to the trustees, thus incapacitating the constituent organizations from determining the course of their own operations. Such organizations might be called *combination trusts,* or trusts of business units. The former class is generally quite legal; but combination trusts are likely to run counter to the law in at least two respects: (1) they may be monopolistic and contrary to public policy, and (2) they may involve a combination of corporations such that those corporations abandon the purposes for which they were created, and so act *ultra vires.* Of course monopoly may be effected under any form of business organization, and is not to be associated with the trust form as such. But it is characteristic of combinations of corporations under the trust form ("corporation trusts") that the combining companies necessarily surrender control absolutely into the hands of trustees, and in so doing they not only make the monopoly more complete, but also they lay themselves open to attack on the ground of *ultra vires.*

As to form and method of organization, two classes of combination trusts may be distinguished: (1) those in which the combining units transfer merely a controlling proportion of their stock to the trustees; (2) those established by transferring all the stock of the combining companies, (a) either retaining mortgages to the amount of the appraised value of their plants (e.g., the Whisky Trust), or (b) making the transfer without any such condition (e.g., the Standard Oil Trust).

Origin of the Combination Trust. — The juristic institution of the trust, briefly described in a preceding chapter, was seized upon in the United States in the early eighties as supplying a form under which permanent centralized combinations of corporations might be formed without the trouble and publicity of forming a new corporation for the purpose. Instead of being imposed by the law for the purpose of conserving property, etc., it was adopted by the beneficiaries themselves who sought to combine for profit and chose trustees from among their own number to administer their own property under a trust instrument devised by themselves.

The form of organization now under discussion was first adopted for the purpose of a large industrial combination by that arch combiner and seeker after monopoly, the Standard Oil Company. Devised in 1879,[121] apparently by Mr. Dodd, the company's general solicitor, the trust was perfected and firmly established in 1882. This lead was followed by the establishment in 1887 of the Distillers' and Cattle Feeders' Trust ("Whisky Trust") and the Sugar Refineries Company ("Sugar Trust"). Trusts were also formed in the cotton seed oil, linseed oil, and white lead industries. The leaders in this direction appear to have believed that their organization would not be regarded as a relation between corporations, as such, and they insisted, when attacked in the courts, that the trust agreement concerned the stockholders as individuals only.

However that may be, by 1890, as we shall see, a leading combination trust had been declared illegal;

and so far as the combination of corporations is concerned the trust movement in the specific sense of the word "trust" came to an end at that time. This kind of business organization, then, is characteristic of big business combination in the eighties.

At the present time, business trusts exist in England, where they have never been looked upon with the disfavor found in America, and in Massachusetts, where the law has encouraged them. The chief use made of trusts in that State is to organize real estate investments. This is very different from a combination of corporations. The electric railways of eastern Massachusetts, However, have also been managed under a trust form of organization in very recent times, and have lately undergone an investigation by State authorities.

Organization of a Typical Combination Trust.—A combination trust agreement in full will be found appended to this volume, but it may be of interest to analyze the main points in the organization of the Standard Oil Trust.

First, the agreement distinguished three classes of parties, which were: (1) all the stockholders of a preceding pooling agreement, the Standard Alliance of 1872, and a few other corporations and limited partnerships; (2) the leading officers and stockholders of these organizations, such as W. C. Andrews, J. D. Archbold, J. A. Bostwick, H. M. Flagler, J. D. Rockefeller, Wm. Rockefeller, W. H. Rogers, etc., — forty-five names in all; (3) a part of the members of certain other corporations and limited partnerships, mostly subsidiary and allied industries.

Secondly, the agreement provided for the formation of several new corporations to be located in Ohio, New York, Pennsylvania, and New Jersey, to be known as the Standard Oil Company of Ohio, the Standard Oil Company of New York, etc. The powers of these companies embraced everything in the oil business from A to Z. Their capital stock was unlimited. All the assets of the first two classes of members, as noted above, were to be vested in these several Standard companies, the consideration to be the stock of these companies.

Thirdly, the stock of the Standard companies together with that of the members of class (3), were to be transferred to a board of trustees, in exchange for trust certificates equal at par to the stocks of the Standard companies, and to the appraised value of the securities of class (3). These trust certificates were in shares of $100 par value. They showed the interest of the beneficiaries in the business, and contained an express agreement that the holder was bound by the terms of the agreement and the by-laws provided for.

In the fourth place, nine trustees were provided for, each to serve three years, and three to retire each year. They were to be elected by majority vote of the certificate holders. The agreement provided that the legal title to stocks and property vested in the trustees should pass to succeeding trustees without formal transfer. The trustees were to issue certificates, distribute dividends from stocks and interest from securities of other companies, "exercise general supervision," and represent the trust when a stockholder in other companies. They were required to render an annual statement. Each trustee received the modest sum of $25,000 a year for his service, and the president of the board got $5000 additional. The essential features of this trust are clearly the following: —

(1) Control of a group of business units by an elected board of trustees through the vesting in this board of the stock and power to elect directors of the said business units.

(2) The issuance of transferable trust certificates in exchange for the stock of the units.

(3) The payment of dividends upon the certificates as though upon stock.

(4) The certificate holders were interested in the financial standing of all the units: their interests were irrevocably pooled during the life of the trust.

An imaginary outline balance sheet of the trust expresses the idea in a nutshell: —

	Assets	Liabilities
Stock of Stand. Oil Co. of O., 10,000 shares @ $100	$1,000,000	Trust certificates outstanding. $5,000,000
Stock of Stand. Oil Co. of N. Y., 10,000 shares@ $100.	1,000,000	
Stock of Stand. Oil Co. of Pa., 10,000 shares @$100	1,000,000	
Stock of Stand. Oil Co. of N. J., 10,000 shares @ $100.	1,000,000	
Stock of other companies.	1,000,000	
Total assets.....	$5,000,000	Total liabilities.. $5,000,000

Advantages and Disadvantages. — The two great advantages of the trust over a pool were its greater stability and endurance and its centralization of direction and management. Its stockholders having turned the voting power of the combined corporations over to trustees and vested it in them permanently there could be no question of instability, and so far as the organization itself was concerned no reason existed why it should not endure forever. The stock of the constituent organizations was held fast "in trust," while the certificates might be bought and sold a thousand times without working any other effect than to change the recipients of dividends. Subscribers to the trust assigned their stock holdings absolutely to the trustees who could not sell them during the life of the trust without the consent of a majority, and the life of the trust was made some considerable period of years, after which it was terminable only by vote of a majority, generally two thirds. In a word, here was a partial *consolidation.*

From these conditions, the situation as to direction and management might be deduced. The trust formed a highly centralized compound business unit. While embracing many plants, these were so consolidated and brought under a central management that they could present an effectively united policy to the public and to their competitors. Said the Supreme Court of Tennessee in passing upon the Cotton Seed Oil Trust: "The beneficial *use* of all such property is surrendered to the common purpose. The provisions for the complete possession, control and use of the properties of the several corporations... is perfect. Nothing is left to the several corporations but the right to receive a share of the profits and participate in the management and control of the consolidated interests as members of the new association."[122] The trusts could have a general manager, a general sales agent, and a general treasurer acting for the combination. More than this, they standardized methods both in accounting and technics, and by closing down plants and distributing orders, they were able to localize production economically and secure plant specialization. Yet all the time the individual existence of the plants which were retained in operation was preserved.

Further advantages are evident when the other tests of efficiency are applied. Thus, under the head of liability, we observe that trusts placed the direction of great combinations in the hands of unincorporated boards which were not fiancially liable except as holding stock in constituent companies. Nor were these boards subject to the laws controlling corporations, and one purpose was to shun publicity and attendant responsibility. As a prominent lawyer testified, if a new corporation had been organized its doings might have been heralded to the world, "and the world would have had the right to go into the county clerk's office,

or the office of some other officer entitled and authorized to receive those papers, and to look at them. The object of the creation of the trust was to avoid that publicity."[123]

Finally, this form of consolidation enabled the effective application of the largest aggregation of capital the world had yet known to the purposes of the combination.

It must not be forgotten, however, that such a combination could not be effected with the facility of a price agreement or a pool. It still retained the mutual consent and contract basis, while involving a surrender of autonomy on the part of the members that resulted in consolidation, and this at times gave rise to considerable difficulty in inducing important corporations to become members. It proved difficult in practice to satisfy members as to the valuation of their plants, a valuation which was dependent upon bargaining and yet was so vital as to determine voting power and percentage of earnings received. Nor was it readily changed. This was a limitation which, while not fatal, was later to be met by the holding-company device.

The most important disadvantage, however, and one which did prove fatal was the doubtful standing of corporation trusts in the courts. Here it is necessary to expand the discussion a little in order to appreciate the force of the deathblow to the trust as a form of combination organization. In adopting the trust form, business men, or their lawyers, appear to have proceeded upon at least two assumptions: first, that it could successfully be maintained at law, that the trust is not a combination of corporations as legal entities, but of the stockholders acting as individuals; second, that the exchange of stock for certificates constitutes a sale which transfers title to the properties in the combination to the trustees. Acting upon the first assumption, they hoped, under the legal fiction of a separate corporate personality, to evade the provision of the law against delegation of corporate power and the formation of partnerships between corporations; while upon the second assumption they argued that the trustees became the only stockholders known to the law. As for the rest, they ran their chances of being declared illegal on grounds of restraint of trade and monopoly just like any other business organization. Unfortunately, however, the courts refused to reason upon their assumptions, while the trust agreements were such definite, tangible matters of record that they were more easily reached than pooling agreements had been.

The trouble came about in this way. Late in the eighties, action was brought by the attorney-general of New York against a corporation which was a member of the Sugar Trust, the North River Refining Company. In behalf of the people he demanded the forfeiture of this company's charter on the ground that it had exceeded its powers — acted *ultra vires* — by surrendering the control of its affairs to a third party. In this action he was sustained by the court, which held (1) that *as between corpora-tion and State* the only substantial question is what the collective action of the members of the corporation has actually accomplished, and (2) that the right to be a corporation is given by the State to individuals as natural persons to be used by them for certain definite purposes, and it cannot be placed in subordination to a different organization without disabling that purpose and exceeding the powers conferred upon it.[124] Thus the court looked behind or through the separate entity fiction and decided that the corporate members of the trust were acting *ultra vires.* The trust idea in itself is legal enough, but the weak spot is that *when applied in combining corporations the constituent corporations can be attacked and dissolved, whereupon no trust is left.*

While the court, in this case, declined to pass upon the legality of the trust as being a monopoly, the decision made it clear that unless authorized by statute, such consolidation as the trust involved is opposed to public policy: —

> "As corporate grants are always assumed to have been made for the public benefit, any conduct which destroys their normal functions, and maims and cripples their separate activity, and takes away their free and independent action, must so far disappoint the purpose of their

> creation as to affect unfavorably the public interest; and that to a much greater extent when, *beyond their own several aggregations of capital, they compact them all into one combination,* which stands outside the ward of the State, *which dominates the range of an entire industry,* and puts upon the market a capital stock proudly defiant of actual values, and capable of an unlimited expansion. It is not a sufficient answer to say that similar results may be lawfully accomplished;... *if corporations can combine, and mass their forces in a solid trust or partnership,* with little added risk to the capital already embraced, without limit to the magnitude of the aggregation, *a tempting and easy road is opened to enormous combinations vastly exceeding in number and in strength, and in their power over industry, any possibilities of individual ownership....*"[125]

About the time of this decision, suit was brought against the Standard Oil Company of Ohio, and a decision was handed down in 1892 which followed that of the court in the North River Sugar Refining Company case.[126] The Ohio court, however, laid more emphasis upon the monopoly element, stating that the object of the oil trust was to establish a virtual monopoly of the petroleum industry, and concluding that, "All such associations are contrary to the policy of our state and void."

Meanwhile, it had been decided in a case involving still another trust, that whether or not trust certificates conferred upon their holders the powers of corporate stockholders they did represent an interest in the property, and the holders had property rights;[127] and it may be said in general that the courts refused to regard the trustees as the only stockholders and as having sole powers to direct the property of the combination.

So every legal support was knocked from under the trusts and one and all they fell. These cases decided: —

(1) Acts of the members of a corporation which lead to the same results as though there had been a formal vote, are acts of the corporation.

(2) It is illegal for corporations to delegate essential corporate powers, or, more specifically, to enter agreements which are virtually partnerships of corporations.

(3) The law affords a remedy for unauthorized monopolistic combinations such as trusts.

At about the same time as these decisions, the popular antipathy to combinations of corporations which had been swelling ever since the seventies, burst forth in a flood of "anti-trust" statutes. Immediately following upon the disclosures of the Sugar Trust case came anti-trust laws in Louisiana (1890), Michigan (1889), Mississippi (1890), North Dakota (1890), Oklahoma (1890), South Dakota (1890), and Tennessee (1889). And above all, in 1890, the very year of the decision, the Federal anti-trust law, familiarly known as the Sherman Act, was passed. This act gave a further impetus to State legislation which continued active down through 1898. Most of these statutes, like the Federal law, specifically mention the trust.

Conclusion. — This chapter has dealt principally with a form of business organization which, as a form, no longer exists, — the corporation combination trust. In reality, however, other forms have been developed which are similar in several important respects, and which gain the same ends sought by the trusts. The study of the trust, then, is not of interest merely as a fragment of industrial history; the trust contained the germ of the idea of the present-day "holding company," and, in the legal decisions on trusts, important principles of the law of business combinations were clearly formulated. We will have occasion to turn back to the discussions of this chapter more than once.

The trust was a dever attempt to utilize certain legal institutions through perversion, that is, to prostitute them. In the first place, the institution of the trust was taken out of its proper and original field and applied for purposes foreign to the spirit of that institution. In the second place, the fiction of the separate

legal entity in the corporation was seized upon and an attempt made to clothe the shadow with substance, — to set it up as a material thing. This attempt was a turning point in the law of business organization, and the courts took the right turn.

Finally, the trust episode — for, from the standpoint of the history of combinations, it may be so called — was one of many efforts to secure greater power with less responsibility, and, as such, was fraught with grave danger to the public. The trusts sought to fuse a great group of corporations into an organization which would act as a unit, yet which would be a mere unincorporated association of individuals and therefore possessed of no adequate responsibility for the acts of the combination. No doubt such a condition would have been remedied in time, but meanwhile the public might have suffered irrevocable injury.

But it would be wrong to carry away the idea that the trust organizers were merely clever knaves. They had legitimate objects partly in view and the slow-moving law was itself to some extent responsible for the trouble. The time had come for “big business”; while the law was framed for little business. The time had come for restraining trade where unrestrained trade meant the cutting of business throats and the wasting of business blood; whereas the law held that all restraint outside of a few cases, like contracts not to set up a rival business under certain conditions, was bad. Although the trust builders were not actuated by benevolent motives, they were acting in accord with economic forces, in so far as they merely sought the undoubted economies of combined production and the avoidance of the undoubted waste of industrial warfare. If the law had supplied some authorized channel through which their legitimate ends could have been gained, they *might* have followed it. In any case, as we will see, the difficulty of dealing with them would have been lessened.

Chapter XIV: Community-of-Interest Organization, with the Beginning of Complete Consolidation and the Transition to the Holding Company

When the trusts were declared illegal and were forced to dissolve, a new form of business organization had to be devised to replace them. Vast businesses had been built up under the trust form, and to have returned to simpler uncombined organization would have resulted in disturbed industry and lost gains of combination. This was the last thing the trust builders had in mind. In the then existing development of business organization, two alternatives were open to them: they could resort to looser forms of (agreement) organization, or they could legitimately go the full length of consolidation and turn all their properties over to a single corporation. Both courses were taken, one trust resorting to federation, another entering into complete consolidation.

One Trust resorts to Community of Interest. — The Standard Oil Trust had been the pioneer in the trust movement, and it will be interesting to see what course the ringleader adopted. On March 21, 1892, at the trust's headquarters in New York, the Rockefellers, Flagler, Archbold, Rogers, and other certificate holders met and passed a resolution of dissolution.[128] This resolution provided that the existing trustees should act as "liquidating trustees" to wind up the affairs of the trust. Property other than the stocks of corporations was sold and distributed among the trust certificate holders in proportion to their holdings. At this time the stock of some eighty-four constituent companies was in the hands of the trustees, but within two weeks the number of such companies was reduced to twenty by transferring the stocks of the other sixty-four to the remainder. The stock of these twenty main corporations was then partially and in a halting fashion distributed among the certificate holders, of whom there were several thousand.

In fact, at the end of six years the distribution was still incomplete. What was done was this: the small certificate holders were well content with their status and dividends, and they were not encouraged to liquidate; whereas the nine trustees and a few other large holders were practically the only ones who liquidated their holdings and obtained stock in the twenty organizations which were retained. It takes no particular keenness to see that the result was that the few large holders dominated these corporations in practically the same way that they had done previously to the nominal dissolution. As individuals, they held a majority of the stock of each constituent company, voting it at the annual meetings of the companies; and the balance owned by the small holders remained unliquidated and unsold in the hands of virtually the same men, in their capacity as liquidating trustees! By the end of 1892 a trifle more than a majority of the trust certificates had been liquidated, but from that time until 1898 only two certificates were turned in.

The most significant and characteristic feature of the arrangement, however, remains to be noted. All of the important liquidating certificate holders were closely bound together by business and family ties. With but one exception, all were either trustees or former trustees or members of the family of one of the trustees. All were closely connected with the management of the trust. All voted their stocks in harmony. Truly here was a community of interest.

When Mr. Archbold was called before the Industrial Commission, the following colloquy is reported to have taken place: —

> "*Q*. Nevertheless, since that time the different Standard Oil companies have worked together in harmony, have they not? *A*. The ownership has naturally brought them into harmony of action; the like ownership, of course.
>
> "*Q*. The general way in which the control has been kept uniform has been this, that the men who were the former trustees have held the majority of the stock in each one of these different companies? *A*. Exactly so.
>
> "*Q*. So that the Standard Oil combination, as we may say, has worked together as harmoniously since the dissolution of the trust as before? *A*. It is hardly fair to call it a combination, but you might call it an aggregation."

The form of business organization illustrated in the preceding pages has come to be known by the specific term, "community of interest." Community of interest may be defined as *a form of business organization in which, without any formal central administration, the business policy of several companies is controlled, by a group of common stockholders or directors.* Generally it finds expression in the placing of directors or officers of one company on the boards of directors of other companies; but, just as the ultimate source of a director's power lies in the votes of stockholders, so community of interest through community of directors generally is based upon community of stockholdings. In any case, of course, community of interest must find expression in the direction and management of the interrelated companies, and it is not unenlightening to think of this form as a sort of pooling agreement in which the pooled factor is directly or indirectly the management of the members.

Classes and Merits of Community of Interest. — The foregoing statement suggests what is a fact, namely, that two classes of community of interest exist, one of which is community in direction only, and the other community in ownership. Thus, sometimes an officer or director of one corporation is given a place on the directorate of another corporation without the existence of an interholding of stock sufficient in itself to create a community of ownership, and as a director he may be able to secure community in direction. The community will be more certain, however, if the mutual directors' seats rest upon a considerable mutual holding by the corporations of each other's stocks.

Nor is this the only basis of classification. Some community-of-interest organizations consist in an interlocking body of stockholders and directors binding together a group of mutually interrelated corporations no one of which is decidedly dominant; others are virtually holding-company organizations securing harmony of interests through the ownership by a central company of a majority of the stocks of a group of subordinated companies; while still others are established by a group of corporations, which are generally, but not necessarily, interrelated, securing stockholdings directly in a third corporation for the purpose of controlling it in the common interest. The case of the Standard Oil community of interest as outlined above illustrates the first of these types; the unity of control established in the tobacco industry between 1890 and 1904 by the American Tobacco Company with the large holdings in the Consolidated and the Continental tobacco companies is an example of the second type; and an equally celebrated illustration of the third type

is found in the railway field as described in the next paragraph.

Indeed, the community of interest was first formally recognized as a specific kind of business organization by the railways. This development occurred about the last of December, 1899, when President Cassatt of the Pennsylvania lines instituted a policy of mutual control in Trunk Line territory. Rates had been cut and the important item of coal traffic had been particularly demoralized. To remedy the situation, both the Pennsylvania and the New York Central secured large stockholdings in the Baltimore & Ohio and the Chesapeake & Ohio roads, which were the disturbing factors. In this way, harmony of operation was secured and with it came the desired effect on rates. Later, a large part of the Pennsylvania holdings was given up to avoid prosecution under the Federal anti-trust law.

But the first of the above types is also found among railways, for when the Northern Securities Company (which held the stock of the Great Northern and the Northern Pacific railways) declared illegal in 1904, its certificates were destroyed and the stock of the Great Northern and Northern Pacific lines was distributed *pro rota* among the certificate holders. Thus a common body of stockholders was created, resulting in a mutual interrelation and a community of interests among independent corporations.

In fact, a great network of interrailway community of interests, embracing all types, was described in the special report on intercorporate relations prepared by the division of statistics of the Interstate Commerce Commission in 1906. We need notice but one section of the country, namely, the Middle Atlantic States. Besides the joint holdings of the Pennsylvania and New York Central lines in the Baltimore & Ohio, the Chesapeake & Ohio, — and, indirectly, in the Philadelphia & Reading and Central of New Jersey companies, — the Lehigh Valley was brought into the "circle of interest" through holdings of its stock by the Erie, the Reading, the Lake Shore, the Central of New Jersey, and the Lackawanna. The Lacka-wanna, in its turn, was closely affiliated with the New York Central. Through various subsidiaries, the New York Central, the Pennsylvania, and the Erie lines held a majority of the stock of the Hocking Valley Railway Company; each of the two first-named systems also had an interest in the New York, New Haven & Hartford, the leading New England road; and, through the Pittsburgh, Fort Wayne & Chicago Railway Company, the Pennsylvania held stock in the Great Northern, the Northern Pacific, and the Chicago, Milwaukee & St. Paul. But this is not all. The Pittsburgh, Chartiers & Youghiogheny Railway, the Monongahela, and the Central Indiana were jointly owned by the two leading Trunk Lines; and the same was true of the Lehigh & Hudson River Railway Company, except that in this last case the Erie and the Lackawanna were also interested. It is no wonder that the report concluded: "The extraordinary concentration of railway interests shown in the situation in the Middle Atlantic seaboard would lead to the conclusion that, so far as this group of railways is concerned, competition has been practically eliminated." Though ever shifting, that situation holds to-day.

A sort of subvariety under the first type of community of interest is well illustrated in the United States Steel Corporation, where, within a holding-company combination, the stock of important subsidiary companies is parceled out among several members with the object of binding them more closely together. A case in point is that of the H. C. Frick Coke Company, 74 per cent of whose stock is held by the Carnegie Steel Company, 11 per cent by the American Steel & Wire Company, 10 per cent by the Illinois Steel Company (a subsidiary of the Federal Steel Company), and 1 per cent by the National Tube Company.

There is still another variation in community-of-interest organization which is a sort of mixture of the second and third types noted above. This variety is found in the packing industry, and it is one that has been attracting interest for some years. In 1902 it leaked out that the great packing plants of the West were planning to form a combination. Whatever their plans were, however, the only materialization was the formation in 1903 of the National Packing Company, organized under the laws of New Jersey, to which were turned over several smaller plants owned by the large packers.[129] Later, the packers acquired other properties through the National

Packing Company. The point of interest here is that the Armours, the Swifts, and the Morrises own practically all of the stock of the National Company, and all but one of its directors are either directors or officers of these three interests. Thus, while the three large packers are not directly interrelated by holding any considerable amounts of one another's stock, this separately organized holding company has been used to secure community of interest by acquiring competing plants, and, if reports be true, by harmonizing the marketing of dressed beef in eastern centers. Of course, the meetings of the directors of the National Packing Company constitute a sort of family reunion at which community of interests in general can be effected.

Every one knows something of the ramifications of community of interest in the banking business. Not long since, evidence was adduced before the Pujo committee of the House of Representatives that eighteen large financial houses in New York and Boston were associated with at least one hundred and thirty-four other corporations through interlocking directorates and interholdings of stock. Morgan, George F. Baker, and Stillman dominated such Eastern institutions as the First National Bank, the National City Bank, the National Bank of Commerce, the Chase National Bank, the Guarantee Trust Company, and the Bankers Trust Company; and through holding stock, or directorates, or other official positions in lesser financial institutions — either personally or through associates — they established a widespread community of interest among banks, trust companies, and to some extent among the larger railway and industrial corporations. While such an organization can not properly be called a money trust, — for money can hardly be monopolized, — it gives the interests concerned great power over the promotion and underwriting of business organizations.

As a rule, the community of interest plan will be used only when no more effective combination is possible. Obviously it depends for its effectiveness largely upon mutual confidence and good feeling among the parties, and so is not a stable form. It is too complicated and cumbrous to do the best work. Again, it affords no centralized direction. Moreover, it is open to objection on the ground of illegality much as are pooling agreements. Where, however, there is a *bona fide* and considerable interholding of stocks by the shareholders of two or more corporations, it holds a stronger position; and the separate holding-company scheme, illustrated by the National Packing Company, has worked well for those interested, though it is now about to be dissolved for fear of being proceeded against by the government.

From the public point of view, under present conditions, the device of community of interest is doubtless to be condemned. It affords too great an opportunity for devious methods and power without responsibility, as is indicated by its abuse in the hands of the Standard Oil Trust. It there became a trust in disguise. The system of "interlocking directorates," of which this is one phase, has been one of the most difficult aspects of the combination movement to handle. Only with full publicity and adequate means of preventing monopoly abuses can it be tolerated.

Another Trust resorts to Complete Consolidation. — At about the same time that the Standard Oil Trust was beginning to take steps towards its community of interest plan of nominal dissolution, the Sugar Refineries Company, popularly known as the Sugar Trust, likewise entered upon a new stage of organization. The sugar interests, however, were not so closely united by friendly ties as were the oil interests, and they sought a more binding form. Accordingly, late in 1890, a plan of organization was circulated which called for a complete consolidation of the twenty odd refineries embraced in the trust,[130] and was favorably received by a majority of those concerned. On January 10, 1891, the receivers who had the property of the illegal trust in hand were discharged, and at once the American Sugar Refining Company was organized as a New Jersey corporation to take over this property. The transfer was effected largely by mere exchange of stock, though some cash was paid. The shares of the American Sugar Refining Company were exchanged for the trust's certificates, each holder of 100 certificates being given 50 shares of common, 50 shares of preferred, and a 5 per cent cash "dividend." All the properties represented by the certificates of the Sugar Refineries Company were thus acquired, and a mortgage

was filed upon the whole to secure a $10,000,000 bond issue. A considerable number of plants were closed and dismantled, practically all the refining thereafter being done in not over seven establishments.

When Mr. Havemeyer was asked to explain the difference between the trust and the new consolidation, he replied: "The trust was attacked and the courts decided it was illegal, and a company was organized in New Jersey which bought outright and paid for the different companies, which were the constituent companies of the trust.... we bought and paid stock and cash."[131]

To-day (1912) the American Sugar Refining Company owns in fee four large refineries, one in Jersey City, one in South Boston, Mass., one in Port Chalmette, La., and one in New Orleans. The last mentioned plant, however, is not operated. In addition, it owns all the stock of three great refineries: the American Sugar Refining Company of New York, the Spreckels Sugar Refining Company (Pa.), and the Franklin Sugar Refining Company (Pa.). It also holds the entire stock of the Brooklyn Cooperage Company. Stock interests are held in four other cane-sugar refineries, and thirty-three beet-sugar factories.[132] Here, then, is an ex-trust which took the consolidation alternative and amalgamated its plants into a single new corporation.

The American Steel & Wire Company of New Jersey (1899) was a notable early consolidation. It secured numerous wire plants by purchase of stock and property, only to cancel the stock, convey the property to itself in fee, and dissolve the corporations. Other plants were secured by direct purchase. Only a few were maintained as subsidiaries controlled through stock ownership.

These illustrations indicate a tendency toward complete consolidation by amalgamating a group of corporations into a great central organization. So strong was this tendency that in 1900 the Industrial Commission was led to report as follows: —

> "The form of organization that seems most common at the present time is that of the single large corporation, which owns outright the different plants. A combination of this kind is formed by the purchase of all of the plants of the different corporations or individuals who enter into it, the corporations then dissolving.... The affairs are then managed entirely by the stockholders of the one corporation through their board of directors, elected in the ordinary way. It is usual for these larger corporations to choose a very liberal form of charter" (Vol. I, p. 10).

It was but the beginning, however, of a movement which, as supplying a form of organization for the largest combinations, has recently received more attention; and the discussion of its merits will therefore be deferred till a later chapter, when a fuller treatment of complete consolidation can be presented. Even in the late nineties of the preceding century the time was hardly , ripe for such organization, and a more facile and elastic form was adopted. This was a sort of incorporated community-of-interest organization, the corporate form making it more stable and permanent and giving it a better standing in the courts. As just indicated, the Sugar Trust and the steel and wire company both held some subsidiary concerns through stock ownership, and to that extent were not *complete* consolidations. An even better illustration of the tendency to the stockholding type of consolidation appears in the organization adopted by another one of the trusts. The American Cotton Oil Trust in 1889, seeing the storm brewing, voluntarily reorganized and continued in business as a consolidated New Jersey corporation under the name of the American Cotton Oil Company.[133] The difference between it and the sugar company is that it owns few of the combined plants in fee, but depends mostly upon stock ownership, holding all the stocks, except directors' qualifying shares, in sixteen constituent companies. In addition, it itself operates a large refinery in New Jersey. Thus the Cotton Oil Company is in part a complete consolidation or merger, and in part an incorporated community of interest, or "holding company." What then is a holding company?

Chapter XV: Holding Company Organization

When the Standard Oil Trust was dissolved (1892) it sought refuge in a community of interest. The Sugar Trust, however, took (1891) the more difficult step of entering into a complete *consolidation* of interests of the most important plants. The Cotton Oil Trust (1889) followed a halfway course in that it adopted a kind of incomplete consolidation which depended upon the holding of stock in various subsidiary companies. Now the position taken by the Standard Oil organization soon became untenable, for men were not slow to see that it involved an evasion of the law, and accordingly in 1897 the attorney-general of Ohio filed a bill of information in contempt, as a lawyer would say, against the Standard Oil Company in the Ohio Supreme Court. In the following year he also brought suit to have forfeited the charter of a subsidiary, the Buckeye Pipe Line. The situation was growing decidedly warm for the oil interests and something had to be done. Immediately they began to liquidate at a lively rate the old trust certificates which, it will be remembered, had been left outstanding in the hands of small holders, and early in 1899 under legal advice they took steps to reorganize the Standard Oil Company of New Jersey with the idea of turning the controlling stock holdings over to it. This meant the adoption of a form of organization similar to that of the Cotton Oil Company.

In pursuance of this plan, the old charter of the Standard Oil Company of New Jersey was amended so as to authorize it to do anything that the various subsidiaries could do; the capitalization was increased by $100,000,000 of common stock, to be exchanged for the stocks of the subcompanies; the liquidating trustees were made directors, constituting a majority of the board; and by-laws which were virtually those of the trust were adopted. Its own previously outstanding stock was made preferred stock and exchanged for the new common stock, and the same course was followed with the stocks of the other nineteen main companies. Thus the reorganized Standard Oil Company of New Jersey in 1899 became the direct holder of the stocks of 20 main companies and of some 23 subsidiary companies whose stocks had been transferred to it by the trustees in 1892; and indirectly, through the 20 companies, it had controlling interests in 40 odd companies subsidiary to them. In all cases of any importance a controlling interest was held, frequently running as high as 99 per cent. This, then, was not a mere community of interest, for it rested on a stronger basis than friendship or a loose interholding of stocks; nor was it complete consolidation or merger, for it maintained the separate formal existence of the constituent companies; it was a securities holding corporation — a “holding company.”

Definition and General Nature. — *A holding company is a form of business organization* (*established through partial or temporary consolidation*) *which is created for the purpose of combining other corporations by owning a controlling amount of their stock.* It necessarily involves the creation or the prior existence of a corporation which has power to hold the stock of other corporations, which corporation proceeds to acquire such stocks by exchanging its own securities for them, or by other means of purchase. The controlled

corporations are nominally independent and operate under their own names, but they are or can be effectively managed by the officers of the holding company, whose directors vote their stocks, or a controlling part thereof, and so elect their directors. In this way, the combined plants are firmly bound together. The holding company is organized just as any other corporation, but its purpose — at least its chief purpose — is merely to hold the stocks of other and subsidiary companies. "The attitude of these combinations is that of a stockholder in many corporations which seeks to manipulate them so as to promote its own private interest." Although they are rather tedious and may be skipped by the cursory reader, the following paragraphs from the charter of the greatest holding company in the world, the United States Steel Corporation, will serve to emphasize this aspect of the matter. In addition to other authorized purposes are the following: —

"To acquire by purchase, subscription or otherwise, and to hold or to dispose of, stocks, bonds, or any other obligations of any corporation formed for, or then or theretofore engaged in or pursuing, any one or more of the kinds of business, purposes, objects or operations above indicated, or owning or holding any property of any kind herein mentioned; or of any corporation owning or holding the stocks or the obligations of any such corporation.

> "To hold for investment, or otherwise to use, sell or dispose of, any stock, bonds or other obligations of any such corporation; to aid in any manner any corporation whose stock, bonds or other obligations are held or are in any manner guaranteed by the company, and to do any other acts or things for the preservation, protection, improvement or enhancement of the value of any such stock, bonds or other obligations, or to do any acts or things designed for any such purpose; and, while the owner of any such stock, bonds or other obligations, to exercise all the rights, powers and privileges of ownership thereof, and to exercise any and all voting power thereon.
>
> "The business or purpose of the company is from time to time to do any one or more of the acts and things herein set forth; and it may conduct its business in other States and in the Territories and in foreign countries, and it may have one office or more than one office, and keep the books of the company outside of the State of New Jersey, except as otherwise may be provided by law; and may hold, purchase, mortgage and convey real and personal property either in or out of the State of New Jersey.
>
> "Without in any particular limiting any of the objects and powers of the corporation, it is hereby expressly declared and provided that the corporation shall have power to issue bonds and other obligations, in payment for property purchased or acquired by it, or for any other object in or about its business; to mortgage or pledge any stock, bonds or other obligations, or any property which may be acquired by it, to secure any bonds or other obligations by it issued or incurred; to guarantee any dividends or bonds or contracts or other obligations; to make and perform contracts of any kind and description;..."

The balance sheet of a typical holding company, like that of the trust, would show as assets merely the stocks of other companies and such office property and the like as might be necessary to conduct the central direction of those companies. For example, the balance sheet of the Rock Island Company on June 30, 1909, stood as follows: —

Assets		Liabilities	
Stocks owned.	$150,012,031	Capital stock, com.	$96,000,000
Cash	12,938	Capital stock, pref..	54,000,000
Due from companies and individuals.	607,419	Due to companies and individuals.	548,643

		Surplus.	83,746
Total	$150,632,390	Total.	$150,632,390

Its own income account contains nothing but a statement of the surplus of the preceding year and "expenses and taxes" of a little over $17,000; but in the combined income account of itself and a subholding company it appears that the entire income consists of dividend installments on the stock of a controlled operating company, while the expenses are made up of interest payments on securities issued in payment for such stock.

What is the difference, then, between the holding company and the trust, one wonders. Economically speaking, there is very little difference indeed. The chief difference exists in their standing in the courts. To change a trust to a holding company, a process already illustrated by the history of the Standard Oil Company, it is only necessary (1) to substitute the stock of the holding company for the certificates of the trust, (2) to substitute the board of directors of a corporation for a board of trustees, and (3) to substitute a permanent transfer of stock or ownership for the trust relationship. At the present time, the law of holding companies is being made and it may be that the courts will more and more refuse to draw a distinction between the two forms, but as yet it may be said that the incorporation of the combination and the absence of the trust relationship make an important difference in the eyes of the law. In the formation of a trust, the stockholders of the constituent companies surrendered their stock to be held in trust for them by trustees. Thus they became the "beneficiaries" of a trust agreement. These stockholders, while they might retain an interest in their shares, at the same time surrendered control over them and abandoned the management of their plants. Holding companies are formed by the exchange of stock in one company for stock in another, which exchange is in the nature of an outright sale; and this sale is made by the stockholders of the combined companies to a legally authorized corporation. Moreover, in the trust agreement a confederated relationship was involved, in which the parties maintained a nominally separate existence, whereas the holding company is a nominally responsible corporation, buying stock in the open market and doing that which the State has authorized it to do. Formally, this makes considerable difference between the two kinds of combination organization. Formally, the combination trust is an agreement between an association of individual trustees and a group of corporations which by implication give up their autonomy and so act *ultra vires:* it involves dealings between corporations which result in partnerships between them. Formally, the holding company is a duly certified corporation, authorized to deal in the stocks of other companies and to hold them; and its dealings are entirely with the individual stockholders of the controlled corporations. Formally, the one is illegal; the other is legal. When it comes to the question of purpose or intent or result, the answer, as we shall see, is different, — at least in part.

Origin and Development. — But the thought occurs to one, if the holding company is legal and yet can be used to accomplish the same results as the trust, why was it not resorted to sooner? Why was the trust form ever used? Why did not all the trusts become holding companies at once? The simple answer is that the holding-company idea was not and is not legal as a general principle in business organization. Of course, it depends upon the right of one corporation to hold the stocks of other corporations, and at common law no such right was established. Pennsylvania even went so far as positively to forbid it by statute, though she has since relaxed the prohibition in several ways. The right to buy and sell the stocks of other corporations is derived from legislative enactment, and prior to 1889 no such enactment on a general scale was in existence. Before this date, therefore, no holding companies were organized under general law, and the form was little known.

It is true that the interholding of stock had been practiced before this time, and there were a few holding

companies created by special law. Perhaps the first real holding company of large size in the United States was the Pennsylvania Company organized in 1870. Its purpose was to centralize the control of the lines affiliated with the Pennsylvania Railroad west of Pittsburgh and Erie, "with a view to give greater simplicity and efficiency to the management of these large western interests," as the president of the road said in his 1871 report. By its charter the Pennsylvania Company was specially empowered "to make purchases and sales for investments in the bonds and securities of other companies." Accordingly, by 1879 this company had a majority interest in the western lines, and over half its assets consisted of their securities.

It was the little State of New Jersey which, probably without fully realizing the full portent of the action, first passed a statute providing a general authorization of intercorporate stockholding. That was in 1888. As amended in 1893, the provision reads: "Any corporation may purchase, hold, sell, assign, transfer, mortgage, pledge, or otherwise dispose of the capital stock of, or any bond, securities or evidences of indebtedness created by any other corporation or corporations of this or any other state, and while owner of such stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon."[134] Since that time, Delaware, Maine, West Virginia, New York, and at least fourteen other States have followed suit, giving considerable choice of domicile to any corporations which desire to form a combination by means of transferring their securities to a holding company. In 1912 only two States specifically prohibited holding companies; but in 1913, according to press reports, New Jersey also passed a law prohibiting any future corporation from holding the securities of other corporations.

Thus it came to pass, when the depression of 1893–1897 was over and the voice of the promoter was heard again in the land, that the holding-company device was much used and the New Jersey charter mill worked overtime. It will be remembered that the combination movement came to a climax about this time, and, since trusts had been tabooed, community of interest had not proved generally satisfactory, and complete consolidation had hardly become practicable, it is easy to understand why the combination movement became a veritable holding-company movement. Business men were not yet prepared for more centralized consolidation by amalgamation or merger; while at about this time the looser forms of combination were being vigorously assailed. The Standard Oil scheme was being attacked in Ohio, and the Sherman Anti-trust Act was about to be applied to railway traffic agreements in the Trans-Missouri Freight Association and the Joint Traffic Association cases. Various economic conditions were driving or beckoning to combine. Such was the situation.

Between 1898 and 1904 the great majority of securities-holding corporations were organized; but to-day nearly all the larger combinations are more or less in this form, and, while the courts have shown a readiness to look through the form to the purpose, it bids fair to hold its own in the field of legitimate combination; unless the numerous threats to pass hostile statutes are carried out.

Some Typical Holding Companies. — One of the simplest, clearest illustrations of holding-company organization imaginable is the Rock Island Company which has already been mentioned in another connection. This corporation was chartered in New Jersey in 1902 mainly for the purpose of highly centralizing the control of extensive railway systems. At the same time, in order to facilitate the accomplishment of the purpose, the Chicago, Rock Island & Pacific Railroad Company was incorporated with a capitalization of $145,000,000, all of which was exchanged for the $138,405,000 stock of the Rock Island Company. Neither of these corporations owns or operates any railway, so both are pure holding companies. The next step, however, was to get control of some real earning capacity in the shape of the two great lines of railway, the Chicago, Rock Island & Pacific Railway Company and the St. Louis & San Francisco Railroad Company. With the aid of some collateral trust bonds, 93 per cent of the stock of the former railway was acquired and 58 per cent of the total stock of the " Frisco." The holding did not end here, however, for the Rock Island

Railway Company acquired a majority of the outstanding stock of the Chicago and Alton, while the Frisco owned 84 per cent of the outstanding stock of the Chicago & Eastern Illinois Railroad Company, which company in turn owned 61 per cent of the stock of the Evansville & Terre Haute Railroad Company. The preceding simple diagram gives a graphic view of the situation as it stood in 1906. Since that time both the Chicago & Alton and the St. Louis & San Francisco Companies have been lopped off.

One first observes that by holding a little over half of the $145,000,000 stock of the Rock Island Company, a small group of financiers could control the whole aggregation of railways just mentioned. This is true; but it is not the whole truth. Of this sum, $48,956,000 was in preferred stock, and, under the organization in force, the preferred stockholders had the right to elect a majority of the board of the company. The result was that a majority of the preferred stock of the Rock Island Company, say $25,000,000, could control that company itself, the Rock Island Railroad Company, the St. Louis & San Francisco, and so on, — a control which embraced a system of over 15,000 miles with a capitalization of $1,500,000,000 !

No account of the holding-company form of business organization, however, could be quite complete without some description of the greatest of all such organizations, the United States Steel Corporation. First, a word about the conditions preceding its formation.

Down to 1898 the iron and steel industry was carried on by a large number of separate organizations, under competitive conditions for the most part. There were ore pools, billet pools, nail pools, and others; but few of such federations lasted for any considerable time. The various business units were relatively small and were confined to one or two stages or trades in the industry. In 1897, however, when the combination movement reached its climax, a period of preliminary consolidation set in, and between 1898 and 1900 the business became divided among a small number of giant corporations. For example, the American Steel & Wire Company, with a capitalization of $90,000,000, was formed as a New Jersey corporation in 1899; and in 1901 it embraced 26 subsidiaries, 7 of which were controlled through stockholding, 20 were owned in fee, and 6 had been dismantled or abandoned. Altogether, there were ten or twelve such consolidations existing in 1900.

These were mostly trade combinations, and they may be divided into two groups according to the stage of the industry in which they fell: the crude products group, engaged in producing ore and crude and semifinished steel, included the Carnegie Company, the Federal Steel Company, the National Steel Company, and the Lake Superior Consolidated Iron Mines; the finished products group, engaged in producing plates, tubes, sheets, wire, etc., included the American Steel & Wire Company, the National Tube Company, the American Bridge Company, and the American Sheet Steel, American Tin Plate, and American Steel Hoop companies. This is not to mention the Jones & Laughlin and Colorado Fuel and Iron companies. Almost immediately after the consolidations of 1898–1900 a strong movement toward industry combination or integration set in. Thus, the American Steel & Wire Company bought coal and ore lands and threatened to erect plants for making crude steel, and the National Tube Company began work on a steel plant. On the other hand, the crude products concerns began to branch out in the direction of finished goods, and to cap the climax the Carnegie Company prepared to erect a large tube manufacturing plant near Cleveland, Ohio.

Now, this would have meant loss in many ways. It would have caused great duplication of investments and a producing capacity far in excess of the existing market. Moreover, it would have brought on a combat between giants, the outcome of which looked anything but alluring either to the iron masters or to the great financial houses which held the securities of the various consolidations. Again, industrial conditions were good and booming, and “the public” was in the market eager to buy stocks, so that not only was no difficulty to be expected in floating a great combination but also its promoters could expect to reap a bountiful harvest by overcapitalizing it. Accordingly, in 1901, almost in a night, the greatest “trust” in the world, the United

States Steel Corporation, was organized in New Jersey to take over most of the plants mentioned above. Since 1901 important additions have been made to the number of subsidiary companies controlled by the corporation.

The financial details involved in the process of exchanging the stocks and bonds of the Steel Corporation for the stocks of the constituent companies need not be presented here. Suffice it to say that with a total capital liability in stocks and bonds of $1,402,846,817, practically all the stocks of the eleven corporations were acquired, a one-sixth interest in two others, and the bonds of the Carnegie Company, a total amount of securities equal to $881,398,450 in par value; and through these constituent companies, ore properties, plants and machinery, blast furnaces, coal and coke, transportation facilities, natural gas fields, and limestone properties, which had a total value of between $700,000,000 and $800,000,000, came under the control of a single corporation. The accompanying chart will convey to the reader some impression of the magnitude and complexity of this organization far better than any adjectives or adverbs could do.

The United States Steel Corporation is modeled on the lines of the Federal Steel Company, over which Judge Gary, the Steel Corporation's president, had formerly presided. The Steel Corporation, as the primary unit, is a pure holding company whose entire property consists of the securities of eleven constituent or secondary corporations. These, in turn, are compound corporations built up by the amalgamation or merging of several plants, and they own a controlling interest in the stocks of numerous tertiary subsidiary concerns which maintain a separate existence. Out of the total number of over 170 of these subsidiary concerns, 39 were independent establishments prior to the time control was secured by the big constituent or secondary corporations; whereas the balance, embracing the great majority, were promoted and organized in the interest of the constituent corporations acting as parents, so to speak. The Steel Corporation holds practically all of the stock of the secondary constituent corporations, and also owns direct holdings in a few subsidiary concerns like the Pittsburgh Steamship Company. Then the corporations of the secondary group own majority holdings in a great number of companies in many different lines of business. More than this, a fact which does not appear adequately upon the chart must be remembered, namely, the fact that the subsidiary companies own in fee many plants which have been bought outright, their stocks canceled, and their separate corporate existences abandoned. In a word, they are partially holding companies and partially complete consolidations by amalgamation or merger.

The stock of several corporations, like the H. C. Frick Coke Company and the Pennsylvania & Lake Erie Dock Company, is divided up among a number of other members, thus weaving them together in a community of interest.

Some of the biggest business affairs occur in the tertiary rank of units. For instance, when it was desired to make the lease of the vast Great Northern ore properties, the deal was effected through the Great Western Mining Company which is controlled by the Oliver Iron Mining Company which is controlled by the Carnegie Steel Company which is controlled by the United States Steel Corporation.

And after all this has been said, it still remains to be noted that the United States Steel Corporation has strong community of interest relations with other great corporations like the American Can Company and the Reading Company (coal and railways), three of its directors being also directors of these companies.

Classes of Holding Company. — The foregoing cases serve to illustrate most of the varieties of holding-company organization. In the first place, there are *consolidated* and *parent* holding companies. When, as has most frequently been the case, the holding company is formed by consolidating existing companies, it may be called a consolidated or offspring company. When, however, it is formed first and then proceeds to organize subsidiary corporations it is known as a "parent company." Thus the United States Steel Corporation, desiring to have a selling agency in the export trade, promoted and organized and held the stock of the

United States Steel Products Company; and, further, desiring to have a steamship line, it organized the Isthmian Steamship Company and turned its stock over to the Steel Products Company. It is common to organize corporations by States in order to avoid provisions adverse to "foreign" corporations, or to adjust management to local conditions, and when so organized a central parent company is formed first and then subsidiaries are formed in each State in which business is done. The American Telephone & Telegraph Company furnishes an excellent example of this policy, which it has adopted largely to facilitate the exploitation of the Bell patents. Some of the numerous offspring subsidiaries, all controlled by stock ownership, are: Michigan State Telephone Company, Nebraska Telephone Company, New York Telephone Company, Bell Telephone Company of Missouri, Mountain States Telephone & Telegraph Company, and the American Telephone Companies of Arkansas and of Iowa.

Again, holding companies may exist with holdings of all the stock of constituent corporations, or of a majority, or of only a minority. A glance at the bracketed figures in the chart will show the facts for the Steel Corporation. It may not be clear how a minority holding could be desired. In some cases, where the stock is widely scattered in small holdings, a concentrated minority holding may be able to dominate a corporation by securing enough proxies to make a majority, or even without that precaution. In other cases, the cooperation of friends and allies among the other stockholders may be relied on. In still other cases the stock may be so divided into classes as to enable a small holding of a certain class to elect the directors. The case of the Rock Island Company, where only a majority of the preferred stock was required, is in point. Again, a provision that directors may not be elected except by a large majority or by a unanimous vote may enable a minority to control; and, as the articles of the Des Moines Union Railway Company provide that a *seven*-eighths vote shall be necessary to elect a director, amend the articles, or increase the capitalization, it is clear that the Chicago, Milwaukee & St. Paul Railway Company with a *two*-eighths holding can secure far more than a one-fourth voice in the Des Moines Company's affairs; it could block all action till opponents came to terms.

Pure holding companies may be distinguished from *operating holding companies,* or mixed holding companies, as the latter might be called. The Rock Island Company and the United States Steel Corporations are pure holding companies, for they engage in none of the technical processes of production directly, and merely hold the stocks of operating companies. Such is the case with the subsidiary Federal Steel Company. It is customary to define a holding company as one formed solely to hold securities of other organizations; but it is hard to draw such a line, for a corporation may operate one plant and own the stock of ninety-nine others. Accordingly, it seems best to class such business organizations as the Standard Oil Company of New Jersey, the American Cotton Oil Company, and the American Steel & Wire Company (see chart) as operating or mixed holding companies.

Some holding companies are *primary,* that is, they stand at the head of the combination organization with no other organization before or above them. Such is the United States Steel Corporation. But others are *intermediary* in that they are agencies through which a primary company controls subsidiaries. The Chicago, Rock Island & Pacific Railroad Company is an intermediary holding company, and so is the Federal Steel Company. The intermediary plan is used either to facilitate control by a single company over other companies, as in the Rock Island case, or to enable a group of companies to establish a joint control over one or more concerns. Thus, through the Reading Company, the New York Central and the Pennsylvania railway companies control the Philadelphia & Reading railway and mining interests; and the Armours, Swifts, and Morrises, through the National Packing Company, jointly control several packing and transportation interests.

Finance and Investment Holding Companies. — Finally, the existence of important finance and invest-

ment holding companies must be taken into consideration, and we may distinguish (a) *finance holding companies,* and (b) *investment holding companies,* from (c) the *manufacturing and transportation holding companies.* Both the finance and investment companies are formed, not to combine competing organizations or those producing in different industry stages, but to promote financial operations and investment. Take the General Electric Company, for example. It owns the stock of the Electric Securities Company and the Electric Bond and Share Company, which companies are merely finance holding companies organized to promote, underwrite, and buy the bonds of electrical companies. On the basis of the securities of such electrical companies, these finance companies issue their own bonds. Of course, the scheme is to encourage the market for the General Electric Company's products. The Securities Corporation, Ltd., a New Jersey incorporation of 1904, appears to be a finance holding company for encouraging and facilitating the operations of mining, milling, and railway properties in Mexico. Investment holding companies, however, as such, act merely as investment agencies. These organizations are especially common in England, where, as investment trusts, they buy the stocks and bonds of corporations in any line of business, and on these securities as collateral issue their own securities in a uniform homogeneous series. This relieves the investor of much trouble, and, by combining a variety of securities, a steadier aggregate income is made available for payment on the investment companies' bonds and stocks. The Securities Company of New York (N. Y., 1899) appears to be such a concern, and nearly its entire list of assets consists of stocks, bonds, and mortgages, while its "consolidated bonds" constitute the chief liability.

Advantages and Disadvantages. — No form of combination organization of anything like the stability and permanence of the holding company is organized with so great facility. Its first great advantage, therefore, is facility of promotion. If the attempt were made to buy the subsidiary companies outright it might be rendered futile by the unwillingness of a few individuals to surrender the separate existence of the organization in which they were interested; but the formation of a holding company requires no consent on the part of the stockholders the subsidiary corporations, for the promoters merely buy up stock in the open market until they get a controlling amount. When J. P. Morgan & Company got control of the American Bridge Company for the United States Steel Corporation, it was without any formal knowledge on the part of the officers or directors of the former concern. There were no negotiations as to the price to be paid for stock; merely a circular was issued offering to exchange steel stock at a certain rate for bridge stock, and the offer was taken advantage of by the individual bridge company shareholders. Nor is it necessary to increase the capitalization of some existing corporation, involving possible litigation and reorganization, to get rid of a hostile minority, for a separate new company is formed, and those members of the constituent corporations who desire the consolidation turn their shares over to it. All that is necessary to finance the deal is to sell securities or exchange them for those of the company to be controlled, and, as a bare majority holding is generally all that is needed, the amount of capital required is reduced to a minimum. Moreover, no limits to the scope of the combination are set by the nature of the business, and the holding company has been the device most used for industry combinations by integration. It would probably have been impossible to have built up a consolidation like the United States Steel Corporation under any other form. The secrecy which may attend control through stockholdings has also been an advantage from the private point of view, and such combinations as the American Tobacco Company have controlled plants unknown to labor unions and customers who would have discriminated against them had the "trust's" stockholdings been known.

On the score of capital, any combination which gives efficient direction has the advantage of applying the combined capitals of the members. But more can be said of the holding company. In the first place, it is itself a corporation, and its greater claim to legality, its ability to appeal openly to investors through the joint-stock device, its limited liability, and its effectiveness in management, all have enabled it to raise vast

funds. The capitalization of the United States Steel Corporation is the largest the world has ever seen — nearly a billion and a half dollars. The greatest advantage of the holding company, however, lies not so much in the vastness of the capital which can be amassed under it, as in the economy gained in the use of capital, and in the concentration of its control. No greater capitalization is necessary than may be enough to secure a majority of the stock of the subsidiaries, and the result is that a number of small holdings will control a relatively great amount of capital. Indeed, a holding company may be called a corporation of majority holdings. A group of half a dozen large consolidations holds 50+ per cent of the stocks of one hundred scattered concerns; the larger corporations, in turn, transfer 50+ per cent of their stocks to a holding company in exchange for its securities; and the result is that the holding company can control nearly four times its own capitalization. And the centralization becomes more and more intense as more wheels are built within wheels. Take two corporations of $1,000,000 capital stock each. A holding company with a $1,000,000+ capitalization can control the two. Another might be erected over it with a controlling capitalization of $500,000; then another with $250,000+; and another with $125,000+, and so on ! As we have already seen, $25,000,000 of stock in the Rock Island Company dominated $370,000,000 of capitalization in subsidiary corporations. The uninitiated reader will be edified by working out a little problem, the question in which is, with how small a capitalization can ten corporations each having $1,000,000 of voting stocks be combined? He will discover that a law of holding-company combination is that *the larger the number of combinations involved the more concentrated the control can be.*

All this suggests the liability test. Of course the liability of stockholders in a holding company, in so far as the form of organization is concerned, is on the same footing as that of the members of any corporation. But a corollary of the law just stated is that the holding-company members in reality are able to exercise more control than they are financially liable for. Is this not plain where those who are liable to the amount of $25,000,000 actually control $370,000,000 of capitalization? It is equally plain that the fact may be counted an advantage from the private point of view, remembering that the public's interests remain for discussion.

As compared with the forms of organization discussed thus far, the case is almost equally strong for the holding company's direction and management. Here the advantages may all be summed up by saying that the holding company may effect a unified central management while preserving some of the individuality and initiative of the constituent organizations. Within the organization of the United States Steel Corporation, the Carnegie Steel Company, the Oliver Mining Company, the Illinois Steel Company, the Tennessee Coal, Iron & Railroad Company, and others maintain a nominally independent existence; their management can readily be adjusted to local conditions, whether legal or economic, and, not the least important feature, the personal interest and special managerial ability of the old leaders cam readily be retained — the general of a small army becomes colonel of a regiment in the great host. To abandon the several companies and cancel their stocks, as in complete consolidation, would make it more difficult both to adjust policies to local conditions, and to attract and hold the active services of the leaders who had built up the constituent organizations.[135] Closely associated with the maintenance of separate individuality is the retention of valuable firm names and other elements of "good will." Having secured control of an organization which has built up established business connections, it would be bad business indeed to destroy such an asset even though intangible, and it is an advantage that the holding company need not interfere with it.

Some of these things, however, could be said of a pool. The point to the holding company's advantage lies in the conjunction of the separate existence of constituent companies and concentrated control over them. Writing of the operations of the "Tobacco Trust," the Federal commissioner of corporations reports: "The American Tobacco Company has not by its practice of acquiring business through stock ownership sacrificed the advantages of close supervision and unity of management. The general system of the Ameri-

can Tobacco Company and the other principal combinations in managing their own plants, keeping accounts, etc., has been very fully applied to the subsidiary corporations, and by means of detailed reports of their business the controlling companies have secured substantially as great control of the operation of these subsidiary concerns as of their directly owned plants."[136] This expresses the idea exactly. It goes without saying that competition in prices is eliminated; but more than this, even in cases of isolated non-competing plants such as those of gas and street railway companies in different cities, economies in direction may be gained. The best administration can be utilized economically for all, and partly unnecessary officials can be retired or put on part time. Great economies may be effected in buying on a large scale, and the possibility of operating the sources of raw materials and plants for utilizing by-products is increased. The system of comparative tests can be installed, so that by reports and inspections the most perfect and economical devices and processes may be enjoyed in common, and the performance of one plant be used as a check upon that of another. This may preserve a sort of competition in service.

As already noted, the holding company is well adapted to the formation of industry combinations embracing the several stages in producing finished goods, and it may be said in general that its great flexibility of management makes the holding company the most perfect kind of business organization for combining in a stable form units which have different processes, operate in different territories, and sell to different classes of consumers. On this point, another glance at the chart of the United States Steel Corporation will be illuminating.

Under the same head of flexibility of direction and management, it may be well to note the advantage possessed by the holding company in that it can adapt itself to the various and varying legal requirements of the several States. Some States, like Pennsylvania, require a company owning land to incorporate within their bounds; others levy higher taxes upon foreign corporations than upon those which they themselves create; and still others require such publicity that, where secrecy is desired, it is necessary to have separate corporations for business within their jurisdictions, so that only this part of the corporation's business need be reported upon.

The endurance in time of a holding company may be that of corporations in general.

From the private point of view, this form of business organization has few disadvantages other than those attendant upon any other kind of corporation, though some of these are concentrated and intensified by consolidation. Such matters as expense of formation, hostility to foreign corporations, restricted credit, may be neglected as being relatively small or largely overcome; but, in spite of what was said about effective management, the questions of personal interest, directness of motivation, and responsibility suggest important limitations. In such great and complex aggregations as the United States Steel Corporation it can hardly be expected that the managers will have the same personal interest in the success of the business as did the partners in the old Carnegie Company! As complex and devious as is the organization, so complex and devious is the motivation. After a certain size is reached, the man or men directing the business cannot have so exact or detailed a knowledge of conditions, and there is less chance to weigh these conditions carefully. The business organization may become so large as to resemble a political government and then some of the stock arguments against government ownership may apply. All the manipulation and "inside management" arising out of a clash of interests between the officers or directors and the stockholders, coupled with inadequate legal responsibility of the former, are given a greater opportunity in a securities holding corporation than in a simple operating one. The complicated structure of secondary and tertiary subsidiaries with their many different lines of business, all of which are controlled by the holders of stock in a single primary company acting through a single board of directors, affords increased chances for fraud. It is now a matter of common knowledge that excessive promoter's profits and great manipulative campaigns have attended the

organization of the Steel Corporation and any one may read of such things in the government reports on the tobacco industry. The overcapitalization, too, which frequently accompanies the formation of holding companies facilitates, if it does not stimulate, fraud.

The legality of holding companies is in a stage of uncertainty. It is clear that the holding corporation as such — as a form — is entirely legal. Corporations have the implied power to buy and sell property, and no reason exists at common law why one corporation should not become a member of another if its intent is legal. The mere holding of stock, unless prohibited by statute, may be *ultra vires,* but is not illegal. Therefore, although the decisions are not unanimous, it seems probable that, even in the absence of a general authorizing statute like that of New Jersey, "a corporation may legally be organized with the acquisition and ownership of shares in other corporations as one of its objects as expressed in its incorporation paper."[137] In several cases, indeed, the power has even been implied, as where the certificate contains a statement that one object is to assist in forming other corporations; and a corporation which has power to lend money has been allowed to take shares in another corporation as collateral. Obviously, however, it would be far safer for a prospective holding company to have some general or special authorization; and it must be observed that without such authorization, while a stock-holding control may be legal, it would probably be *ultra vires* of a corporation.

Where there is any ulterior illegal intent it is now well established that the courts will look to that intent, however it may be cloaked under the guise of authorized stock holding. In the case of *People* v. *Chicago Gas Trust Company* (130 Ill. 268), it was held that though the certificate of incorporation stated that the company might deal in the stock of other companies, the control of competing gas companies by this means was unlawful as constituting a monopoly; and the fact that the Chicago Gas Company sought *all* the stocks of constituent companies was pointed to in this connection in confirmation of the conclusion. In the celebrated Northern Securities Company case (193 U. S. 197 (1904)) the attorneys for the company sought to maintain that the company was authorized by the State of New Jersey to purchase and hold securities of any company; and that to deny it that power would be a blow at a State's right to incorporate business organizations. This contention was overruled, however; for the court looked to the obvious intent, which was to prevent competition between parallel lines of railway in violation — so it held — of an act of Congress. Thus, the corporation was formed for an unlawful purpose; and of course no State authorizes corporations for unlawful purposes. In line with these decisions, the Supreme Court of the United States has recently dissolved two great holding companies, the Standard Oil and American Tobacco[138] trusts; not because they were holding companies, but because they were in restraint of trade. The point is that their State charters empowering them to hold stocks of other corporations availed them nothing as a defense against charges of restraint of trade.

The obvious conclusion follows that the tendency of the law is to scrutinize closely the objects and methods of holding companies, and when these are found to be monopoly, restraint of trade — either unreasonable or prohibited by statute — or violation of sound public policy, they will be dissolved.[139]

From the public point of view, power without responsibility is the great objection to holding-company organizations. In the first place, we have seen that the financial liability of the members of a holding company may be only a fraction of their financial power. In the second place, they are under no adequate responsibility for their economic and social power. To the extent that monopoly and restraint upon the freedom of trade are harmful, the holding company is a menace which, while it perhaps need not be destroyed, needs public supervision. The ease with which it enables the concentration of control in the hands of a few, the secrecy and deviousness of its interests, the "amphibiousness" of its situs, all give it evil potentialities. Its amphibiousness makes State control futile; for, while it operates under a State certificate of incorporation,

and its constituent units are State corporations, its business is mostly interstate and beyond State control; and by procuring incorporation from a lax State and forming subsidiaries in hostile States the regulations passed by strict States concerning foreign corporations may be evaded in part. The State of Texas has a railway anti-stockwatering law, and a railway which has issued its maximum legal amount of securities still wants to issue more — wisely or unwisely, that is not the question. Accordingly, a holding company is formed in Virginia to hold all the common stock of the Texas railway, and on the basis of this maximum amount it issues collateral trust securities to any amount it pleases.[140] As already remarked, overcapitalization has commonly attended the promotion of holding companies; and, in many cases, the hope of gain through selling watered stock has been a chief object in forming such combinations. Although overcapitalization is not the fatal catastrophe pictured by uninformed persons, it is serious enough, for it encourages fraudulent promotion, speculative management, payment of unearned dividends out of capital, and the exploitation of the "investing public." As conducted at present, holding companies have been sinners in this respect and it would be in the interest of public welfare to have full publicity concerning their operations or even to limit their capitalizations.

Chapter XVI: Complete Consolidation: Amalgamation and Merger

Just prior to the great holding-company epoch which began about 1899 and reached its climax between that date and 1904, a number of important consolidations of a different type arose, — complete consolidations. This form was not new, but its application to the huge combinations of that time was a new development, for it then played a brief part in the "trust movement." Just what is a complete consolidation, and how does it differ from the securities-holding type?

Definition and General Nature. — Noyes in his standard work on *Intercorporate Relations* (§310) sets it over against the holding company in the following terms: "As a part of a plan for combining competing corporate interests, a *purchasing* corporation is organized, with a share capital sufficiently large for the purpose, which purchases the properties — plants, stock in trade, good will — of the several corporations, and issues its own stock in payment therefore.... The purchasing corporation, as the result of this process, becomes the absolute owner of the properties of all the corporations, and may continue or suspend the business theretofore carried on by them, and otherwise manage the affairs without restriction or supervision except by the State and its own stockholders." This statement is in accord with and serves to amplify the definition of complete consolidation to be adopted here, which is that it is *a form of business organization which is established by the outright purchase of the properties of constituent organizations and the merging or amalgamating of such properties into a single business unit.* In a word, complete consolidation is combination through sale. It is a union in which the parts are fused and lose their identity, at least for operating purposes.

The following steps will be found in the ordinary consolidation. First, the directors of the constituent companies get together and make an agreement as to the capitalization of the consolidated corporation and the method of exchanging its securities for the stock or properties of the constituents. Next, this agreement is submitted to the members of the constituent companies for the purpose of securing their assent. Then, if, at properly called and conducted meetings, the majorities required in such cases favor the step, a certificate or articles of consolidation, together with copies of the agreements of the stockholders, are filed with the Secretary of State of the appropriate commonwealth.

Statutory authority is always necessary to make valid a complete consolidation by merging or amalgamating business units, and mere provision for it in a certificate of incorporation is not enough. Such authority may come through the enabling acts under which the constituent companies were organized or incorporated, through legislation at the time of the consolidation, or through a sanction by law of an existing but illegal consolidation. As a matter of fact, nearly all general corporation laws to a greater or less extent permit

consolidation for lawful purposes. The assent of the stockholders of all constituent companies is required, and where the statutes provide for consolidation a favorable majority of from two thirds to three fourths of the shareholders is generally prescribed, but otherwise the assent must be unanimous. Payment is generally made in the securities of the consolidated corporation, but the members of the constituent companies cannot be made to accept stock instead of cash unless, perhaps, the certificates of their corporations so provide.

The difference between the form of organization thus described and the holding company is fairly obvious. The hold-ing company retains the separate existence of the combined organizations and controls them by voting their stocks. Nor can it formally act for them independent of their directors. It is at most a partial or temporary consolidation. Of course its constituent units must be corporations or joint-stock concerns, and the relationship is between their stockholders and the holding corporation. The complete consolidation, however, wipes the separate existence of constituent elements off the slate and they become one with it. It would be a contradiction of terms to say that it controls them, for they are not! These elements need not be corporations, as the consolidated corporation does not depend upon stockholding. Moreover, the properties being fused, there is no occasion for separate existences and the relation established *necessarily* involves the organizations concerned as well as their individual members. Where, as is generally the case, the constituent elements are corporations, the relation lies between the corporations as such, and not, as in holding companies, between the stockholders as individuals and a corporation which combines their organizations indirectly through combining their stocks. While the pure holding company merely holds stocks and does not engage directly in the management of the constituent plants, the complete consolidation is, at least nominally, above all an operating unit.

From a legal point of view, it is important to draw a distinction between consolidation and sale. Is any sale of its property by one business organization to another a consolidation ? Generally speaking, yes; but at law, as well as in economic significance, no; for, as the best considered cases have held, a mere sale terminates the interest of one of the parties in the property which is transferred, whereas a consolidation results in a union of interests in the property and so is more than a sale. If the stockholders of the vendor corporation retain an interest in the united properties, it is evidence of combination, and laws against combination may apply.

To illustrate consolidations which involve mere sales, mergers which arise in the course of the normal expansion of a business may be mentioned; for they are not the result of a plan to combine competing concerns to the end that the margin between price and expense may be raised. Such consolidations will have no trouble with the law. On the other hand, stand those consolidations which are the result of a desire to combine all the plants supplying a given market, and here the results upon public well-being will determine legality. Closely associated with this classification is the distinction between those consolidations which occur gradually over a period of years of steady growth, and those which spring up all at once, showing evidence of intent to combine.

But the classification to be emphasized here is that which distinguishes between the “merger” and the “amalgamation.” A merger is a consolidation in which one business organization is absorbed by another that retains its own existence. Amalgamation, however, results from the creation of a new corporation by the coalescence and virtual disappearance of a group of business organizations. Perhaps the most common case of merger is found in the absorption of branches and extensions by the main line of a railway system; for in such cases the branches cease to exist as separate organizations, while the main railway company continues on with little or no change; but, now, if two systems, the A and the B lines, were to combine under the name of the C line, and cease to exist as system A and system B, the consolidation would be amalgamation. Thus in 1910 the Gulf & Chicago Railway Company was consolidated with the Mobile, Jackson & Kansas City

Railway Company to form the New Orleans, Mobile & Chicago Railroad Company by their amalgamation. The use of the term "merger" in the sense here employed is fairly well established; and, while the term "amalgamation" has been more loosely used, its clear significance makes it the logical means of designating the coalescence just illustrated. Such is the usage in England.

In a very general sense complete consolidation is as old as business organization, but as a characteristic feature of the combination movement of the second half of the nineteenth century it has a more special significance. In this special sense it is a corporate consolidation, and it seeks the same object sought by the trust form. The tendency in the earlier days of the combination movement was strongly towards the federation nominally independent business units. Entrepreneurs were loath to surrender the autonomy of their organizations, and the business world had not yet become trained in the game of combination. Perhaps, also, competition had not become severe enough to act as an effective driving force. However that may be, consolidation built on a large scale and directed toward the restriction of competition was relatively rare. Then, between 1890 and 1900, after the trusts had been ruled out and before holding companies became the style, there was an epoch of complete or nearly complete consolidation, notably in the iron and steel industry, the railway business, and also in sugar, paper, and cotton oil. The application of the anti-trust act to the looser forms of agreement combination went so far as to drive business organization into corporate combination; but, as already stated, the holding corporation won favor over the complete consolidation as being more facile and more in harmony with the desire to retain the names and separate organizations of the subsidiary concerns. In 1904, however, the Northern Securities Company was declared illegal, and it became evident that even corporate combinations, if in restraint of trade, could not be carried on safely under the holding-company form. This decision undoubtedly somewhat checked the holding-company movement, and at the same time it seems to have given a new impetus to complete consolidation; for the belief arose that by dissolving the constituent companies and owning their properties combinations would become less readily assailable in the courts. Since the more recent decrees of 1911 dissolving the Standard Oil and American Tobacco holding companies, the possibilities of merger and amalgamation have been further canvassed.[141]

Throughout the development thus briefly sketched one purpose runs, the purpose of business men to regulate competition whether in trade conditions or prices to the end that the margin between price and expense might be raised or maintained. On the other hand, down to 1911 the statute law, as construed by the courts, has steadfastly opposed all such regulation. The result has been that one form after another has been evolved in an effort to effect a combination that would permanently regulate competition without meeting the active opposition of the law. Whether the merger or the amalgamation affords the desired form will be indicated below.

Amalgamation Illustrated. — One can hardly pick up a financial paper without learning of some consolidation. Because of their greater importance and interest, however, we will confine attention to two well-known cases, the American Tobacco Company and the "Powder Trust," the former illustrating amalgamation and the latter merger. Prior to 1904 the Consolidated Tobacco Company as a holding company had gained almost complete control of the common stock of the American and Continental tobacco companies and so had established a close community of interest in the tobacco industry. Such control seemed adequate, and there appeared to be little reason for change. But at least two reasons induced the leaders to form a more complete consolidation: they desired to simplify the organization, which under the community of interest through stockholding was very complicated, and also they wished to make their legal position stronger. In 1904, as already noted, the United States Supreme Court declared the Northern Securities Company to be in violation of the Sherman Act, and, as the organization of that company was not dissimilar to that of the tobacco interests, the decision caused doubt as to the legality of the existing arrangement. As the commis-

sioner of corporations puts it: “There is little doubt that the stockholders and officers of the Consolidated Tobacco Company felt that this decision rendered the legal position of the Consolidated very uncertain, and that they therefore considered it desirable to transfer the actual assets of the American and Continental companies to a single corporation.”

Accordingly, in the latter part of 1904 the directors of the three companies drew up a so-called “merger agreement” and submitted it to the stockholders concerned. This agreement Provided that the stock held by the Consolidated together with certain inter-company holdings should be canceled, that the small outside holdings should be retired by exchanging them for the stock of the amalgamated company, and that outstanding preferred stock should be exchanged for bonds. This agreement was favorably acted upon by the great majority of the stockholders—indeed, why should it not have been, when the Consolidated interests were that majority—and became the basis of the certificate of incorporation of the reorganized American Tobacco Company, into which the three concerns were amalgamated. Under the “agreement” a board of twenty-eight directors was established, all the members of which, but one, were directors of the amalgamating companies, and that one had been treasurer of the Consolidated. Promptly upon the merger, the entire stock issues of the old American company and the Consolidated and Continental companies were retired and complete consolidation reigned.

Was the legal position of the combination under this new form of corporate consolidation stronger than that of the old organization? Apparently not, inasmuch as seven years later it was forced to submit to a decision dissolving it. Nevertheless, as will appear shortly, the situation in which it found itself upon dissolution was very different from what it would have been had the amalgamation not been effected.

Merger Illustrated. — The case of the “Powder Trust” consolidation is even more interesting.[142] Prior to 1899 the powder industry was not organized on consolidated lines, but price agreements and pools had been the form which combination had assumed. The leading powder producer was the firm of E. I. du Pont de Nemours & Company, a partnership. In the year mentioned, however, holding-company consolidation began. The du Pont Company was incorporated, and in 1902 its stock was turned over to a new corporation, the E. I. du Pont de Nemours Company (of Delaware), which company, in order to make itself a pure holding company, likewise turned all its assets over to two subsidiary concerns in exchange for their stock.

But, beginning about 1904, — at the very time the American Tobacco Company amalgamation was formed, — the policy of complete consolidation by merger was substituted for securities holding. In 1903 The Consumers’ Powder Company, the Enterprise Powder Company, the Moosic Powder Company, and the Oliver Powder Company, all Pennsylvania corporations, were merged into the E. I. du Pont de Nemours and Company of Pennsylvania (one of the subsidiary concerns of the Delaware holding company of 1902), that company increasing its stock from $2000 to $2,000,000, but retaining its identity. As the next step toward complete consolidation, in 1903 the E. I. du Pont de Nemours Powder Company was organized in New Jersey. This New Jersey du Pont company had a capitalization of $50,000,000 which it used in acquiring the Delaware company of 1902 (including its Pennsylvania merger) and several other corporations which had been organized to consolidate plants in various sections of the country. The situation in 1903, then, was this: (1) several preliminary mergers had been effected and scattered interests had been brought together in several holding companies; (2) the securities of these preliminary consolidations, complete or partial, were controlled by the 1903 du Pont powder company of New Jersey.

From 1903 to 1907 the merging went on merrily. It is known that during those years the New Jersey du Pont company and a subsidiary, the Eastern Dynamite Company, gained control over sixty-four different corporations which they caused to be dissolved, and merged the properties of the dissolved concerns into their own companies. In 1907, when suit was brought against the organization now under discussion, the defendants frankly acknowledged that their policy was “eventually to vest absolute ownership of all the plants, manufactories, and tangible

properties acquired by the methods above mentioned in one corporation, and then to dissolve the subsidiary corporations."[143] The suit was brought before this policy could be entirely carried out.

The object is plain enough, being similar to that of the tobacco amalgamations, namely, to simplify organization and gain a stronger legal position. Thus, counsel for the defendants in the suit just mentioned contended that the title of the New Jersey du Pont company, into which the others had been merged, could not be impaired. "The most that government in any event can claim," they argued, "is that prior to the organization of the present defendant companies there did exist contracts and combinations in restraint of trade, and possibly a monopoly..., and that such combinations and monopoly were participated in by some of the corporations which were later purchased by the present defendants.... Even so, the corporation had title to such properties, and if such combination and monopoly no longer exist, the title to such property must be good in subsequent purchases thereof." As in the tobacco case, however, the defense based upon the consolidated form of the combination was given little weight by the court.

Railway Consolidation. — Just a glimpse at the situation in the railway business. Every one knows that here great systems have been built up which are more or less compactly organized and which divide up the United States into transportation principalities. The question as to how these systems are organized and held together is an interesting one. Every year numerous changes take place. Some roads are being reorganized, some merged, some amalgamated; others are being leased, others abandoned, and some are merely having their names changed. The net result, however, has been that three fourths of the railway mileage consists of roads which are operated by the companies that own them and are independent operating lines, while only the remaining one fourth consists of roads which are operated by companies that do not own them in fee. The largest part of the latter class of roads is operated under lease, while others are controlled by stockholding, by trackage rights, and other contractual arrangements.

One can infer, then, that complete consolidation has been carried to a great length in the railway world. Back in 1894 only 68 per cent of the railway mileage was operated by independent companies which owned their lines; in 1904 the percentage was 74; in 1910, as just stated, it was 75. Most thinkers agree that this tendency to complete consolidation is the result of laws prohibiting railways from cooperating by means of the looser forms of organization like pooling and traffic agreements, and doubtless the application of the Sherman Act has encouraged the merger and amalgamation of railway companies. Also there is some evidence that the tendency to shift from securities-holding organization to complete consolidation, which we have found in manufacturing, appeared in transportation. The statistics show that the independent operating roads increased markedly in number in the 1904–1906 period, and that the increase was not due to a splitting-up process, for at the same time the mileage embraced in large systems of over 1000 miles each grew steadily.

The maximum number of complete consolidations occurred during the three years 1900–1902, the great majority being of the merger type; but this fact is partly to be explained by the great mileage built in 1899–1900 and 1901–1902, which resulted in numerous mergers of newly constructed lines into parent companies. The following table taken from the data given by the Interstate Commerce Commission's Division of Statistics show the facts: —

Period	Amalgamation	Mergers	Total
1894–1898	93	125	218
1899–1903	158	314	472
1904–1908	113	188	301

The largest part of the mileage of the subsidiary roads is controlled by lease, and such control may be

mentioned as a kind of temporary consolidation similar to stock ownership. Leasing has been so commonly resorted to in the railway business partly because the laws of several States prohibit complete consolidation. In a way, too, it is a simpler process than consolidation, for no new capitalization need be issued and the nominal identity of both lessor and lessee roads is undisturbed. A majority of leases provide for the payment of a fixed money rent to the leased line, but some make the payment contingent upon the earnings received from its operation. When the lease is for long periods of time it virtually amounts to complete consolidation, and illustrations of this occur in the lease of the West Shore to the New York Central for a period of 475 years and of several parts of the Pennsylvania railway in perpetuity. The most common period is probably 99 years, though shorter terms are frequently found. Wise public policy should restrict the period to not over 100 years. On the whole, the lease method of consolidation is less used than formerly.[144]

Advantages and Disadvantages. — There are two problems in corporate combination: one is the corporation problem, the other is the "Trust Problem." This is true because such combinations are, in the first place, to be regarded as corporations and as units of business organizations; while, in the second place, they may also be considered as checks upon competition and as agencies of monopoly. The first problem is one primarily of production; the second is one primarily of distribution or consumption.[145] Later, some attempt will be made to deal with these problems separately, but here they may be left intertwined.

The chief advantage of the complete consolidation lies in the simplicity and directness of organization which it brings. For the complex mass of subcompanies and of sub-subcompanies which are found in the large holding corporations, it substitutes one united operating company. This makes possible the abolition of numerous figurehead officials, and of expenses involved in maintaining nominally independent establishments. The presidents or vice presidents of the constituent companies are replaced by superintendents entirely responsible to the central office. Moreover, it binds the constituent corporations into a complete harmony of interest which is absolute and irrevocable and it removes a part of the incentive to manipulation of constituent companies which exists where control by stockholding is depended upon. One interest is less likely to be "milked" by the other.

Again, the complete consolidation has a somewhat stronger position in the courts than even the holding company. It is true that it may fill the same function as the trust, and that in both the tobacco and powder cases the courts have dissolved this sort of organization as far as seemed possible and expedient; but the limitation contained in this statement suggests the point. Once effected, a complete consolidation with ownership in fee is more difficult to disintegrate. In the case against the E. C. Knight Sugar Refining Company, involving the purchase of Philadelphia plants by the American Sugar Refining Company, the United States somewhat feebly tried to have a consolidation set aside and failed. In the dissolution of the American Tobacco Company, also, it is not to be forgotten that an American Tobacco Company still exists and produces about one third of the output of the cigarettes and smoking tobacco. The corporation which was built up in 1904 by the merger of the Consolidated, the Continental, and the old American Tobacco companies survives and the merged companies can no longer be recalled. Simply, the American Company's interests in thirteen allied and subsidiary concerns have been severed, so that the Liggett & Myers Company, the American Snuff Company, the British-American Tobacco Company, and others are separate and presumably independent organizations. And in the du Pont de Nemours case the court said: "The dissolution of more than 60 corporations since the advent of the new management in 1902, and the consequent impossibility of restoring original conditions in the explosives trade, narrows the field of operation of any decree we may make." The whole Point is that the merger and the amalgamation, while they be attacked as being illegal combinations, are the forms of combination least likely to violate any principle of corporatioi law: *as a form* of business organization, the merger has the strongest position at law. It is a single (though really compound) corpora-

tion, arising out of sale and purchase between parties which are corporations and have the right to buy or sell property for legal purposes.

But here we must pass to a recognition of the limitations of the complete consolidation; for, in spite of the difficulties, the courts will surely look to the purpose and methods of the consolidation, and if these be found to be monopolistic and unlawful the consolidation will surely be attacked. Said the court in the case last referred to: —

> "The du Pont Company of 1903 was created to aid the combination in concentrating its power and fastening its hold on the monopoly which it had sedulously built up. We do not propose by our decree to deal with titles to property. Our power is defined in the fourth section of the Anti-trust Act.... If our decree, limited to that purpose, shall necessitate a discontinuance of present business methods, it is only because those methods are illegal. The incidental results of a sweeping injunction may be serious to the parties immediately concerned; but, in carrying out the command of the statute, which is as obligatory upon this court as it is upon the parties to this suit, such results should not stay our hand. They should only challenge our care that our decree may be no more drastic than the facts of the case and the law demand."[146]

Though a few cases have held that the purchase by one corporation of another which results in the suppression of competition is not illegal,[147] the weight of opinion is that the corporate purchase cannot authorize power which has as its object combination that will be in unreasonable restraint of trade or competition.[148]

The economic disadvantages of complete consolidation are: (1) It is not a facile means of combination because it involves consent to sale by a large majority of the stockholders of the constituent companies; it is a more expensive process, which necessarily involves greater capitalization in proportion to control; and it is not one that can be kept secret. (2) Valuable franchises and firm names possessed by constituent companies may be lost by purchase and dissolution. (3) The flexibility and capacity for adjustment to local conditions which characterize control through stockholding are not present. (4) Although the danger is less likely to occur than in the case of holding companies, complete consolidations may be "overgrown" making the business unit so large that no entrepreneur can adequately grasp its details or judge them carefully.

Social Point of View.— From the social point of view, it is difficult to judge the merits of mergers and amalgamations. It seems to the author, however, that, granting the desirability of combination and "big business," the complete consolidation is the logical way to bring them to pass. Economy, responsibility, — using that term in the very broadest sense, — and harmony with sound social institutions, must be the tests. From the purely economic standpoint, the complete consolidation has the advantage of the most concentrated direction and management, and all the economies that lie in large-scale, combined organization may be more easily attained. Under the system of securities-holding combination, which is the only other form of combination that need be considered here, the same individual may be a director in fifty or sixty different corporations, to say nothing of acting as an executive head of one of these organizations. In such a case, no adequate information or attention can be given to the affairs of any one or two concerns without sacrificing those of the others, and this breeds irresponsibility among the officers of the various corporations. Consolidation, by reducing the number of separate corporations, would concentrate directors' responsibility. It would tend to remedy the abuses of interlocking directorates with their irresponsibility and possible inefficiency. There is some danger that consolidation will result first in overcapitalization, due to excessive stock and bond payments, and then in the petri-fication of that capitalization as the result of losing the identity of the several properties against which it was issued. The holding-company form makes readjustments in capi-

talization easier. But, on the other hand, the holding company is more apt to retain such a mass of plants and business organizations as to result in a combination which is overgrown, — one not able to secure the complete economies of large-scale production. Useless wheels within wheels often exist, especially where an attempt is made to conceal from the public the fact of control. Moreover, it is usual to precede or supplement the formation of holding companies by merging or amalgamating some of the properties in order somewhat to simplify the organization. One must conclude that while in its formation the consolidation may be more expensive, once established it gives a more economical organization in that its direction is simpler and in that it is not so apt to keep up a wasteful duplication of organizations and plants. And as to the facility of formation, it is to be remembered that ease of forming combinations of competing organizations may encourage monopoly and overcapitalization, and certainly it is no unmixed blessing from the public point of view.

As to responsibility to the public, or even to stockholders, the complete consolidation is decidedly superior to securities-holding organization. True, both are corporate combinations; but in one, combination has been carried so far as to make a single compound corporation which acts directly and which is controlled only by a majority of all the stock involved, whereas in the other there is but a combination of controlling holdings in the constituent organizations, which combination acts indirectly through these holdings upon the constituents, and is or may be controlled by a small fraction of the total capitalization. In the holding company the total power is lodged in a few; the total responsibility is spread among many.

Finally, the sociological test of consonance with the institutions of the environing society must be met. If, whether for good or evil, the society concerned is organized on a democratic basis, and its dominant ideal is the preservation of the greatest measure of individuality among its citizens that is consistent with the greatest well-being of the greatest number; then the form of business organization which is the most democratic in its control and which affords the largest measure of individuality consistent with economy of operation is the one to be favored. When used for combination of competing plants, the holding company allows more nominal individuality, but this is generally not realized in practice; and certainly that form of organization lends itself to undemocratic control more readily. Furthermore, over against the nominal independence of the holding company's parts is to be placed the fact that in a field of any great extent the complete consolidation is not so readily formed as is the holding company, and consequently is not so apt to become a monopoly by embracing an entire industry.

Here the thought occurs to one, is the greater difficulty of dissolving the complete consolidation not in favor of the holding company? The answer partly depends upon the desirability of dissolution, and, as a rule, dissolution will prove an elusive and delusive remedy. Secret evasion is commonly the result; the danger of destroying economically desirable organization is run; and those most injured are generally the innocent minority interests involved.

It is the author's judgment, then, that sound public policy will encourage complete consolidation by merger or amalgamation rather than by securities holding, and that, in the long run, legitimate individual interests lie in the same direction.

Some Conclusions concerning Combination Organization. — A few generalizations may be drawn from the foregoing discussion of the various combination forms of business organization. For example, on the score of direction and management, it appears (1) that in consolidations, the more extensive or complex the organization, the more the entrepreneur's function is delegated by the stockholders to representatives; (2) that the more extended or complex the organization, the more the business function is separated from the technical, and the more the directors attend to the former, leaving technical matters to salaried managers. Also, (3) under these same conditions, the wider becomes the gap between those who bear the owner's

responsibility and those who exercise the directive power. (4) It follows from all this that the old arrangements for transmitting authority from the shareholders to the management have become less and less adequate as a democratic means of securing control of business by investors.

Again, it has appeared that there are two great types of combination: on the one hand there is the federation type, or unincorporated combination; on the other hand there is the consolidation or corporate combination. The federation (1) retains the separate existence of the combining organizations, (2) is less stable, (3) is more secret, and (4) is not so effective in securing economies in management and direction as in marketing. Its greatest economy generally lies in selling through a central agency. The consolidation takes away the independence of the units, and is more stable. If not overgrown, it affords a great chance for economical management. In each type the trend has been toward the most stable and centralized form, on the one hand the sales-agency pool with output allotment, and on the other the amalgamation or merger.

It is interesting to reflect that with the complete consolidation we may be completing a cycle in the evolution of business organization. Beginning with the individual, we found various forms of association which reached their culmination in the simple corporation. Beginning with the corporation, there developed various forms of combinations of corporations (and other simple associations) which seem likely to culminate again in — the corporation! The new corporation, however, is a compound corporation built up through the consolidation of preceding organizations. Perhaps the pool, the trust, and the holding company will continue to exist alongside the compound corporation, just as the partnership and the joint-stock company have continued to exist beside the simple corporation. Probably it will be well to encourage the various combination forms in certain cases and subject to appropriate restrictions, just as it is best to encourage partnerships and individual organizations where they are effective. The end has not come yet, and who can tell through what new cycles business organization must swing! But surely it is worth while to have grasped the concept of such organization as ever evolving through continuous differentiation and integration caused by the struggle of business men to adjust its existence to the growth of society.

Book III: Structure and Life History of a Typical Business Corporation

Chapter XVII: Internal Organization of a Going Corporation

Organization in General; and the Accounting and Economic Points of View. — The corporation is easily the central figure in the world of business organization in the United States. Whether viewed as the culmination of association among individual business men, or as the initial unit of the material out of which combinations are built, it is without question the most important primary form of business organization; and there is little need for a more detailed discussion of unincorporated organizations. It is most important, however, to know the structure and the life history of the business corporation. With this end in view, we will first examine the internal organization of a going corporation. Taking the corporation for granted, we will inquire into its organs and their functions. How are they arranged and coordinated and directed? What, in short, are the anatomy and the physiology of a business corporation regarded as an operating organization? We may then pass more intelligently to a consideration of the formative stage of corporate existence, covering the periods of promotion and underwriting.

In looking at the corporation as an operating business unit, business men take two points of view which we will call the accounting and the economic points of view. The former generally means an individual way of looking at the business; for it concerns a relation between the business unit and its proprietors. In a word, it is the function of accounts to show the condition of a business organization regarded as a source of income to its owners. In a way analogous to that in which economists are wont to distinguish the wealth of a nation from its annual income, accountants set forth the condition of a business unit under two heads, the balance (as shown in a "balance sheet") and the income (shown in an "income account").

The balance sheet is a sort of periodic inventory which shows the standing of the business at any given time. On the one hand are summed up the "assets"; on the other the "liabilities." The assets show what the proprietors have put into the business as it exists at any given time and what others owe the business, and includes such items as plant and equipment, materials, cash, and accounts receivable. The liabilities show what the business owes to the proprietors and others, embracing such accounts as stock, bonds, accounts and bills payable, and profits. The income account is designed to show the net return from the business to the owners on what they have put into it, the two main heads, of course, being revenue and expenditures. Thus it shows the results of operations over a period of time, a month or a year. The operating expenses and others are deducted from the receipts from all sources to ascertain the net revenue, out of which dividends may be paid or a surplus be accumulated.

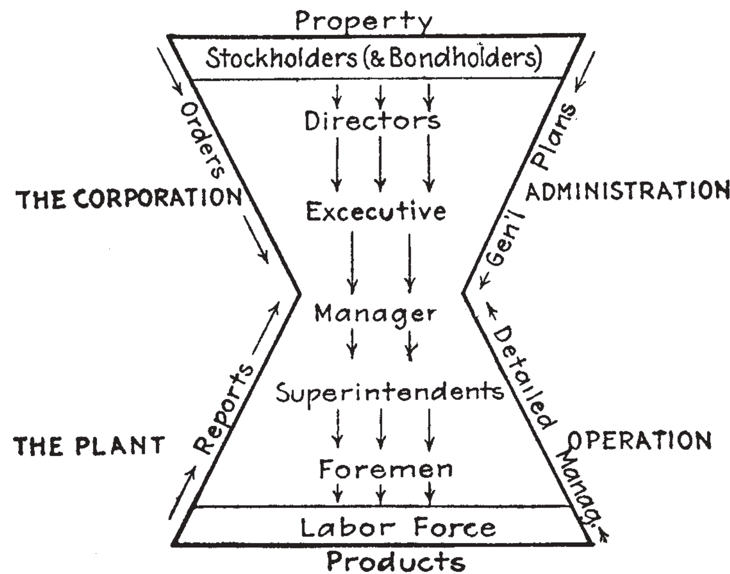
We, however, are not here concerned with accounts. We are to take the economic point of view, which regards the business as a productive unit, or means of organizing and directing the factors of production; and it follows that attention will be devoted to the productive cooperation of land, labor, capital, and entrepreneurial ability, rather than to the relation among them as set forth in accounts.

In the chapters describing the evolution of business organization, attention was centered chiefly on the ownership of the units, and the formal external aspects were emphasized. Now, it behooves us to take a glance within and see the organization from the internal operating point of view. We have seen that the operation of a business unit is affected by the character of ownership and the external form of organization, but chiefly, of course, it is dependent upon the kind of work that is done. The operating organization of a bank differs from that of a factory, and both are unlike that of a railway. Factories, in turn, are variously organized according as they produce steel or cloth or ice. All, however, are engaged in production, and have the same general problem. All must combine land, labor, and capital, under the direction of an entrepreneur; all take in some "raw" materials, and, by applying labor power with capital, must operate to turn out a finished good or service; all must sell the product, collect the income, and account to the owners for expenditures and receipts. In each case these various processes must be more or less subdivided, and at the same time they must be so interrelated and coordinated that they will work together for the good of the business unit. There will be certain classes of interests which must be effectively subordinated and directed; and the internal aspects of the organization of ownership and administration are found on the one hand, while the organization of the technical processes of operation (manufacturing, transportation, mining, etc.) lie on the other.

Just as there are general principles of anatomy and physiology which can be studied by dissecting cats or corpses, so certain general forms and principles of business organization exist, and in a brief sketch like the following these general features alone can be taken up. They will concern (1) the division of the work into departments (differentiation), and (2) the central direction of these departments to secure cooperation (integration).

Classes of Interests. — Several classes of interests are to be distinguished in any discussion of the internal organization of a business unit, and notably so in case of a large corporation. In single-entrepreneur and partnership organization the situation is relatively simple, for ordinarily those who are the owners are at the same time the ones who direct and manage the business, — although a salaried manager is not uncommonly employed. Then there are laborers, of course; and, when capital is borrowed, the creditors who hold the owner's notes may in practice have some voice in his affairs. In such a case, however, they can hardly have the long-time, organized influence often exerted by corporation bondholders.

The typical corporation is a much more highly differentiated organization. First come the stockholders, who are nominally the owners and the ultimate source of authority. They, however, exercise their authority through an elected board of directors, composed of men who are supposed to represent them. Very commonly there is also a body of bondholders; and, as bonds are in practice regarded merely as one means of raising capital and as being a part of the corporation's capitalization, and as they generally run for long periods of time, without any thought of their being really retired, the bondholders not infrequently play a considerable part in the direction of the corporation. In rare instances they are represented on the board of directors.[149] The directors choose an executive head, which may be either a president or an executive committee, or both. Associated with the executive are a secretary and a treasurer. The executive chooses a general manager, and under the manager are placed superintendents of departments. Foremen under the superintendents supervise the labor force. The whole organization has been likened to an hourglass, in one section of which lie the owning interests pouring authority through the executive head to the manager who supervises the manufacturing and commercial operations.



Clearly the human exertions or services comprised within this scheme may be divided into four great groups: (1) investment risk (or owner's responsibility); (2) administration, including direction and executive service; (3) management; and (4) labor.[150] The ownership and administration, under our existing social order, fill the top cup of the hourglass; the management and labor force lie in the lower. We may logically discuss the internal operating organization of a corporation under the two general heads thus indicated.

Organization of Ownership and Administration. — The organization of the ownership and administration of a business is generally the corporate organization, and where this is the case, the corporation may be regarded as a sort of political machine for enabling the stockholders to govern their property. Within the sphere of the corporation so regarded, we find authority concentrated and directed much as in a political unit, the body of stockholders being roughly comparable to the voters in a democracy, the directors to a parliament, the executive head to a prime minister, and the other executive officials to his cabinet.

It is to be observed in advance that it will be difficult to discuss organization pure and simple without encroaching on the subject of management; but the point of view is to be that of one concerned with organization, and where management is brought in it will be to throw lighten the functions of the organs.

Stockholders. — Being the nominal owners of the corporation's property, the stockholders are the ultimate source of authority, subject only to the law, the property rights of creditors, and the personal rights of employees. As a body they generally have the following rights: —

(1) To amend the certificate of incorporation and by-laws;
(2) To elect directors of the corporation;
(3) To pass upon the mortgaging or sale of its permanent assets;
(4) To dissolve the corporation.

In another chapter the certificate was likened to a constitution and the by-laws to a body of statutes. It is fitting, then, that the owners of the "little republic" should have the franchise in amending these instru-

ments. Generally a two-thirds majority is required to change the "charter." Of course, the stockholders act subject to the general corporation law and public policy; and in practice it seems that their power over bylaws may be somewhat reduced. Thus, the charter of the United States Steel Corporation says: "Subject always to by-laws, made by the stockholders, the board of directors may make by-laws, and from time to time, may alter, amend, or repeal any by-laws;" and that corporation's by-laws themselves vest in the board full power to make new by-laws or change the existing ones.

The two most important powers are the second and third of the ab.ove list. The election of directors need not be discussed here. As we shall see, all direct control over the corporation is nominally in their hands. It is not a universal rule that the stockholders' consent must be given to validate any disposition of permanent assets, for the courts of some States take the position that all administrative power is turned over to the directors. However, the form is generally gone through, even in such States. The incorporation certificate of the Steel Corporation provides that a two-thirds majority of the shareholders must sanction any mortgage or pledge of the corporation's real property or of the stocks of constituent companies.

As individuals, stockholders generally have these additional rights: —

(1) To representative general meetings, embracing the right: —
 (a) To receive notice,
 (b) To attend,
 (c) To participate,
 (d) To be represented by proxy.
(2) To an inspection of the books when consistent with the corporation's interest.
(3) To a share in dividends.
(4) To a share in additional stock issues.
(5) To a share in assets when the corporation is dissolved.

The first of these rights is nearly self-explanatory. What shall constitute due notice, however, is a serious question. The trend of development in this right has been to insist that notice shall be given at a certain time in advance of the meeting, and that it shall contain a statement of the subjects to be taken up. The proxy right has been much abused, being used to secure a majority by getting the proxies of scattered small holders, and so to run corporations in an undemocratic way. It seems essential, however, that the distant holders of small amounts of stock should have the power to send their representatives. The length of life of a proxy is sometimes wisely limited by law.

The stockholders have no unlimited right to inspect the books of their corporation. Thus the certificate of the Steel Corporation says: —

> "The board of directors from time to time shall determine whether and to what extent, and at what times and places, and under what conditions and regulations the accounts and books of the corporation, or any of them, shall be open to the inspection of the stockholders; and no stockholder shall have any right to inspect any account or book or document of the corporation except as conferred by statute or authorized by the board of directors, or by the resolution of the stockholders."

At common law, however, this right exists when sought at proper times and places and for proper purposes. When sought for speculative purposes, or for giving information to a competitor, or for mere curiosity, it does not exist. "If every shareholder could inspect for such purposes, at his own will, the busi-

ness of most corporations would be greatly impeded."[151] The statutes of several States specifically authorize the inspection of books by stockholders, generally at "reasonable" times. In such cases it seems that no reason need be given by any *bona fide* stockholder.

As to sharing in dividends, that right exists only if the directors declare any. Generally the power to declare dividends is conferred upon directors, in which case the stockholders cannot compel the declaration of a dividend nor determine its amount. Of course, dividends are shared according to the kind and amount of stock held.

By the right to share in new issues is meant the right to subscribe for shares issued subsequently to those held by the stockholders. This privilege has been upheld by the courts on the ground that the new issue affects the value of the existing stockholder's equity and dilutes his voting power.

Bondholders. — To an increasing extent, nowadays, corporations of all sorts raise funds by issuing their notes in uniform series; and generally, in America, such notes are secured by a mortgage on some tangible property. These notes are called "bonds." Of course the bondholder is primarily a creditor rather than a proprietor; but, when he holds a mortgage, he has a. claim which may become ownership in case the interest is not paid currently or the principal is not paid at maturity. It may be said, then, that the bondholders have a sort of contingent ownership. From this it results that if interest payments to them are defaulted they may throw the property into the hands of a receiver to be operated in their interest; and in case the corporation becomes bankrupt, as holders of the first claim against it, they have a strategic position in bidding for its assets and reorganizing it. In a word, bondholders may be thought of as "proprietors who have relinquished the privilege of actively directing the business in which they are interested in exchange for a first claim upon the earnings during operation, and upon the assets in case of dissolution."[152]

More than this, the courts will not allow the owners to act in such a way that the security for the bonds is wrongfully impaired. For example, corporate mortgages often provide that real estate covered by bonds cannot be sold without the bondholders' assent. In general, new issues of bonds having a claim prior to an outstanding issue cannot be made without the consent of the holders of the latter. And, under several conditions, the bondholders may legally interfere in the management of the corporation: when stockholders fraudulently divert income to their own use, the bondholders may demand an accounting; where low rates are prescribed by a commission so as to violate the State or Federal constitution, the bondholders may have their enforcement enjoined; and any encroachment on the security for the mortgage which is not in the ordinary course of the corporation's business may be prevented.

In practice, considerable attention is paid to the wishes of bondholders. They may be consulted as to proposed action, and may even be given a definite representation. In case of reorganization, the bondholders act through committees. Some of their number will constitute themselves a committee and appeal to the others to deposit all bonds with them. They thus become trustees with full power to act, and, by presenting a united front, prevent hasty action contrary to their best interests. Ordinarily the security pledged by the corporation is deeded to a trustee, and he takes such action as may be necessary to protect that security.

Of course, the stockholders' share in the assets of a dissolved corporation would be subject to the prior claims of creditors, bondholders, and higher grades of stock, if any such exist.

The liabilities of stockholders may be very briefly stated. All stockholders arc individually liable to creditors for any part of the par value of their shares that may remain unpaid. Only a few States by statute add to this limited personal liability. In the second place, stockholders arc liable for any dividends which are not earned, but instead are paid out of capital. It follows from their power to pass upon what is done with permanent assets that stockholders should be held accountable for any wasting of such assets. It is obvious that to pay out as current income what must economically be kept intact as a capital asset is a fraud upon

creditors and a prostitution of the corporation.

In Indiana, New York, North Dakota, Pennsylvania, South Dakota, and Tennessee employees may recover for wages directly from the individual stockholders when they cannot collect from the corporation; but in some of these States this rule applies only to manufacturing, mining, and other industrial corporations.

Directors. — In this country it is usually provided by law that the affairs of business corporations shall be conducted by directors; and, in the absence of express provision in the corporation regulations to the contrary, directors are always elected by the stockholders. Boards of directors vary in size, seldom consisting of less than three or more than twenty-four members. In general terms it may be said that the powers of directors are those possessed by the corporation itself: what the corporation may do, that its directors may do for it. In some respects they are like the agent of the corporation; but the relation between the two is even closer than that between principal and agent, for, in dealing with third parties, the directors are equal to the corporation. They, as it were, have full powers of attorney; and between the stockholders' meetings, their power is nearly unlimited.

Such limitations as affect the powers of directors may be summed up as follows: (1) Their powers are limited to the regular business of the corporation. Thus, they have no power to increase the capital stock nor do any other act which would change the fundamental constitution of the corporation, without the consent of the stockholders. The directors have no primary powers to make by-laws or to dissolve the corporation. (2) Directors are subject to the general control of the stockholders, and "have no right to violate a resolution of the shareholders prescribing the policy to be pursued by the company,"[153] providing that resolution is in accord with the constitution of the corporation. (3) Also, special powers, such as that of levying an assessment, may be conferred by statute upon the stockholders, and these powers the directors cannot exercise.

The main points concerning directors which are found in the by-laws of the United States Steel Corporation will be of interest here. In this corporation there are twenty-four directors who are elected for three years, with the terms of eight expiring each year. They are required to hold only one share of stock in the corporation. The compensation is ten cents per mile traveled in attending directors' meetings, and $20 per day in attendance. Regular meetings are to be held each month without notice, and special meetings may be held at the call of the president or of one third of the members, with two days' notice by mail or one day's notice by telegram. A majority forms a quorum, but an affirmative two-fifths vote of all members is necessary to pass any resolution. The directors may elect and remove officers, create and select from their members executive and finance committees, provide for the inspection of the books, fix the working capital, declare dividends out of net profits, use the same in purchasing and retiring shares of the corporation's stock, and make or amend by-laws.

More specifically, a corporation's board of directors generally exercises, or may exercise, the following powers or functions: —

(1) Connect the stockholders with the operation of the corporation.
(2) Determine the general business policy, including dividends.
(3) Appoint and remove officers.
(4) Fill vacancies in itself.

Under the first function comes the calling of stockholders' meetings and the making of such reports as may be required by law or by the corporation's constitution. Although in practice sadly modified, it is undoubtedly the sound doctrine that the prime function of directors is to administer the corporation's business in the interests of its owners, the shareholders.

The second head is most important. Here fall the powers of determining the organization of the business into departments, and the interrelation among those departments; of deciding the general business policy as to buying and selling, especially buying; and of declaring dividends. As stated in discussing stockholders' powers, the authority to declare dividends is usually vested in the board. Here, naturally enough, lies an opportunity for manipulation and abuse of power which is not seldom taken advantage of.

In all the foregoing statements, it must be remembered that we are dealing with powers which according to law may be exercised, but which often are not possessed in practice. In practice, it appears to be growing more and more common in our large corporations for the directors to turn most of the direction over to executive officers or special committees. Often the directors know little or nothing about the business, being chosen for their financial connections. Not infrequently, economy of operation suffers as a result.

Under the head of directors' personal liability, the following points may be made: —

(1) Directors are liable for injury to the corporation which is caused by their neglect or wrongdoing.
(2) Directors are liable for issuing stock as fully paid which in fact is not paid up.
(3) Directors are liable for declaring dividends out of capital.
(4) Directors are liable for disobedience of statutes.

So long, however, as the members of the board stay within the bounds of lawful action and commit no fraudulent or neglectful act, they incur no personal liability.

The Executive. — As we follow the sands of authority down the upper cup of the hourglass, — the one containing the organization for ownership and general administration, — we next come to the executive; and here we begin to see the transition to the organization for operating management, for the executive's position is characterized by its location between the corporation and the plant, — between the owners and the operation, between the entrepreneur's direction and the labor of managers, clerks, and workmen. But his services are such that he is best classed with the administrative group. The chief executive is elected by the stockholders or directors and generally is required to be a director, which means the ownership of some stock.

In the organization of the smaller corporations, the chief executive is the president. The president represents the board of directors, and, subject possibly to an executive committee of directors, he has general supervision of the business. Ordinarily his functions are to preside at the meetings of stockholders and directors, to sign important documents such as stock certificates, bonds, and contracts, and to make an annual report to the stockholders. He is generally made an *ex-officio* member of committees. His position is indicated by a provision in the by-laws of a leading corporation that "he shall do and perform such other duties as from time to time may be assigned to him by the Board of Directors."

The larger companies have an executive committee as the seat of chief executive power, and when this is the case the chairman of the executive committee may be said to be the chief executive. This committee is composed of directors; and it includes the president, who generally, though not always, is the chairman. During the intervals between directors' meetings, the executive committee exercises all the powers of the board; while between the committee's sessions those powers pass to its chairman. The reason for this development in corporate organization is the fact that the huge and complex affairs of the largest business units cannot be adequately comprehended by one mind. This is indicated in a by-law of the Steel Corporation which reads: "So far as practical each of the six elected members of the Executive Committee shall be a person having, or, having had, personal experience in the conduct of one or the other of the branches of manufacturing or mining, or of transportation in which the company is interested."

When the corporation is of considerable size, the work of administration is generally subdivided into departments, and a vice president is given supervision over each. There may be several vice presidents, one for legal affairs, one for operating affairs, one for financial affairs, and others. In very large companies, a special finance committee may exist.

Other executive officers are the secretary and the treasurer, each of whom does the work ordinarily handled by such officers.

All these executive officers are personally liable for damages caused by their neglect or wrongdoing in office, their duty, of course, being faithfully to serve the corporation. It is not always easy, however, to decide what constitutes wrongdoing or neglect. Two acts which one might not think of are generally made the basis of personal liability by statute: (1) failure to keep stock and transfer books open during business hours; (2) making loans to other officers or stockholders.

Organization for Operation and Management. — Authority passes on through the executive to those who manage the labor force and capital engaged in the technical processes of production. Indeed, nothing said in the preceding section should be construed to deny that, under the general direction of the board, the executive determines many important matters of operating policy and supervises the cooperation of the operating departments. The inverted cone containing the administrative organization has ownership as its base; the cone below is based on the cooperation of labor, land, and capital in production. In the one, the form of organization varies with the character of ownership; in the other, it is dependent upon the work that is being done. The chief problem of organization in the former field is that of securing concentration of administration: how can a large body of investors cooperate so as to function as an entrepreneur, is the question. In the latter field, which we are about to enter, the problem lies in securing first an efficient division of labor, and second an efficient management of the parts. In this field, organization consists in subdividing the management of a business into parts small enough for an individual to handle, and in so devising the subdivision that the parts can cooperate efficiently. Accordingly, we will first turn to the division of the operating plant into departments.

If the reader is a student of economics he will recall what is meant by "division of labor" and the stock statements of its advantages. Simply stated, the idea is that, by dividing great processes into stages or subprocesses, both labor and capital can be more economically employed. A place can be made for the full utilization of each special ability in some special subdivision. Time is not lost in passing from one process to another, nor is capital allowed to be idle the while: all the processes go on all the time. Moreover, greater skill, the skill of the specialist, is acquired. In fact, division of labor is specialization of function, and that is just what the aspect of organization which we now approach stands for. The division of plant operations into departments is adopted in order to adjust organization to the different kinds of work that exist in the nature of things, and the more complicated the work is, if on a large enough scale, the greater the number of departments that are naturally called for. Speaking of department divisions one writer says: —

> "The number of these will depend upon the number of processes into which the manufacture of a given product can be naturally or economically divided. There are two lines of division in every factory. In the first place, there is the separation into departments; and, in the second place, with the increasing volume of business there is the further division of each department into sections. It is this that gives to the factory its unique position as a type of organization. As an illustration of this general truth, we may refer to the manufacture of machine-made shoes. In order to be able to use machinery, the shoes must pass through many stages of manufacture for the reason that each machine must repeat its own work. Each step requires special machinery, special workmen, and special supervision, so that each department is made by the grouping of machinery

> and workmen around each definite process. This becomes fundamental to the economy of every manufacturing establishment. As a rule, the number of processes will be determined by the degree to which machinery can be used, and the size of each department will depend upon the amount of business which the factory is doing.... Everything is graded and subordinated from the work of the manager down to that of the least employee."[154]

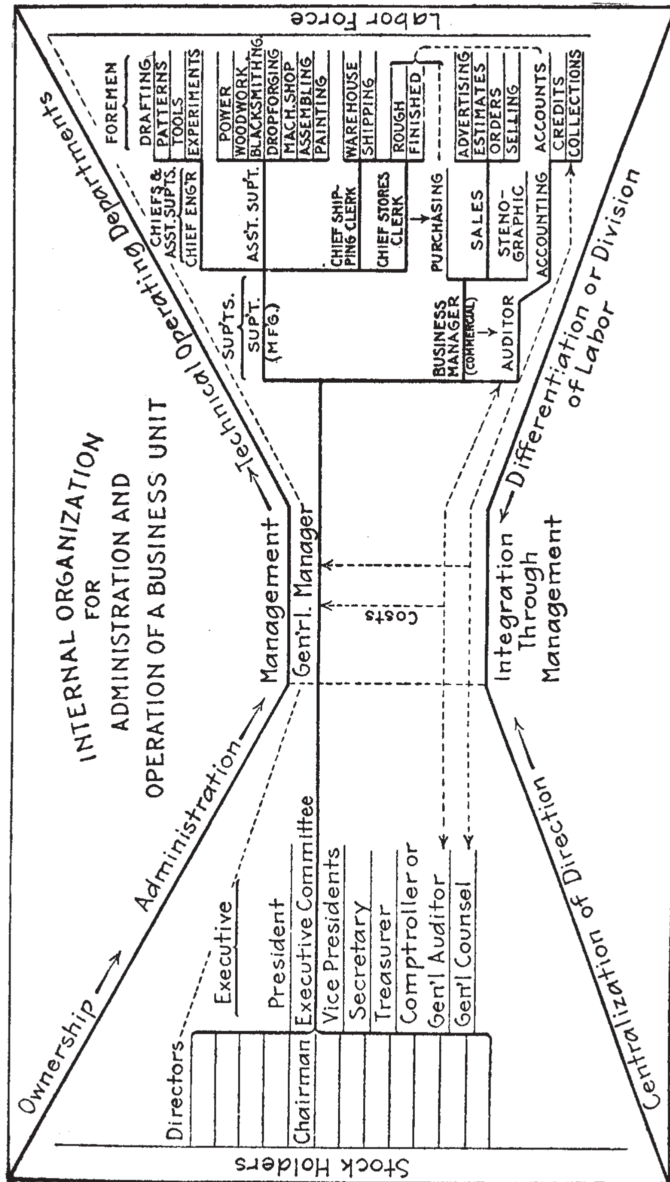
The object in all such arrangement of business organization into departments and their adjustment to the work to be done, is, of course, economy in operation. This is brought about in two ways: (a) by increasing motivation through increased definiteness of responsibility, (4) by decreasing friction through simplified processes.

When it was said above that operating departments are called for by the nature of things, it should not have been inferred that the formation of departments can be left to take care of itself, for so closely interwoven are the different processes that it is often a nice question to know where to divide them, or even whether they should be divided at all. Take the case of the accounting, credit, collection, and legal processes, for example. Again, consider some process which is subsidiary to two other processes; with which shall it be affiliated? This is the case with the purchasing department, and it is hard to say whether it belongs with the manufacturing or the commercial process. Or, some processes may concern the business as a whole in a general way, as do those of the accounting and legal departments; whereas others are specialized and may be pigeonholed along with related but distinct processes, as is the case with the tool room, the blacksmith shop, and the drafting room in a factory, or the train dispatching, care of locomotives, and care of roadbed of a railway. And the problem of keeping the departments in cooperation and harmonious adjustment is always present. In the field of biology, we study living organisms and seek to understand their differentiation as well as their integration and central nervous systems; in technical machine production, economists have long talked of "division of labor" and of management; but, in the field of business organization relatively little scientific attention has been given to differentiation or division of labor, and to integration or composition of labor. Meanwhile, business men have worked out various schemes appropriate to their particular businesses, and some general principles have begun to emerge. At least we can make a chart like that which accompanies, which will give a fair idea of a typical manufacturing organization.

Perhaps the first point noticed in the operating organization is the division of operation into two great groups of processes, the manufacturing (or mining or transportation, as the case may be) and the commercial or business groups. This is entirely logical, although overlapping makes it difficult to carry out at points; for the one suborganization embraces the technical physical processes of receiving and working up raw material aad storing and shipping the finished goods, while the other is concerned with the technical economic processes of receiving orders, selling, and collecting for finished goods. The latter is the business operating organization, standing between the physical processes of manufacture and the demands of consumers. Accordingly, a "superintendent" is put in charge of the one suborganization and a "business manager" is set over the other. It would be a more logical terminology, perhaps, to call one "superintendent of manufacturing" and the other "superintendent of business."

One difficulty lies in the location of the purchasing department, an important subdivision for buying all materials and supplies needed by the whole operating organization. Some business men have put it with the manufacturing suborganization on the ground that it starts manufacturing processes by supplying the raw materials, and that in purchasing the raw materials an intimate knowledge of the technical processes of manufacture is desirable; but it seems to be the better practice to put it with the commercial suborganization, inasmuch as it is concerned with the buying, and naturally cooperates with the work of estimating and

selling.



The accounting department also offers a peculiar problem. Formerly it was the practice to have the work of accounting parceled out among the several operating departments, each keeping its own record of receipts and disbursements; but the tendency now is to make a separate accounting department, and to place it farther toward the top of the operating organization. It is important to have the accounts of all processes brought together, and to keep them without bias in favor of any department. An independent auditor may well be associated with the executive.

To go into the details of the work of the various departments would take us too far out of the field of organization and into the subject of management. At any rate, the diagram is for the most part self-explanatory.[155]

One great problem in operating organization remains for discussion and that is the issue between "line" organization and "staff" organization,[156] and its particular manifestation in the conflict over the relative merits of "departmental" and "divisional" organization. Line organization is concerned with the transmission and perpetuation of authority. These ends it achieves by maintaining a series of officers one directly over the other, all exerting a similar kind of authority and differing only in the amount of power possessed. As in the fighting force of an army there are generals, colonels, captains, and lieutenants, so in a corporation's plant there may be a general manager, superintendents, foremen, and so on. The subordinate decides all questions in his small field, and when the question is too big it goes to his superior. Staff organization, on the other hand, stands for expertness in function, seeking to gain its ends by specialization and departmental subdivisions. Instead of a hierarchical series of all-embracing authorities, it establishes groups of parallel specialists, — specialists by function. Staff officers serve not any one locality or part, primarily, but the whole organization, — to the extent of their special functions. As a matter of fact, these two plans are complementary and not antagonistic; but the old idea of line organization has become so dominant that a great need at present is the introduction into business organization of more of the staff idea, that is, the introduction of experts who have specialized in buying, or selling, or managing employees, or supervising tools, etc., to render services to the whole organization in so far as their several functions are concerned.

One special phase of the line *vs.* staff problem is found in the issue between the "departmental" and the "divisional," or territorial-unit, plans of organization. This issue has been notably prominent in the railway business, but also arises in the organization of large manufacturing and mercantile corporations. Briefly, the issue is this: Shall all the operations of a division or territorial unit be put in charge of a single local manager, or shall the operations of separate departments be kept separate within the division, or territorial unit, and remain in charge of central departmental superintendents? Under the former, or divisional plan, a railway's operating organization would run somewhat like the first chart on page 279, in which it will be observed the division superintendent has entire charge of all operating departments within the area of his division.

Under the departmental system, however, the local officers report not to the local division manager but directly to the central department heads. Such organization is illustrated in the second chart.

The arguments *pro* and *con* are interesting, and it will be noticed that they all center around the ideas of breadth, elasticity, and local autonomy as opposed to those of specialization, uniformity, and centralization.

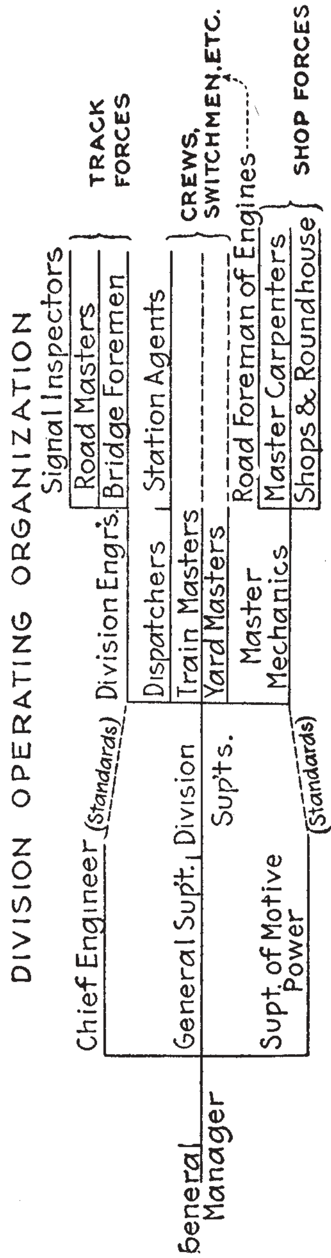
Advantages of Divisional Organization

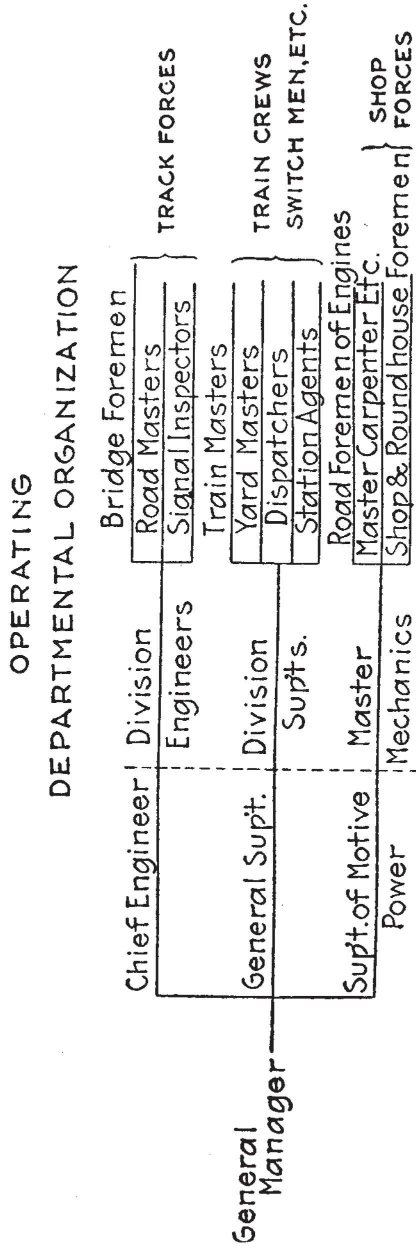
1. It is elastic in that each division is freer to adjust itself to local conditions.

2. It favors prompt action in that the officer in charge is local.

3. It brings effective responsibility, the superintendent being responsible for all operating conditions in his division as a unit.

4. It produces broadly trained officers.


DIVISION OPERATING ORGANIZATION
General Manager
Chief Engineer
(Standards)
Division Engrs.
Signal Inspectors
Road Masters
Bridge Foremen
TRACK FORCES
General Supt.
Division
Supt's.
Dispatchers
Station Agents
Train Masters
Yard Masters
CREWS, SWITCHMEN, ETC.
Master Mechanics
Road Foreman of Engines
Master Carpenters
Shops & Roundhouse
SHOP FORCES
Supt. of Motive Power
(Standards)


OPERATING
DEPARTMENTAL ORGANIZATION
General Manager
Chief Engineer
Division
Engineers
Bridge Foremen
Road Masters
Signal Inspectors
TRACK FORCES
General Supt.
Division
Supt's.
Train Masters
Yard Masters
Dispatchers
Station Agents
TRAIN CREWS
SWITCH MEN, ETC.
Supt. of Motive
Power
Master
Mechanics
Road Foremen of Engines
Master Carpenter Etc.
Shop & Roundhouse Foremen
SHOP
FORCES

Disadvantages of Divisional Organization

1. Harmony of operations as a whole, or system co-operation, is difficult on account of different superintendents and separate boards of local experts. Lack of uniformity.

2. Responsibility of local experts is divided: they are responsible partly to the superintendent and partly to the heads of their departments.

3. Limitations of the capacity of a non-specialized individual.

Advantages of Departmental Organization

1. Uniformity: System co-operation is achieved by having local experts report direct to a few department superintendents.

2. Specialization: The best experts in each department are in charge.

Disadvantages of Departmental Organization

1. Lack of harmony within the division.

2. Slowness in emergency. The division superintendent must report to the general manager for instructions, and local experts are responsible to different departmental heads.

3. Responsibility not so effective, because, (a) authority is more remote, (b) it is not so well informed on local conditions, and (c) there is difficulty in separating the departments in practice.

In terms of line and staff, it is clear that "divisional" organization subordinates the staff to the line, while "departmental" organization subordinates the line to the staff. In the one case the staff (departmental) lines are drawn together near the bottom and the division or plant superintendent reports to his managerial superiors after the fashion of a fighting military organization. In the other case, on the contrary, the staff lines run parallel nearly to the top of the operating organization.

In the railway practice of the United States, the divisional system is decidedly predominant. Of course, with a small road with only one division there is little choice between the rival systems.

If the foregoing pages suffice to give a rough sketch of the operating organization of a typical business unit, we may end the discussion with a word about the work of the general manager. Management is to be sharply distinguished from direction; for the manager is an employee receiving general instructions from the owners through the executive, whereas directive authority is exercised by the owners or their duly authorized and elected representatives. The line between the executive and the manager is not so clear: the functions of the two officials shade into one another and the chief difference is that the one has its principal affinities with the owning group and the corporate administration, while the other is aligned more closely with the operating group and the technical and business processes of the plant. The manager is a supervisor. He stands at the head of the departments of the business, and on him are focused the reports of the departmental superintendents. Within the limits of power set by his lack of authority to make decisions on broad questions of policy or matters fundamentally affecting the business, he manages or supervises the technical and commercial operation of the plant. Through him the operations of business are made to work in harmony, and the differentiated parts are integrated into a whole.

Under the supervision of the general manager comes a more or less complicated series of superintendents and foremen, shading finally, and almost imperceptibly, into the labor force.

The whole story of the reason for internal business organization may be compressed into outline form as follows: —

Object
Economy,
location
I. Administration
    Means:
        1. Concentration
        2. Effective direction
            Wide experience
            Combined judgment
            Direct transmission
II. Operation
    Means
        3. Increased motivation
            Responsibility
        4. Decreased friction
            Simplified process: specialization
            Harmonious cooperation
            Continuous operation

Chapter XVIII: Promotion as a Step in Organization[157]

If the foregoing chapter has conveyed any adequate idea of the structure and internal organization of a corporation, it is now time to study the life history of this form. How is it conceived? How is it formed and constructed? How is it endowed with the breath of financial life, — funds? How, finally, is it reorganized when overcome with disease or age? In the following chapters the object will be to set forth the chief stages in a typical corporate life history.

Definition and Illustrations. — First must come conception and a stage of incubation, for business organizations, whatever their source, do not spring up full grown. The public is sometimes inclined to be cynical toward the work of those who are concerned with the corporation-to-be, but that work is necessary if we are to have corporations. Some one, as will appear later, must see the chance for gain and father the organization which will utilize it, and that some one is the promoter. The promoter has been defined as a "persuasive optimist," because, like legitimate fathers in general, he must believe in the future of his offspring, and in addition he must be able to win others to his way of thinking. But, to speak more exactly, *promotion may be defined as the process of organizing and planning the finances of a business enterprise under the corporate form:* and a promoter is one who actively engages in this process. The business enterprise thus organized may be a simple corporation formed for the exploitation of some new invention or undeveloped natural resource; or it may be a corporate combination, the desirability of which lies in its opportunity either through economy or through monopoly to secure an increased margin between the expenses and the income of the business units concerned. In any case, promoters are the men or groups of men who see the opportunity, and also seize it. A special profit is the goal of the promoter; but, in so far as business men gain by producing goods that people want, the result is good for society. This, however, is a point that can be better appreciated after some description of the work of the promoter.

As already indicated, promotion may merely involve the incorporation of a group of individuals to work some newly discovered resources, or it may be concerned with the combination of several going concerns into a holding company or merger. Also, it may be legitimate or illegitimate. In the first place, then, it will be well to examine a case of the simple, legitimate promotion of a new enterprise. Once upon a time, a Pennsylvania lawyer's client had a dispute with his neighbor over a few paltry acres of coal land, and the lawyer in making his investigations observed that many farmers in the vicinity had like paltry acres. He was observant and optimistic, so he quietly widened the scope of his investigations. Unexploited coal lands lay all around him!

The next trait to be developed by this lawyer-promoter was persuasion. Like most promoters, he lacked the funds to carry out his dreams; and, therefore, having induced a prominent local man to vouch for him, he proceeded to procure options upon the various individual holdings. To be precise, he secured a six months'

option on some three thousand acres at $40 per acre, a feat which cost him three months' labor and $5000 in cash. Now, persuasion is generally most effective in business when accompanied by reason. The arguments which proved effective in this case were the following: "It is true," said the promoter and sometime lawyer, "that there is coal here, and I *may* be able to make a little on it; but you lack the technical knowledge to take this deal on yourselves; you haven't the capital, and I doubt if you will have the influence to enable you to raise it; you know from past experience that you could never agree among yourselves on a plan of organization; and it is clear that unless you give a third party a chance to develop your land it will never be worth more than its value for farming purposes. Here, let me give you twice what it is worth as agricultural land."

More persuasion follows when our promoter sets out to get the capital with which to finance his project. He hies to a Philadelphia banker and succeeds in interesting this moneyed man, who cautiously looks into the "proposition" and has experts examine the properties. As "things look good," no difficulty is experienced in inducing others to come in, and a corporation is formed.

The concern is capitalized at $600,000. Its stock is then sold at fifty cents on the dollar, with the result that the snug sum of $300,000 is realized in cash. Of this sum, $150,000 goes to the faithful farmers whose individualistic proclivities have been noted; $75,000 is retained as working capital with which to prosecute mining operations; while the remaining $75,000, minus $5000 expended in procuring options, goes to reward the optimism of the persuasive promoter.

The foregoing description has some foundation in actual happenings, but is not intended to be more than a general and somewhat idealized account of one great type of promotion. Next, we may pass to an actual case of legitimate combination promotion.

In 1898 the Rubber Goods Manufacturing Company was organized as a New Jersey corporation, and its promoter, Mr. Charles R. Flint, shortly thereafter gave a rather full account of his methods to the Industrial Commission.[158] Flint had made a thorough study of the rubber industry in connection with a preceding promotion, even going so far as to visit South America for the purpose of investigating sources of raw material, so that he knew his ground thoroughly and possessed the confidence of the trade. After concluding that great economies in operation could be effected by combining the various producers of rubber goods (other than boots and shoes), his first step was to form a syndicate which raised $3,000,000 cash with which to begin operations, making no other stipulation than that the money was to be invested by Flint in rubber-goods properties. This sum was deposited with a trust company; and it was agreed that the securities to be purchased with it would be placed in the same depository.

Simultaneously with the formation of this syndicate, or "pool," Flint organized the Rubber Goods Corporation with an authorized capitalization of $50,000,000, divided equally into common and preferred stock. The agreement was that for each $100 which they subscribed, the members of the syndicate should receive one share of preferred stock of $100 par value, together with one share of common stock of $100 par value less 10 per cent, making a total or $190 in securities. A limit was set upon the total amount of stock, however; for the issue of preferred stock was not to exceed the value of the tangible properties of the combined plants, and the common stock was also limited to a sum arrived at by capitalizing the last year's net earnings at 7 per cent. In any case, the syndicate members got securities representing tangible property equal in value to their cash advances, and, in addition, they received a 90-per-cent bonus in a more speculative common stock, the value of which was based on the earnings of the combining corporations.

As for the promoter, he was to buy the various plants to be combined as best he could, paying stock or cash for them, and, if in the end his expenses were less than the stock he retained, he would profit by the difference. He started with a certain maximum amount of common and preferred stock of his new corporation, and out of this he had to pay the stockholders of the old corporations which were to be combined. This

he did partly in his stock and partly in the cash advanced by the syndicate. For such cash he paid, as already noted, one hundred cents on the dollar in preferred stock and a bonus in common stock. What was left after these payments were made was his. By agreement, however, the amounts of stock to be issued were limited by tangible assets and net earnings, so that the size of his gains depended on his ability to buy the plants cheaply. As the subscription agreement provided, "Any shares... which shall remain in the hands of Charles R. Flint after delivery to the Central Trust Company of the shares referred to for distribution among the subscribers as hereinbefore provided, shall become and be the property of Charles R. Flint, for the payment of bankers' commissions, searching titles, payment of fees of brokers, and in consideration of his services in the premises."

One of the most difficult problems met by any promoter of a combination is to satisfy the owners of the constituent companies as to the valuations of their several plants. This was partly provided for by Mr. Flint in advance in his prospectus. There it was set forth that the tangible assets were to be appraised by three men, one a bank president, another an engineer, and a third the president of a rubber-goods plant. Such assets were to include real estate, buildings, machinery, raw materials, goods in process, finished goods, and accounts and bills receivable, — these last items to be guaranteed by the vendors and 15 per cent of their stock to be retained as collateral. Common stock was to be issued in payment for good will, patents, secret processes, trade marks, contracts, and other values; and its amount, as already stated, was to be determined by capitalizing the net earnings of the preceding year at 7 per cent. So valuable were these intangible elements in the industry that the common stock exceeded the preferred by over 100 per cent, the amounts of the two classes of stock as at first issued being $13,000,000 and $6,000,000 respectively.

We may conclude that in this case the promoter's profit depended upon his ability to convince investors of the value of a common stock based upon the earning capacity of various intangible items and upon the increased economy of combination; and that he took considerable risks, while at the same time his chances for gain were great.

In the earlier promotion, mentioned in the course of the preceding description, Flint made no definite agreement as to securities to be received by those who advanced funds, and he himself received a definite amount for his services, namely, 5 per cent of the capital stock of the new corporation, — no more and no less. Here, then, the situation as to risk was reversed, while the promoter's chances for gain were limited.

We may now briefly examine a classical case of fraudulent or illegitimate promotion,[159] that of the Asphalt Company of America.[160] This company was organized in 1899 to take over the most important asphalt and paving companies in the United States, its prospectus stating that 95 per cent of the asphalt business and 75 per cent of the paving work would be controlled. The promoters promised 10 per cent on the par value of their stock, with what plausibility, will appear in a moment.

The plan of finance involved two classes of securities. First, $30,000,000 of 5 per cent collateral-trust gold certificates were issued, that is, bonds paying 5 per cent interest and secured by collateral. These bonds were issued to buy up the stocks of the various companies to be combined, and the stocks thus secured were themselves placed in trust as collateral for the bonds. Second, 600,000 fifty-dollar shares of stock were issued. No payment was required on the stock, but it was subject to call, and within a short time as much as $10 a share was called. This brought in $6,000,000 on the stock. It was with this $6,000,000 as a working capital that the company sought to make good its promise to pay 10 per cent on the $30,000,000 par value of the stock!

The significance of the stock does not concern the point here, and may be passed over with a word. Aside from providing a working capital, it was used by the promoters as an inexpensive means of control over the company in this way: A majority of the stock was issued to two "dummies," who then turned it over

to the promoters. This deal cost the promoters very little, for the simple reason that (1) but $10 a share was called, and (2) even this small payment was met by them from proceeds of sales of the minority holdings to the public.

The profit, however, came in selling the bonds for more than had been paid for the collateral on which they were issued. Altogether, thirteen asphalt and paving companies were taken into the combination, which was completed about July 1, 1899. In the month of March, preceding, the promoters owned stock in but six of these companies; but between that time and July they obtained stocks in the other companies and increased their holdings generally, so that at the time of combination they held the majority of the shares of all the companies. What their object was will appear from the following facts. The United Asphalt Company, one of the constituent concerns, was organized as a holding company and bought up the stocks of several properties. Four of the American company's promoters held all but a very few shares of the United Asphalt Company, having paid $618,000 in round numbers for their holding, and they sold these shares to the American for $3,670,000 in bonds. This meant a profit of over $2,441,000. Likewise, in the case of the Warren-Sharf Asphalt & Paving Company, three of the promoters bought 9493 out of a total of 9500 shares, paying therefore $1,500,000; and then disposed of them to their own project, the American, for $2,278,000. A similar course was followed in dealing with the other constituent companies.

The whole affair was rotten with fraud. Extravagant dividends were promised; bonds were exchanged for stocks without even an appraisal of the properties; the promoters, having planned the reorganization of a corporate combination, proceeded to buy up the stock of the constituent companies with the deliberate intention of disposing of their holdings at a profit to the corporation which they were promoting. No disclosure of the facts was made to the American Asphalt Company. Later, when suit was brought against them, they bought up all the bonds and so left no interests opposed to them.

Since 1899 the asphalt interests have gone through at least two reorganizations.

Steps and Problems in Promotion. — The illustrations given in the foregoing pages will enable the reader, on the basis of authentic facts, to form some independent opinion of the nature of the promoter's work; but it may not be amiss to add a concise statement of the essential steps found in the typical legitimate promotion: —

(1) First, of course, comes the idea, and with it the preliminary investigation into the feasibility of the scheme.

(2) Then, options must usually be secured on the properties involved, in order to hold them pending progress and to serve as a basis of further negotiations.

(3) Next, funds must be raised, in the shape of cash or credit or both, by interesting some capitalist, or by forming a syndicate to provide the financial support required to carry out the organization.

(4) Meanwhile, a suitable organization must have been devised, embracing legal form and capitalization. The proper State for a domicile must be chosen, and the main details of the certificate of incorporation be worked out.

(5) The securities of the companies to be combined, or the properties to be exploited, must be purchased by the capitalist or syndicate through the promoter.

(6) Finally the securities of the new corporation must be exchanged for such stocks and properties, together with some cash for working capital.

All these things the promoter must ordinarily supervise. And all the time he must maintain a persuasive aspect of optimism. Three of the preceding points may be singled out for a little amplification. For one thing,

it *is* to be recognized that the promoter must devote considerable ability and thought to developing his project. As a street-railway promoter says: "I had to have a knowledge of the exact relations the operating expenses of the railway would bear to the total income, the operating cost per mile, the problems of competition, the methods of economical operation, the probable increase of traffic, and so on. I had to be able to analyze reports of the corporations and their bookkeeping, and from all my data arrive at a general proposition for promotion. Beyond such work as this a professional promoter must call experts to his assistance." As we have noted, the promoter of the Rubber Goods Company had made a study of the entire industry, not excepting the sources of raw materials and the transportation problem. Of course, one need not always go to such lengths, and much special expert knowledge will be hired, but even then the promoter, directly or indirectly, must pass upon it.

Again the problem of securing capital could well occupy a separate chapter, or even a volume. In so far as possible, the wise promoter will make a start on his own or his friends' capital, for the further his project is developed, the stronger his position is in bargaining with outside interests or appealing to the public. Also, it is well to secure considerable funds from the investors of the community in which the project is located, as this means a stronger backing and is a good "talking card" in dealing with distant interests. A recent writer on corporation finance makes the following interesting generalization with more immediate reference to small corporations: —

> "It is usually far better both for himself and for the corporation that the promoter sell his securities to a large number of small buyers rather than to a small number of large buyers. In the former case the stockholders are scattered and their holdings are too small to induce them to take any active interest in the business. Consequently the promoter, even if he fails to retain a majority of the voting stock, is left in absolute control. In the second case, the promoter is watched and perhaps hampered by the large stockholders; even if he holds a majority of the voting stock he will probably not desire to arouse their objections.... Such an arrangement the promoter who has faith in his own ability and ideas does not desire."[161]

The same writer adds that a widespread stockholding is desirable for the corporation, inasmuch as it means a wider following of friends and makes it easier to dispose of additional securities.

The importance of providing adequate working capital is a point to be stressed here. This is the pit into which many a newly promoted corporation has fallen, for, no matter how skillfully designed, unless enough cash is on hand to pay current operating expenses, insolvency at once becomes imminent. Indeed, it is more than likely that many combinations are brought about largely to enable the operations to be carried on with sufficient working capital and avoid the strain of constantly borrowing funds on short-term notes. One way of caring for this matter is to retain "treasury stock," — that is, stock issued, but held in the corporation's treasury, — which may be sold to provide working funds. In any case, in a legitimate promotion, enough securities should be issued to provide working capital as well as pay for properties and recompense promoters.

A further aspect of the problem of raising capital is the form of capitalization. Here come the questions of total capitalization, the various kinds of securities, and their relative proportions. Of course, the general object is first to secure as favorable terms as possible in purchasing the securities or properties needed for the project, and secondly, to market such kinds and amounts of securities as will bring in the largest returns in cash. The details of this subject fall in the field of corporation finance; but a few words are essential to an understanding of the promoter's work in organizing the business unit, for it involves a step in assembling the capital, land, and labor which, along with the promoter's own direction, are the elements of all business

organization. But the barest outlines of this complicated subject will be mentioned here.

Two general methods may be followed in determining the total amount of securities to be issued, an analytical method and a synthetical method. On the one hand, the promoter may analyze his properties into their various tangible and intangible elements, and make his capitalization equal to the sum of their values as determined by appraisal; on the other hand, he may take the net earnings of the business, actual or estimated, and capitalize them at the prevailing interest rate, course, the promoter may also combine these two methods, using each for an appropriate class of property, as was done in the case of the Rubber Goods Company. This last is generally the fairest way, and is less likely to lead to false results than either of the first two methods taken alone. In businesses in which patents, trade marks, secret processes, and good will play a large part, it is but fair that net earnings, if normal and *bona fide,* should be largely relied upon. When net earnings are used, the average earnings for a period of years should be taken, in order to avoid giving undue weight to abnormal fluctuations. Needless to say, these observations assume that the business is not a "public utility," and that the promoter is seeking only a legitimate profit: for in public-utility businesses, rates are subject to regulation, and neither the law nor justice will allow unregulated capitalization of earnings which are the result of rates; and, when the promoter deliberately seeks to overcapitalize and place false values, he follows no rule but that of fraud. The question then remains as to how the total capitalization shall be divided among the different classes of securities. Some mortgage bonds will ordinarily be issued by the promoter, inasmuch as investors in some cases will insist on a mortgage security for their loans. Moreover, funds can ordinarily be obtained cheapest by using bonds up to a certain extent, depending upon the amount and the life of such tangible assets as real estate, buildings, and machinery, or securities representing such assets. A conservative promoter might decide to issue bonds up to say 75 per cent of the value of assets of this class. In practice, however, a large bonded debt may lead investors to fear for the solvency of the corporation, so that the amount of bonds is rarely as large as this, unless it be in the railway business. Stocks fall into two classes, preferred and common, the former generally having a prior claim to dividends over the latter. Sometimes, when it is feared that it will be impossible to pay the interest on bonds, — which, of course, cannot be defaulted, — preferred stock is issued in place of them, and most of the promotors of large industrial corporations have used preferred stock in place of bonds to a greater or less extent. In such cases it has usually been issued to the full amount of the appraised value of the tangible property. The logical arrangement, however, is to divide tangible property into two classes, and issue bonds on the part that is most essential to the business and stable in value, with preferred stock covering the remainder.

The common stock is most abused. It is used to cover the more speculative assets — the things hoped for, but not seen. Logically the promoter will figure the gross earnings he expects during the average year, deduct the operating expenses and interest on the tangible assets covered by bonds or preferred stock, and capitalize the balance at some rate per cent, chosen according to his judgment as to the certainty of the earnings. Common stock is issued to cover intangible and uncertain assets including the gains and economies hoped for from combination. In practice the promoter seeks to sell as much as he can, as his profits commonly depend on such sales. Human psychology is such, too, that a larger total return can be secured by selling a large number of shares at a low price than a smaller number at a proportionally higher price. Moreover, it is usual to give large bonuses of common stock with bonds or preferred stock in order to "lubricate" the deal and to give investors a chance to share in speculative gains. Where likelihood of a future increase in earnings is strong it may seem desirable to issue a greater amount of stock in order to take up the expected slack and conceal what might seem to be an unreasonable increase in the rate of dividends. All these considerations modify the more conservative basis of capitalization, and lead to "stock watering."

Finally, among these special problems of promotion, the choice of the State of incorporation deserves

some discussion. It is important not alone as a practical issue in promotion, but also as throwing light on a serious evil in the corporation law of the United States. Some of the chief points of difference between the laws of the different States concern taxes and fees, publicity, Powers, liability, and payment for stock. Ordinarily the small corporation will do well to incorporate at home, but great advantages and disadvantages must be weighed by the promoter of a large concern. Thus, the organization expenses of a $10,000,000 corporation run from $43 in South Dakota to $5015 in New York; and while there is no annual franchise tax in the former State, a New York corporation of the same size must pay one of $15,000. The States differ greatly in the amount of information required concerning the affairs of the corporation. The reports that must be made by corporations organized under the laws of Massachusetts, for example, are thought to constitute a disadvantage to incorporation in that State. As to powers granted, there is wide and important diversity. First comes the right to hold stock in other corporations mentioned in a previous chapter. Another important point to the promoter is the right to issue stock for other than cash consideration. Some States prohibit the issuance of stock for services, and different restrictions are placed upon the exchange of stock for property. Again, some States, like Texas, limit the number of purposes for which a corporation may be formed; others restrict the right to hold lands, especially in the case of foreign corporations; and still others prohibit foreign corporations from exercising certain franchise rights. Two States, California and Minnesota, provide for a double stockholders' liability, — that is, liability for unpaid installments on their stock, plus an amount equal to its par value; and New York and a few other States make stockholders liable for unpaid wages to employees. Finally, there is considerable difference as to requirements that stock shall be subscribed and paid for before business is begun. And all this is to say nothing of the certainty of the laws, and a host of minor matters such as the place of holding meetings and the residence of directors.[162] Truly our laws are so variegated that the promoter's problem in choosing a home for his corporation is very complex.

It has been concluded that the attention of promoters may practically be confined to twelve jurisdictions: Maine, Massachusetts, Connecticut, New York, New Jersey, Delaware, District of Columbia, Virginia, West Virginia, South Dakota, Nevada, and Porto Rico; and Arizona might be added. For a large corporation, the choice until lately generally lay among New Jersey, New York, Delaware, and West Virginia, with the balance of advantage favoring the first-named State; but regulatory measures recently passed by the New Jersey legislature have decreased the attractiveness of that mother of "trusts."

The Necessity for the Promoter's Services; an Entrepreneur.— Every business organization goes through a promotion stage of more or less distinctness. By the same token, some one must always act as promoter. But the promoter is not always a specialized individual, and promotion need not exist as a formally recognized stage. Moreover, much criticism has been leveled at promotion as at present conducted. What are the facts? Simply these. In the case of a new enterprise, two separate potentialities exist, one in the shape of some natural resource or invention, and the other in the capital of the "investing public"; the problem is how to connect the two. The promoter is the one who makes such connections. The necessity for his services is indicated in the arguments of the lawyer to the coal landowners, mentioned in a preceding illustration: even when the owners realize their opportunity, they are unable to agree among themselves or to get in touch with capital. Or take the case of a combination of old enterprises. Say that excessive competition exists with rebates, discounts, and prices falling below cost, — surely here the prospective members will get together. But experience shows the contrary. They can rarely reach an agreement on the prices to be paid for their several properties. They need some third party who will be unbiased and informed concerning the general situation. Indeed, it may be necessary to keep the prices paid for various plants a secret. In the testimony taken by the New York Legislative Commission for the Investigation of the Trusts some years ago the following colloquy with a successful promoter is recorded: —

> "*Q*. How can you explain to the committee the fact that combinations of legitimate business enterprises have to be made the subject of promoters' agreements....
>
> "*A*. For the same reason that men of high intelligence are needed to make treaties between the nations, particularly during periods of war....
>
> "*Q*. You mean that it is a delicate diplomatic situation that has to be met?
>
> "*A*. It is one that requires the very highest intelligence, and, as a rule, neutral parties — parties not interested, men of the intelligence and reputations to inspire unlimited confidence on the part of manufacturers.... The advantage of a neutral party, of a banker, is that he is in a position unlike another in the same trade, to get at the facts... to reduce the pretensions — the exaggerated pretensions of the manufacturers, and bring their minds together upon a reasonable and proper basis."

But, as already stated, promotions, even of the larger sort, can be effected without any special promoter. Thus, in the organization of the International Paper Company, there was no separate bill for promoter's services. A representative committee examined and appraised each plant which it was intended to purchase; and, after some trouble, each company finally accepted the award, and received payment in the securities of the new corporation. The committee made no charge for its services.

The economist may well distinguish two grades of promoters. One includes those who take over the job of promotion as the employees of certain property owners who want their properties combined or developed in some other way, and in this case the promoter receives a stipulated sum as his reward. Such promoters are to be classed as laborers. To the extent, however, that their compensation consists in securities whose value partly depends on their services, they run risks akin to those of the entrepreneur. Promoters of the other class work independently. Their services may be requested; but they are not "hired," and they assemble their propositions independently. They are given free rein, and their reward is contingent upon the success of their organizing ability. Clearly the work of such a promoter is largely that of an entrepreneur. In small and simple cases, the ordinary operating entrepreneur may also do the promoting. The promoter of the second class independently assembles land, labor, and capital, and organizes them into a going concern for producing or acquiring wealth. Not infrequently he maintains connection with his corporation as a director. He is the responsible head of the embryo corporation and runs the risk of its beginning as a failure, in which case his profits may become *nil* or turn to loss. He is vitally connected with the direction of business organization, giving it the form and equipping it with the substance which for good or ill partly determine its whole course. If he severs his connection with the business, he turns it over to an operating entrepreneur who continues to promote the progress of the organization.

Needless to say, in so far as the promoter opens up new resources and brings about economies in production he is an extremely useful person. On the whole he is most likely to succeed when he is promoting organizations which will do just these things, and most promotion is accordingly worthy of the high rewards it often receives. No one will maintain, however, that all promotion is productive, and, no doubt, some promoters gain a living by very shady devices. For that matter, are there not usurious loan sharks among the capitalists, and lazy, dishonest workmen among laborers?

Classes of Predatory Promotion.[163] —All the classes of fraudulent promotion ultimately involve the sale of property to stockholders at an excessive or fictitious price, and all are possible only because of secrecy. In such cases, hopes are held out as to opportunities of exploiting resources or inventions, or of the economies of combination, which cannot be realized, and the net result may be a transfer of funds from the pockets of investors to those of the promoter and his allies. More immediately, two general classes of fraud

may exist: in one the promoter acts as a principal in dealing with his corporation; in the other he acts as the agent or ally of a third party. The acts of the promoters of the asphalt company illustrate the first class of fraud. Also, an individual named Spooner and others once secured a right of purchase on a mining option for $20,000, whereupon they organized the Pittsburgh Mining Company, and induced subscribers to its stock to pay $100,000 with the understanding that the property had cost $90,000. Then the option was bought, and the $70,000 difference between its cost and the price at which it was turned over to the corporation was converted to the use of Spooner and his pals. It is not difficult to understand why the court held that the company had good cause for action. This case was sheer burglary.

The case of *Gluckstein* v. *Barnes*[164] shows more finesse. Here a company whose affairs were being wound up was in such straits that it was believed that its assets would not cover its bonds (debentures), and these bonds were consequently selling cheap. Accordingly, a group of capitalists bought up the bonds, and at the same time purchased the business from the receiver for about $700,000, thus putting themselves in a dual capacity as creditors and owners. As owners of the bonds, the purchase price of the business would stand to their own credit. Indeed, they made some $100,000 on the bonds. Then, as planned all along, they promoted a corporation, and sold to it the business for about $900,000, stating publicly that they had paid $700,000 for it, but saying nothing about their ownership of the bonds. Thus, they virtually stated that their profit would be $200,000, whereas it was really $300,000. It was held that the corporation could recover the $100,000 profit.

In the other class of cases, the promoter is in collusion with some third party who has some property or service to dispose of. A owns a patent right on a mortising machine and arranges with B to help him promote a company for purchasing the patent, agreeing to pay him a commission. Then the C Speciality Machine Works is organized with B as a director, and that disinterested individual advises the purchase of A's machinery, secretly pocketing his commission. All such cases are similar in principle, there being differences in the methods of sharing the loot.

Without carrying the subject any closer *ad nauseam,* it is apparent that such promotions are predatory and not conducive to production in any economic or legal sense. They constitute one of the most serious evils under the head of the corporation problem, and we will return to them later on. One of the first steps which should be taken along the line of publicity is to follow England's example in providing statutory means for securing publicity of promotion.

All this suggests the common-law rules as to the promoter's liability to the corporation.

Relation of the Promoter to the Corporation. — No discussion of promotion would be complete without a statement of the relation that exists between the promoter and his corporation. The underlying idea of this relation is that it is one of trust; and the promoter is supposed to safeguard the interests of the corporation as well as his own. "Their relation to the proposed corporation, when formed, is a fiduciary relation, or a relation of trust and confidence."[165]

It follows, then, that while a special profit is regarded by the law as being just and legal, it must be made in a manner that is consistent with a relation of trust. The law is well settled that a promoter must not take advantage of his position to make a secret profit. An old but leading decision is that handed down in the English case of *Erlanger* v. *New Sombrero Phosphate Company* (aff'd, 3 App. Cases, 1216 (1878)). Erlanger and others, having secured a phosphate island for £55,000, formed a company to purchase their property. They named five directors, of whom two were out of the country, two were public officials who knew nothing of the business and made no investigations, and one was Erlanger's secretary. They were virtually "dummies." However that may be, they voted to buy the island for £80,000 in cash and £30,000 in stock, and the promoters all but got away with their ill-gotten gains. Their greed was their undoing, for when they

realized on their stock, the stockholders came into power and brought suit. The sale was ordered canceled and the price returned. Said the court:

> "... he is bound to take care that he sells it through the medium of a board of directors who can and do exercise an independent judgment on the transaction, ami who are not left under the belief that the property belongs not to the promoters but to some other person." Independent directors should have been named and material facts should have been disclosed to them.
>
> When he does not actually own the property sold, any special profit made by the promoter is illegal unless made with the consent of an independent and informed board of directors, or with disclosure of conditions to the stockholders before their purchase. If a promoter says that he owns property when the truth is that he merely holds options upon it, or that he is selling for cost when the truth is that he is making a profit, he is misrepresenting essential facts and renders himself liable for the profits received on the transaction. But if the consent of a *bona fide* board of directors is obtained, or the facts are disclosed to the stockholders before purchase, the promoter may make any profit he can. He is then only subject to suit by the creditors of his corporation. The courts have held that "any men... owners of any kind of property... may form a partnership or association with others and sell the property to the association at any price which may be agreed upon between them, no matter what it originally cost, provided there be no fraudulent misrepresentations made by vendors to their associates."[166]

When, however, the promoter actually does own the properties to be exploited or combined, and owned them prior to the promotion, any profit appears to be lawful, barring positive misrepresentation.[167] In the great majority of cases, however, the promoter merely has an option or acts as an agent of the vendors, and such possession establishes that relation of trust which is the underlying idea of the relation between promoter and promoted.

Chapter XIX: Underwriting as a Step in Organization

After the promoter has discovered his opportunity, one of the great difficulties that confront him is that of getting the funds with which to equip his projected corporation. This difficulty has given rise to a distinct function in the organization of corporations called "underwriting."

Definition and Illustrations. — To underwrite is to insure, and, as the term is used in the financial world, *underwriting may be defined as insuring the sale of a corporation's securities in advance of a public offering*. At law, it appears, the term is used in a narrower sense, and indicates an agreement to take such part of a specified number of securities as may not be subscribed for by the public before a specified date. According to the legal definition, the underwriter binds himself to take stocks or bonds which are not bought by the public, and the corporation can put his name on the stock record book and hold him as a shareholder to the extent of such unsold securities. As we shall see, however, there are other kinds of agreements, under which the virtual sale of a corporation's securities may be guaranteed, and, following economic usage, they will be included as underwriting.

Suppose that a promoter has secured his options and laid his plans for organizing a corporation to take over the properties concerned. Say that he needs $5,000,000 in cash — $4,000,000 for purchasing plants, etc., and $1,000,000 for working capital: how shall he get the funds? The first plan that occurs to one is, let him sell the bonds of the new corporation. But a moment's consideration shows one that this would probably be very unsatisfactory if not impracticable. The success of the project is still in doubt, and securities based upon it, if they would sell at all, would not yield immediate, cheap, or certain returns. There would be delay, and a large discount from the face value would have to be made. Some one with financial power is needed to stand behind the securities and vouch for them, or even to insure their sale. It is here that the underwriter comes in. The promoter seeks to get a capitalist or group of capitalists (1) to certify his securities and (2) to guarantee a market for them.

He goes to a firm of private bankers, say J. P. Morgan & Company, and, having first laid before them the facts of the case — the expenses to be met and the probable earning capacity of the new concern — makes the following proposition. The bankers are to form a syndicate to raise the cash; in return for the $5,000,000 in cash, or its equivalent, he proposes to turn over to the syndicate $10,000,000 in the stock of the new company, half in preferred and half in common; the banker is to receive $5000 in common stock as a special commission, and in addition may share in the chance to make a profit on the stock offered for funds by joining in the syndicate himself. If in doubt, the banker makes a thorough investigation, going as far as to have appraisers estimate the value of the properties, accountants certify as to the state of the business, and lawyers look into titles and the legality of the organization. When the banker has satisfied himself as to the soundness of the venture, he may accept the promoter's proposition, in which case he proceeds to form a

"syndicate."

A syndicate is a temporary association of capitalists for the purpose of financing an enterprise which needs large funds. The chief reason why financial houses generally enter into syndicates for underwriting purposes is that their financial standing would be endangered if they were to embark all their funds in one or two enterprises, as they would have to do if they took in no associates. The danger might come about in two ways: either so large a part of their funds would have to be tied up in underwriting that they might be unable successfully to meet a general panic, or so much might be involved in a single industry that a special depression in it would cause serious loss. Furthermore, a syndicate has an advantage from the fact that when a number of houses in different parts of the world are associated, a much wider market is opened to the securities underwritten. In order to form a syndicate, the banker lays the "proposition" before various trusted customers, either individuals or companies, by circulating a "syndicate agreement" or "subscription agreement." This is a document in which it is provided that, for the purpose indicated, the parties whose signatures are attached do agree to take the number of shares of stock or bonds set down after their respective names, providing the whole amount be subscribed. One form of agreement runs like this:[168] —

> We the undersigned in consideration of our mutual promises and agreements, and for other good and valuable considerations, do hereby agree with (the A. B. C. Banking Company) and with each other, to subscribe and pay to the (X. Y. Z. Trust Company) on the demand of the banking company, the amount set opposite our respective names, for the purpose of the syndicate hereby organized, to promote the consolidation of certain plants and interests now engaged in the manufacture in the United States of (certain goods).
>
> John Doe (the promoter) shall have authority to invest the money subscribed hereunder in the stocks, securities, or assets of any or more of such manufacturing properties, subject only to the approval of the (A. B. C. Banking Company), and all interests so purchased shall be deposited with the (X. Y. Z. Trust Company) to be held by it subject to the orders of John Doe (the promoter) for the purposes of this agreement.

Other forms are more in the nature of an ultimatum issued by the banker as lord of the situation and dictator of the terms upon which his subjects must sign the agreement, — and which his victims must pay for the funds thus raised. Thus, in the syndicate agreement between J. P. Morgan & Company and the subscribers to the stock of the United States Steel Corporation,[169] it is recited that whereas the corporation has been formed and J. P. Morgan & Company are authorized to issue stock to such persons as they may see fit, it is agreed that each subscriber shall be liable for the total amount of his subscription and shall pay when called upon.

Syndicate members are rarely liable jointly, and the agreement generally provides that they shall not be held as partners: they share profits and losses on the basis of their individual subscriptions.

But, to return to the case under discussion, the banker circulates the agreement among his customers, and, if it appeals to them, they "come in," and the $5,000,000 cash is placed at the disposal of the banker as syndicate manager, to be invested by the promoter subject to the banker's consent.

This, is a case of underwriting, and the syndicate described is an underwriting syndicate. Evidently the essential feature of the operation is that a group of capitalists, under the management of a banking house, agree to take a certain amount of securities at a certain price before their exchange value is determined by putting them on the market. The promoter virtually goes to the financial house and has his securities discounted. The underwriters act as financial middlemen between corporation and public.

Classes of Underwriting Agreements. — Now, there are various kinds of underwriting agreements, for

they differ (1) as to the kind of underwriter, (2) as to the stage of development of the corporation, and (3) as to the method of guaranteeing the sale and of paying the underwriter. Taking these points of difference up in the order named, one first observes (1) that any responsible person or group of persons may be the underwriter. Ordinarily, however, it will require men of strong financial standing, so that underwriting will generally be done by banking houses, trust companies, or syndicates of capitalists formed for the purpose. Some doubt, however, exists as to the right of trust companies to engage in such business.

(2) The illustrations given so far deal with the underwriting of the securities of new corporations during the period of promotion, and the underwriting agreement involves the promoter. It may be either before the properties have been purchased, in which case the funds are to be invested by the promoter for that purpose; or it may be after the promotion proper is effected, the object being to enable the promoter to start his corporation off well and to realize on his stock to best advantage. But, in other cases, underwriting is resorted to by well-established companies. When the money market is very sensitive and the importance of the issue great, bankers may be asked to take charge of the floating of securities, and so to remove from the company all risk of loss and damaged prestige. For example, in 1902 the Pennsylvania Railway needed $90,000,000, and desired to issue $75,000,000 stock at 120 cents on the dollar. Their bankers formed a syndicate by corresponding with allied interests all over the world, and raised the desired sum without any disturbance of the railway company's credit or of the money market. This achievement was deemed worth the percentage paid the bankers. Frequently, bond issues are handled in the same way.

(3) Another point of difference lies in the methods that the underwriters follow in affording their service of insurance and in taking their pay. From this standpoint, there are two general classes of underwriting: (a) guarantee of sale to third parties, and (b) purchase.

(a) The underwriters may guarantee the sale of securities which are offered by the corporation directly to the public, with or without making themselves liable to take the same. In this case, the stocks or bonds will be marketed by the corporation or its agent; and, though the underwriter might possibly act as the sales agent himself, that would be outside his essential function as underwriter. The point is that the corporation offers its securities to the public at a fixed price, and the underwriter agrees to take at a somewhat lower price any remaining unsold after a given time. Or the underwriter may simply advance funds to the promoter or corporation pending the sale of the securities to the public. Frequently the underwriter's guarantee is at once made the basis of a discount, secured from some trust company. The plan of sale direct to the public, however, although the original one, is now not so commonly used, for corporations are not so well fitted to market their securities as are the financial houses.

(b) The second class, according to the way in which the underwriters' services are furnished, embraces those cases in which securities are not sold by the corporation directly to the public, but to the underwriter, who purchases them and undertakes to supply the desired funds at such times and in such amounts as may be agreed upon. This plan is especially desirable for the corporation when the market is "soft" or panicky, or when a very large amount of securities is to be placed gradually and with skill. Within this subclass, there are several varieties, (1) The most common arrangement is for the underwriting syndicate to deal directly with the corporation. In that case, the entire block of stocks or bonds will be purchased by a group of capitalists and be sold by them to investors, some financial house acting as syndicate manager. (2) Another not uncommon arrangement exists when some financial house, acting as sole underwriter, buys the securities and then calls upon other houses and capitalists to take part of the issue at prices lower than those quoted to the public. (3) A third method of procedure, and one which has grown in popularity, is to distribute the purchased securities among the members of a syndicate who act as subunderwriters in disposing of their holdings to the public. This practice has grown out of the first arrangement, the object being to utilize fully the selling

capacity of the individual firms. Though there is no central manager in this case, there are general stipulations as to the minimum price and condition of sale to the public.

Under these various indirect, or underwriter's, purchase methods, the underwriter may be forced to hold the securities for considerable periods of time before he can dispose of them at a profit, a situation which causes that financial malady known as "undigested securities." At such times financial houses pray for the pepsin of boom times.

A capital illustration of this situation occurred in 1907, preceding the crisis of that year. In February, 1906, a powerful banking syndicate composed of Kidder, Peabody & Company of Boston, J. P. Morgan & Company of New York, Kuhn, Loeb & Company of New York, and Baring Brothers & Company of London, took over the American Telephone & Telegraph Company's issue of convertible bonds[170] having a total par value of $100,000,000. The price paid was 94?, that is, the syndicate guaranteed a payment of $94,500,000 to the telephone company, hoping to sell the bonds to the public for more than that sum, and to profit by the difference; but it was found impossible to market them at a profit. Hardly a bond had been sold in January, 1907. Meanwhile, the bankers had paid over $30,000,000 of the purchase price, with other installments falling due; and the company was in urgent need of funds. In this quandary, the bankers agreed to take an issue of $25,000,000 short-term notes (three-year, 5 per cent), with the understanding that the price they had paid for the bonds should be reduced to 91. The notes they underwrote at 95, and soon sold to investors at 97, making 2 per cent on the deal. Here, then, such giant banking houses as those mentioned found themselves embarrassed by the state of the bond market, and a strong company like the American Telephone & Telegraph had to pay what, after all concessions had been made, amounted to 11 per cent for its funds.

Corresponding to the foregoing ways in which the underwriter may furnish funds and handle the securities, there are different methods of paying the underwriter. When he simply guarantees the sale to the public, a concession of a certain per cent on the par value of the securities underwritten is perhaps the usual way; or the underwriter may be rewarded with a bonus of so many shares of stock. When, however, he takes the securities himself, a price is agreed upon which he believes is below what they can be sold for, and what he gets above that price is his gain. Here, his compensation is a contingent one. In either case, both the price to be paid by the underwriter and the price at which the securities will be offered to the public may be agreed upon. This, none the less, makes his reward contingent; for if he sells no securities he makes nothing, while the more he sells the larger his gain. The method of a fixed commission is generally preferable from the corporation's standpoint, for the other method results in complications such as the telephone company experienced, or in scandalously large underwriters' profits.

Underwriting United States Steel: Huge Profits. — This statement reminds one of the underwriters' profits on the stock issues of the United States Steel Corporation, and, as that case illustrates an arrangement somewhat different from those mentioned above, a brief account of it is worth while. As a matter of fact, promoting and underwriting were in part combined in this case. First, a syndicate, headed by J. P. Morgan & Company, was formed to subscribe sufficient cash to back an arrangement for exchanging the new corporation's stock for that of the constituent companies. Nominally, the members by subscription agreed to make themselves liable to call for $200,000,000 if so much should be needed to help float the corporation's stock; but an agreement with the corporation allowed them to abandon the transaction at any time, and there was no thought of ever paying more than 12½ per cent of this sum, or $22,000,000. Indeed, it has been stated on excellent authority that the huge sum was mentioned merely to pad the syndicate's risk, and to justify in the public's eyes the fat profit which they expected to receive.

The syndicate members then entered into an agreement with the corporation by which they undertook to secure at least 51 per cent of the stock of the constituent companies — to this extent acting as promoters

— and immediately to furnish $25,000,000 in cash. In addition to this sum, $3,000,000 was expended in fees, purchasing miscellaneous securities, and the like. On its part, the corporation agreed to purchase the stock and to issue its own securities therefor in certain specified amounts. Any excess of these amounts over what had to be exchanged by the underwriters in securing the stock of the con-stitutent companies was to be their profit.

As it turned out, there were 1,300,000 shares, of a par value of $100 each, left in the hands of the syndicate manager. For an actual cash consideration of only $28,000,000, then, the syndicate, as underwriters of the issue and the exchange of stocks, received a total par value of $130,000,000. During the first year of the corporation's life (1901–1902), the price of its preferred stock averaged 94 cents on the dollar, and that of the common averaged 44, so that the average market value of the securities was $89,700,000. More was actually realized by selling when prices were highest, the true amount being estimated at $90,500,000.[171] Deducting $28,000,000 leaves the sum of $62,500,000 to be divided among the syndicate members, and T. P. Morgan & Company, as managers, received as an agreed reward 20 per cent of the profits, or $12,500,000.[172] It is but fair to observe, however, that part of this amount is to be regarded as payment for promoter's services.

Services and Compensation of the Underwriter. — The tremendous compensation received by the underwriters in the foregoing case naturally raises the question, was it earned? Are the large profits of underwriting syndicates earned? In answer, one must first analyze the services of the underwriter. And, first of all, what is the need for them? Clearly, where there is little or no risk in selling its stocks or bonds, a corporation may dispense with an underwriter's services. This may be the case with a small issue of a few hundred thousand dollars, or with much larger issues if the corporation is so large and well established that it can dispose of them largely to its own stockholders. Sometimes, too, bankers have consented to discount the promoter's notes up to several thousand dollars. But it is now rare, indeed, for any considerable issue to be sold directly to the public, and then it will always be guaranteed, or insured by some underwriter.

As will already have appeared in a general way, the need for underwriting lies in uncertainty and risk, (1) Doubt may exist at the outset as to what price to put upon the securities, or, in case of a consolidation, upon what terms they should be exchanged for others. There is uncertainty as to funds: (2) the securities may not sell at all or only in part, or (3) they may sell slowly, when funds are needed at once. Again, the credit and prestige of the company may be involved: (4) however badly the funds may be needed, it may be too dangerous to put securities on the market at any given time, when credit conditions may be already strained; or (5) the issue may be so large that the public confidence might be weakened, affecting the price of the company's outstanding securities. These are a few of the reasons why corporations resort to underwriters.

Such being the need for underwriting, just what does the underwriter contribute towards meeting it ? His costs and services may be summed up under the heads of risk undergone and special ability expended. That some risk is involved is evidenced by the experience of the syndicate which took the American Telephone Company's bonds. The existence of some special ability can hardly be doubted, and is evidenced by the continued resort of corporations to certain underwriters who receive large sums for their services. It takes great judgment to determine the underwriter's price; and he must decide approximately not only what is the real market value of the securities, which sets a maximum for his price, but also what will be the probable selling price under the conditions existing when the securities are offered to the public. This is to say nothing of skill and adroitness in the floatation process. To put the underwriter's services in a compendious statement we may say: —

(1) Underwriters take great risks in guaranteeing a sale for securities at agreed rates, before their

market value is known.

(2) They provide cash funds, (a) in large amounts, and (b) quickly, and (c) at certain times.

(3) They supply the special ability necessary to a thorough understanding of the market, and a knowledge of when, where, and how to place securities.

(4) As men of financial integrity and established reputation, they indorse enterprises to their many connections.

Beyond these rather general statements concerning the nature of the underwriter's services, it is difficult to go. At least this much is clear: if we *regard the price of underwriting services as determined by forces of demand and supply, we must conclude that the price should vary in proportion* (1) *to the stage of development and the reputation of the corporation,* (2) *to the condition of general industry,* (3) *to the kind of security underwritten,* (4) *to the amount of the security, and* (5) *to the arrangement under which compensation is received.* When the corporation is new and untried, when the times are bad, when the security is a speculative stock rather than a bond, when it is issued in a large block, and when the profit is contingent upon ability to sell at a price fixed a little over a purchase price, both risk and service are great, and reward should be relatively high; but when these conditions are reversed, the risk and the service are small, and the reward should be likewise. In the case of the steel corporation, most of the tests point to a large compensation; but, on the other hand, industry was booming, and the readiness of the public to invest greatly reduced the risk. The chief justification for a large compensation in this case is only valid from a private point of view, for it is that the securities were speculative stocks containing a large amount of water. Under such circumstances, was the amount received too large? Even if we deduct from the receipts $12,300,000 as being in part a compensation for promoter's services, and if we admit the underwriter's liability to be $200,000,000, we still have a profit of 25 per cent, which certainly seems too large. Under ordinary conditions, when a commission is paid, it is about 5 per cent on the par value of the securities underwritten, or somewhat less; and in underwriting bonds the usual margin between the purchase price and the sale price makes a similar per cent. Therefore, 10 per cent would appear to have been generous for the steel underwriting.

Chapter XX: Marketing and the Stock Exchange[173]

A distinct stage in the life history of the modern business corporation might be called the "marketing stage." After the enterprise has been promoted and, perhaps, underwritten, its securities must be sold to the investing public. Only by this means can promoters and underwriters realize upon their holdings of stock. Needless to say, the more doubtful the future of the enterprise, the more anxious are these persons to "unload." In case the corporation is of considerable size, the usual way to accomplish this marketing is to have the securities of the company "listed" on some stock exchange, and to endeavor to create there as favorable a reception as possible. It is important, therefore, to understand the organization and working of such exchanges, merely as a step in the formation of business organizations.

But more than this, stock exchanges are themselves business organizations, and are worthy of study as such. They are associations of such business men as are engaged in buying and selling the stocks and bonds of joint-stock enterprises, and have been called into existence by the need of an organized market for those securities. With the growth of corporate enterprise and the multiplication of corporate securities, market places and rules for the orderly conduct of dealings in those market places became necessary. These the stock exchanges supplied.

Consequently stock exchanges are vitally connected with the whole joint-stock principle of business organization, and are close to the heart of those "pecuniary relations" which characterize modern business life.

Finally, it is worth while noting that the stock exchange is the seat of several serious evils in the conduct of corporate business, evils which must be understood and remedied if we are ever to deal thoroughly with the corporation and trust problems.

Stock exchanges exist in most civilized countries and are found in a majority of the larger cities of the United States. Thus, there are exchanges in Philadelphia, Boston, Pittsburgh, Chicago, St. Louis, Kansas City, San Francisco, New Orleans, Denver, and a few other points. These organizations deal mostly in a few special securities of a local character. The New York Stock Exchange, however, is of national scope and is far more important than the others. On it are listed the securities of most of the large corporations and joint-stock companies of the country. In the following pages attention will be largely confined to the New York Exchange.

About 1792, some two dozen brokers met under a tree on Wall Street, New York, and agreed upon a uniform rate of commission for their dealings in the government and bank securities with which they were chiefly concerned. From this small beginning, the New York Stock Exchange took its rise. Following the growth of industry and corporations which began about 1812, a permanent organization was effected, and began operation in 1817. During the Civil War, when speculation was rampant, and several rivals sprang

up, the Exchange moved to its present location on Broad Street, and shortly thereafter (1869) absorbed its most important competitor. At that time its membership was enlarged to the present number.

Definition and General Nature. — The constitution of the New York Stock Exchange states its objects to be as follows "to furnish exchange rooms and other facilities for the convenient transaction of their business by its members as brokers; to maintain high standards of commercial honor and integrity among its members; and to promote and inculcate just and equitable principles of trade and business." Accordingly, we may say that a stock exchange is an association of brokers organized for the purpose of furnishing a convenient and regular market for the securities of governmental and business units.

The New York Exchange is an unincorporated association, with a limited membership of 1100. "Seats" on the exchange are the property of active brokers and pass to their heirs or assignees as other property. Therefore, these seats are transferable and command a price proportionate to the chance of gain which they afford. In 1893 they sold as low as $15,250; but the price has lately stood in the neighborhood of $90,000. In saying that seats are transferable, it must be observed that after purchasing one, a prospective member must secure the approval of the membership committee before he is admitted to trade on the floor. A $1000 initiation fee is charged and the annual dues amount to $50.

It is clear that while the Exchange is a business organization, it is not, as such, engaged in marketing the product. It is a sort of privately owned public market place. It merely supplies its members with a place for doing business, and with a set of rules to govern that business. Its members, as brokers, then offer their services to all comers at a fixed commission. The Exchange is not to be thought of as a corporation marketing its wares with the public, or as a band of financiers engaged in running an establishment which pays them a dividend. Each member does business on his own hook, and gains according to his individual energy and skill.

The Machinery of the Exchange. — As to its first function, we note that the Exchange furnishes a magnificent marble hall fronting on Broad Street near Wall Street. Here, in a spacious and lofty room, are pillars which bear placards indicating where the various stocks may be bought or sold. Around the room are hundreds of private telephones connecting with brokers' offices, and most of the business is directed by this means. Each broker has a number and may be called from the floor to the telephone or the door by means of the annunciator, a device which displays the desired number on the wall. In the basement, vaults and safety-deposit boxes are provided for securities. A salaried chairman opens dealings at 10 A.M., and closes them at three in the afternoon. It is also his duty to preserve order, to announce suspensions on account of insolvency, to announce the addition of new members, and to bring up matters of business concerning the Exchange as a whole. He is a member of the Exchange, but not of its governing committee.

For the rest, the government of the Exchange is in the hands of a governing committee of forty members, ten of whom are elected each year, and with whom are associated a president and treasurer. This committee has powers similar to those exercised by the board of directors of a corporation. Various subcommittees are drawn from its members. Thus the committee on admissions passes on new members, enforcing the rule that they must be of sound credit, of good reputation, and without disreputable connections; the arbitration committee settles disputes between members, without resort to the courts; the committee on stock list, subject to the approval of the governing committee, passes upon the admission of securities to dealings on the Exchange, etc.

In the case of a railway company, for instance, the stock-list committee requires the following data: location and description; title, date, and authority of organization; brief balance sheet and income account; authorized capitalization, and par value of shares; list of officials; and some other information. In order to have its bonds listed, the railway company must state the authorized amount, date, rate of interest, provision

for retirement, etc., and present a certified copy of the mortgage together with the proof that it is duly recorded. Only bonds issued on completed mileage will be accepted. Companies which reorganize must submit a financial statement for the year preceding the reorganization, and a description of the new security. Some control over methods of combination is also exerted: information is required concerning the financial and Physical condition of the constituent companies; and the combination is compelled to file an agreement that it will not dispose of the constituent companies without a vote of the stockholders, and that annual statements and balance sheets will be furnished. All active stocks must be registered with some responsible financial institution. In strongly recommending that corporations publish full balance sheets and income accounts and distribute them to stockholders at least fifteen days prior to annual meetings, the committee has done good work for the cause of publicity to stockholders. Formerly an unlisted department was maintained, and unlisted securities could be dealt in with virtually no information as to the standing of the companies which issued them. This department, however, was abolished in 1910. One result has been a great increase in the number of listed securities.

The Exchange, then, does not guarantee the value of the securities which its members deal in; but it does require considerable information before consenting to list stocks and bonds, and it insists on certain conditions which undoubtedly offer some protection to investors. Stocks listed on the Exchange have a higher standing at the banks as collateral than do unlisted securities.

While describing the machinery of the New York Stock Exchange, and especially in view of the foregoing regulations on listing, it will be logical to note the various safeguards which the Exchange maintains to insure the soundness of its operations, (1) Each member signs the constitution, obligating himself "to maintain high standards of commercial honor and integrity." (2) Insolvent members are suspended until they have settled with their creditors. (3) Suspension or expulsion is the penalty for making fictitious sales, or fictitious or trifling bids or offers. (4) A broker who accepts a commission less than that fixed by the by-laws is liable to the same penalty. (5) Members are not to be connected with any "bucket shop," — that is, a place where bets are made on stock prices without any buying or selling. (6) In order further to prevent "bucket shopping" methods, brokers who have orders both to buy and sell the same security are forbidden to make the transaction until they have first offered the security at a slightly higher price than they are to bid. This would insure actual marketing. (7) They are forbidden to buy or sell on their own account at the same time that they sell or buy for a client, as they might thus offset the effect of his order. Brokers so buying or selling "shall be deemed guilty of conduct or proceeding inconsistent with just and equitable principles of trade," says a rule of the Exchange. (8) By a recent ruling of the Exchange, a broker who offers to buy or sell over 100 shares has to take any smaller offer or bid of 100 shares or multiple thereof up to the amount of his offering. Formerly a broker could offer, say, 10,000 shares "all or none," in the belief that no one would have or want the exact amount, and that his offering could be recorded without being taken. The rule is designed to prevent manipulation by preventing bids and offers which are not *bona fide*. (9) Members must keep complete accounts, and these are open to inspection by the governing committee. (10) In general, all "obvious fraud" and insubordination concerning the rules of the Exchange make members liable to suspension or expulsion.

So much for what must be but a brief outline of the place, the organization, and its rules. Before leaving the subject of the machinery of the Exchange, however, a word may be added concerning the stock-loan desk, the "money crowd," and the clearing house.

The loan desk or loan corner, is the place in the Exchange at which stocks are lent and borrowed. When a broker makes a contract to sell securities he does not always have them on hand and may desire to borrow them, hoping that he can buy them cheaper at some later time. On the other hand, other brokers are holding

stocks, which they would be glad to lend for their cash value, as banks would only advance a part of that sum. Accordingly a place is maintained where such interests can get together.

Also, another place is set aside for the borrowing and lending of money. Here we find the "money crowd." Here is one great point of contact between the Exchange and "Wall Street." Great amounts of cash are needed by brokers who have bought stocks for that large body of customers who only make a part Payment ("margin"). On the other hand, the banks or trust companies of New York have large amounts of cash to lend. Therefore, before noon each day, bankers, having ascertained their loanable funds, call in those members of the Exchange who act as money brokers and order them to make loans up to a certain aggregate amount. To this group come the brokers who want cash, and bid for the desired sums. Thus, the money rates are determined by the changing demand and supply, and vary greatly from time to time. Such loans are generally made subject to "call," and are payable on demand. Practically, nowever, they are one-day loans. Of course, stocks and bonds are given as collateral.

One of the triumphs of American business organization is the Stock Exchange clearing house. Formerly each transaction on the Exchange involved the transfer of securities and money. Now, in case of active stocks, all transactions are pooled and only the balances change hands. This is the same general idea that underlies the various bank clearing houses. The Exchange clearing house is managed by a committee of five members. Before 4.15 P.M. each day except Saturday, when the time is 1.15, all those who have sold securities send "deliver tickets" to the offices of the buyers, and the buyers reciprocate by sending out "receive tickets."[174] These are written evidence of the verbal contracts made on the floor of the Exchange, and they serve as checks upon the transactions. (Loans of securities are treated as sales, and are cleared in the same way.) Next, each broker makes up a clearing house sheet in two columns headed "Receive" and "Deliver." Then, if the balance of these columns is a debit, he prepares a "balance check"; if a credit, he draws a draft to his order. These sheets, with their appropriate checks and drafts are sent in to the clearing house each day, and balances settled. Stocks are cleared in the same way, so that a broker who has sold 1000 shares and bought 500 of the same kind merely sends 500 to some one whom the clearing operation shows to be in need of that amount.

Classes of Members. — The members of the Exchange may be divided into several groups, according to their objects and methods, (1) *Brokers.*—These are men who are primarily engaged in executing the orders of others for the commissions that are paid. Some do a general business; some are "specialists," dealing in one or a few securities; others are the so-called "two-dollar brokers," who execute orders for other members of the Exchange at a low commission ($2 a hundred shares). (2) *Room Traders.* — These are professional speculators who buy and sell on their own account on the floor of the Exchange. "Scalpers" are. room traders who work for profits on slight changes in price. (3) *Capitalists.* —The "Capitalists" are men like Sage, Harriman, Gould, and Rockefeller, who do not appear on the floor, but deal through brokers. As members, they are charged lower commissions than outsiders.

Method of conducting Business. — Sales are usually made in "blocks" of 100 shares. As the par value of a share is commonly $100, this means that the usual unit involved in stock exchange transactions is $10,000 in par value.

The commission charged by brokers on business done for non-members is one eighth of one per cent, or $12.50 per 100 shares. As the great majority of purchases are made with the purpose of selling again, the charge for making a complete transaction is $25. Thus, the price of a stock must rise at least one fourth of one per cent, or $0.25 a share, to cover the cost of speculating for a rising market. On the business for members, the commission is one thirty-second of one per cent when the name of the principal is not given up and the broker makes the delivery. When, however, the principal's name is made known and he is to make

the delivery himself, only one fiftieth of one per cent is charged, or $2 per "block."

Suppose a group of brokers has been ordered to sell Rock Island, and another to buy. One broker offers at 29; another bids 28. If few are bidding and many are offering, the price drops. On the Exchange, prices move in eighths, and a "point " is one per cent on par, or $1. The offers drop to 28⅞, to 28¾, to 28⅝, etc., till finally a buyer calls "taken," and the deed is done. The whole process is an admirably clear exemplification of the law of demand and supply.

Needless to say, there is no actual exchange of securities on the floor, but merely an oral contract to deliver or receive outside of the Exchange.

There are several different kinds of transactions, but the most common one is called "regular way." This calls for delivery on the day following the sale. It is inconvenient to settle during business hours, and the frequent necessity for borrowing makes some time necessary. "Cash" deals involve delivery on the same day, after hours. "At three" deals are those in which the delivery is to occur at the end of three days.

Very usually, even when made " regular way," the transaction is not fully completed, or at least its effects are not fully worked out, for some time; for it is generally attended by a process of borrowing or lending. For example, A sells stock to B. A, however, does not own any of this stock; and, as he believes that it is going down in price, he does not want to buy any now. He therefore borrows it from C, and delivers to B. His relation to B ceases. Later, he will buy and repay C. Meanwhile, B had not the cash with which to pay A for the stock. He has bought believing that the stock will go up in price. Accordingly, in order to pay A, he turns the stock over to D as collateral for a loan of cash. If the price goes up, he contracts to sell the stock at a profit, repays D, gets his collateral, delivers it, and pockets his profit.

No account of the method of conducting business on a stock exchange would be complete without a word concerning "margin dealings." This much misunderstood process is very simple. In dealing for others, a broker demands the deposit of "margins" as part payments to guarantee himself against loss through price changes. As a broker, it is no part of his business to run risks or make profits through price changes. His clients, therefore, are required to advance a part of the value of the stocks dealt in. The amount of the margin depends in a general way upon the likelihood of the stock to fluctuate in price. In the case of railway securities the margin is generally 10 per cent of the par value, while with "industrials" 20 per cent is the usual rate. A orders his broker to buy 100 shares of New York Central at par, and he deposits 10 per cent of the price, or $1000, as his margin. The stock rises in price to $105, five points above par; and A sells. The broker then turns over to him $1475, which sum is his margin ($1000), plus the amount gained on the rise ($500), minus the broker's commission ($25). The interest on the 90 per cent which the broker contributed to make up the sum used in buying the stock will also be deducted. If the stock had fallen to 95, $500 of the margin would have been lost and the broker would have demanded more. Then, in case A were not to respond, the broker would sell the stock and A would be out the $500 and commission and interest.

The Forces which determine Prices on the Exchange. — In very brief outline, the forces or conditions with which we must reckon in dealing on a stock exchange are as follows: —

1. *The Personal Composition of the Market.* — Professional speculators are ready to take advantage of any fluctuation, whether up or down, and are quick to react from any movement which has a public following. They constitute a wary and steadying influence. Non-professional speculators, comprising "the public" are generally "bulls," that is, those who are speculating for a rise. But they are quick to sell on a declining market. "Capitalists" are generally in the market to buy for the sake of dividends or interest, and are a steadying influence. Bankers are generally "bulls," being commonly interested as investors or as underwriters. Obviously, the course of prices will somewhat depend upon the proportions in which these elements are in the market. Thus, when the professionals are almost alone, the market is generally "dull."

2. *Technical Conditions within the Exchange.* — Just as the operations of a machine are affected by internal friction, so the working of the Exchange varies with technical conditions. If time deals are numerous, that is, buying and selling on time for future delivery, a more complicated market results than if cash deals predominate; for the buyers and sellers retain a strong interest in the course of prices, and there is a sharp clash. Again, the proportion of margin deals is an element, as stocks bought and sold on a margin are less firmly held. Much, too, depends on the funds at the disposal of the various interests concerned. And the amount of manipulation by operators who create an appearance of activity by buying and selling at the same time through different brokers ("wash sales," "matched orders"), is an important factor.

3. *Conditions outside the Exchange.* — The general political and legal situation strongly influences prices: wars, judicial decisions, elections, and the like. Above all, the money market must be watched. Its chief influence is exerted through the interest rate on demand loans ("call loans") which are generally secured by stocks and bonds that have been bought or sold on a margin. Perhaps 80 per cent of margin speculation on the New York Exchange is financed by bank loans made from surplus deposits. During certain seasons of the year, these deposits are usually swelled by country banks, which send in their idle funds for the sake of the 2 per cent interest paid by the central banks. These funds are nominally subject to call. All this means periodically a mass of cheap money, which stimulates speculation. But if some panic causes the money to be withdrawn, speculation is rudely checked, and the collateral for loans is thrown upon the market. The remoter effects of the money market need not be discussed here. In addition to the foregoing external conditions, the general industrial situation must be followed by one who would understand the Exchange,

4. *Normal Value of Securities.* — Finally, the underlying importance of what is sometimes erroneously called the "intrinsic" value of the securities remains to be noted. Perhaps this should have come first. To understand the reasons for the price of any stock, one would have to study the organization and financial statements of the company concerned. This would give information as to character of management, value of assets, net income, and dividends, all of which are of fundamental importance.

Manipulation of Prices and Manipulative "Pools." — Among the technical conditions within the Exchange, "manipulation " was mentioned. Manipulation in this connection means any artful influence upon the demand or supply of a security with the purpose of making a profit by maintaining or changing its price. Generally, manipulators seek to cause fluctuations in price above or below the normal value; but this is not always the case, as will appear in a moment.

Indeed, there are several varieties of manipulation. First, we may distinguish marketing manipulation from speculative manipulation. The former kind is designed to create a market for new issues of securities, and when carried on by honest means may be quite legitimate, just as advertising may be. Governor Hughes' commission on speculation in securities and commodities (1909) put the case admirably: —

> It is essential to the organization and carrying through of important enterprises, such as large corporations, that the organizers should be able to raise the money necessary to complete them. This can be done only by the sale of securities. Large blocks of securities, such as are frequently issued by railroad and other companies, cannot be sold over the counter or directly to the ultimate investor, whose confidence can, as a rule, be only gradually established. They must therefore, if sold at all, be disposed of to some syndicate who will in turn pass them on to middlemen or speculators, until, in the course of time, they find their way into the boxes of investors. But prudent investors are not likely to be induced to buy securities which are not regularly quoted on some exchange, and which they cannot sell, or on which they cannot borrow money at their pleasure. If the securities are really good and bids and offers *bona-fide,* open to all investors and

> buyers, the operation is harmless. It is merely a method of bringing new investments into public notice."

But speculative manipulation is to be decried; for the operators try either to boost prices abnormally ("rig" the market) in order to unload upon the public inflated securities, or to depress prices in order to buy cheaply and later sell at a profit.

Again, we may distinguish long-time manipulation from short-time manipulation. Short-time manipulation is carried on by "room traders" through the temporary technical condition on the Exchange. Long-time manipulation, however, is generally carried on by "capitalists" or outsiders, and consists in inducing a complete speculative cycle in prices and encouraging the public to buy at high prices and sell at low ones. Frequently this involves a manipulation of the corporation's financial policy, dividends being paid when not earned and then stopped to be put into improvements for a while. Of course such actions affect the price of the securities concerned.

Manipulation is generally carried on by "pools," which are sometimes dignified by the name of "syndicate." Most frequently the idea is to get control of a big holding, boost the price, and then sell out. The participants in the pool may or may not be members of the Exchange; but each agrees to handle a certain amount of stock, and the orders are distributed along according to some agreed plan, sometimes allowing such fluctuations as will prevent suspicion. Some skilled manipulator is generally in charge. In 1907 a strong pool was formed to support United States Steel common stock, and by making large purchases it succeeded in keeping the price near 20 during the panic, thus establishing a good reputation for it. Then, when the public came in again, the price went to 95, and the pool unloaded at a handsome profit without breaking the market.

Good and Bad Features of the Exchange; Remedies. — The beneficial features of the Stock Exchange are so great that if one had to choose between leaving the Exchange as it is and doing away with it altogether, the former alternative would be preferable. It furnishes an open and continuous market for securities, thus facilitating the organization of industrial enterprises and making sound investments easier. Because of this openness and continuity of the market, the average fluctuation in prices of stocks is reduced and violent extremes occur less frequently. It supplies an index of the social utility of various enterprises by making public the judgment of skilled financiers and encouraging the flow of investment funds to the most productive fields. By increasing the amount of easily negotiable instruments, too, the Exchange affords a broader basis for credit.

But many evils lurk on the Stock Exchange as it runs at present. The greater part of manipulation is such an evil, and serves to pervert the chief function of the Exchange, the recording of true market values. More specific evils under the general head of manipulation are "wash sales" and "matched orders." The "wash sale" consists in a collusion between two or more brokers, one agreeing to go through the form of buying and the other of selling. The result is a fictitious sale, the idea being to make the stock seem active and worth a price which the brokers desire. Orders are "matched" when an operator gives orders to buy and to sell to different brokers, thus creating a specious activity. This is less reprehensible than "washing" the sale, but prevents true quotations.

Spreading false rumors, "tips," and advertisements is still too common, though perhaps unavoidable. At any event, it can hardly be attributed to the Exchange.

It is but fair to observe that the governing committee of the Exchange has very recently (1913) taken some steps to reduce the evil of manipulation. It has decided to organize a committee on business which is to consider matters relating to the business conduct of members with respect to customers' accounts. It will be

the duty of this committee to keep in touch with the course of prices of all securities listed on the Exchange for the purpose of determining when improper transactions are being used. If honestly and actively administered, the duties of such a committee might be very salutary.

An undue multiplication of highly speculative securities is another great evil, to minimize which even more thoroughgoing requirements prerequisite to listing would be desirable. The Exchange might accomplish considerable improvement by enforcing more rigid requirements for listing, and by taking more stringent steps to decrease overspeculation, or "stock gambling." For example, it would be well to require the presenta-lon of exact statements showing what compensation is received by corporations for stocks listed on the Exchange, which statements should distinguish between cash, property, and services of promoters and underwriters.

But, over and above initial listing requirements, it is the opinion of unbiased authorities that corporations whose securities are dealt in on the Exchange should be compelled to file statements of financial condition at reasonably frequent intervals.

Finally, speculation is encouraged among those who have no business to speculate, — the "lambs." The Exchange eats too much young mutton. Its business would be reduced, but it seems imperative that some step be taken to prevent financial suicide on the part of "the public" who follow the lure of the ticker. Their operations are not true speculation. It is gambling on the part of the "lambs," and robbing on the part of the Exchange members. It should be made more difficult for ignorant persons of limited means to take "flyers" on the Exchange. One of the most effective measures for accomplishing this end would be to require larger margins in most cases. The Hughes commission recommended that the Exchange endeavor to prevent members from soliciting and generally accepting business on a lower margin than 20 per cent. That seems to be an adequate margin, and the author would go so far as to urge legislation to compel the requirement of a 20-per-cent margin for all dealings in securities which statistics and common knowledge show to be subject to considerable fluctuations in price.

A question often asked when remedies for the evils of the Exchange are being discussed is, should the Exchange be required to incorporate? This is a delicate question, and one upon which there is no general agreement. While incorporation would subject the Exchange to a greater amount of publicity and regulation, it would also expose it to hasty and ignorant measures, and, above all, would deprive its governing committee of the summary power which it now exerts.

The gist of the whole matter is that the New York Stock Exchange is a highly valuable and extremely sensitive machine for registering the market values of securities; but the normal oscillations of the needle are too often interfered with and perverted by manipulative activities.

Chapter XXI: Reorganization and Receivership

Perhaps a majority of existing corporations are the result of reorganization. Certainly "reorganizations," with or without receiverships, are very common occurrences. The very name, re-organization, suggests the appropriateness of treating this subject in a book on business organization.

A business reorganization is any important adjustment made in the affairs of a going business unit with the purpose of preserving the unit or of fundamentally increasing its efficiency. As we shall see, it may concern the certificate of incorporation or merely the capitalization.

There are two classes of reorganization, one optional and one inevitable. Optional reorganization is voluntary and not necessitated by industrial conditions. It exists when a fundamental change is made in the organization of a business which could have continued to exist without that change; whereas inevitable reorganizations are made necessary by inability to continue in business under the old organization, and are usually attended by insolvency.

Optional Reorganization. — Although probably less frequent than the inevitable sort, optional reorganizations are of no inconsiderable importance. They may go through the forms of receivership and sale, but if these are mere formal steps, assented to by all parties, the reorganizations can hardly be called necessary, or involuntary. Some of the reasons for voluntarily undertaking to reorganize a corporation will throw light on the nature of the proceeding, (1) Sometimes, in order to extend the operations of the corporation, the majority stockholders may desire new funds; but the minority may be unwilling to make any further investment. Then, if the stock has been issued "fully paid and non-assessable," so that no recourse can be had in that direction, but one way out of the difficulty is left. A new corporation is formed to take over the assets of the old one, its stockholders consisting of those who desire to venture more in the business. (2) Sometimes, too, the earnings of a corporation are so great that they seem to yield an excessive rate of dividend on stock, and, as all the authorized stock has been issued, nothing remains to be done by way of avoiding appearances but to amend the charter or to form a new corporation. In such cases, the company may be truly undercapitalized in view of legitimate net earnings; or the object may be to perpetuate monopoly earnings by what is really an overcapitalization. In short, reorganization may occur as a part of a scheme to water stock. (3) Again, the certificate of incorporation may have proved to be ill-adapted to the business; when, if for any reason amendment may be difficult or impossible, a new certificate will be sought. (4) Or, again, the laws of the State may become "unhealthful" to such an extent that reorganization under another jurisdiction seems advisable. (5) For various reasons there may be a desire to "freeze out" certain stockholders, in which case the reorganization can hardly be called voluntary on their part! In general, therefore, optional reorganization takes place to readjust either the organization or the capital account. In the latter case the process is sometimes called "refunding." The method pursued will generally be somewhat as

follows: —

1. A meeting of the stockholders of the old company. (Unanimous consent being given, the affairs of the company are wound up. Creditors' rights must be protected.)
2. A meeting of the directors of the old company. (They prepare a proposition to the new company.)
3. A meeting of the incorporators of the new company. (They elect officers.)
4. A meeting of the directors of the new company. (They accept the proposition of the old company.)
5. A formal transfer of property, with payment either in stock or cash, or both.

Of course, practically the same individuals are the actors throughout. It is to be remembered that creditors' interests must be carefully observed, and in several States statutes make the transfer of all assets void unless creditors are given notice.

Inevitable Reorganizations; Insolvency. — When an adjustment of the interests of the stockholders to those of the bondholders is necessary in order to preserve or restore the ability of a business unit to keep on as a going concern, an inevitable reorganization occurs. It is forced by circumstances. Generally, in such cases, there will be foreclosure and receivership; but that is not necessary. The essential fact is that, both in common and in legal language, the business is insolvent. It may be conducive to clear thought, however, to distinguish voluntary and involuntary forms of reorganization even when the readjustment is inevitable; for there is a difference between taking the initiative before a foreclosure suit compels reorganization and waiting till the receiver has taken charge.

It is most essential to understand that there are two kinds of insolvency: (1) immediate insolvency, and (2) ultimate insolvency, or bankruptcy, (1) *Immediate insolvency,* or "commercial insolvency" as it is sometimes called, is a condition of business in which current assets are insufficient to cover current liabilities. Ultimately, the business unit may be perfectly solvent; but if the claims which must be met currently, say within a month, cannot be covered by quick assets, an adjustment must be made. Many a corporation, which, if time could have been obtained, would have weathered the storm, and which ultimately paid one hundred cents on the dollar, has gone under because its cash, and bills and accounts receivable, were insufficient to cover current interest charges, wages, and bills payable. (2) *Ultimate insolvency,* or "bankruptcy," exists when total assets are insufficient to meet total liabilities. Either kind of insolvency may lead to an unavoidable reorganization, involving the readjustment of the interests of bondholders (creditors) and stockholders (owners).

Causes of Inevitable Reorganization. — Besides fraud and unlawful acts, two great underlying causes or groups of causes of inevitable or necessary reorganization are found, that is, two broad reasons why honestly managed corporations become insolvent, (1) The first one, as the reader will have judged, is *mismanagement*; but there are several types of mismanagement to be noted, (a) One of the most common types is a failure to maintain adequate safeguards against the normal fluctuations in business. Normally and naturally, under existing conditions, business has its ups and downs which may come in seasonal swings or in longer cycles; and, also, fire and storm are ever-present dangers. It is gross mismanagement, therefore, to fail to maintain reserves against bad debts, adequate leeway in working capital, and insurance against the accidents that beset all enterprise. Failure to allow for depreciation may also be mentioned here; for, by not allowing for the wasting of assets through wear and tear or obsolescence, a business man may be committing the sin of paying dividends out of his capital. (b) Another general type of mismanagement comes in the shape of unprofitable investments: through merging branch lines or plants, through making leases, or through guaranteeing returns on the securities of controlled properties, the solvency of many a strong corporation has

been sapped. The Wabash Railway, for example, in its eagerness to secure an entrance into Pittsburgh, about ten years ago, made ruinous leases and guarantees with the result that it recently entered the receiver's hands. (c) Perhaps several other types of mismanagement might be mentioned, but only one more need be touched upon here, and that is the neglect to observe costs. It is astounding how few business men have had any exact notion of what their unit costs have been; and the result has been a frequent failure to conduct their businesses on a profitable basis, a condition which may be due not only to selling below cost, but also to inability to bid accurately in competition with more exactly informed competitors. Nowadays, fortunately, most business organizations have installed cost-keeping devices of one sort or another, and it is even apparent that before long the last stronghold of ignorance in this matter, the farm, will be won over to better management.

(2) The second great underlying cause of inevitable insolvency lies in *abnormal business conditions.* No one can tell just when a panic will come, and the sun spots and the generations come and go with no evidence of direct relationship to crises. Of course, panics and industrial depressions are explainable phenomena, and are, in that sense, normal; but as yet they are phenomena against which ordinary precautions may not avail, and panic years will long be strewn with numerous receiverships.

When widespread mismanagement and abnormal business conditions are by some unhappy chance combined, then inevitable reorganizations reach their maximum frequency.

So much for the general fundamental causes. More immediately, numerous particular occasions precede the kind of reorganization now under discussion: the underlying causes generally find expression in one or the other of the following occasioning conditions: —

(1) Inability to meet fixed charges. Said Mr. Stetson in testimony given to the Industrial Commission, "... that is the whole point of the reorganization, to get a smaller annual charge";[175] and he meant by that statement that the great aim in reorganization is to scale down the fixed charges, such as interest on bonds, which fall due periodically regardless of the amount of business done. The existence of excessive annual charges is generally due to mismanagement, and the trouble is very apt to come to a head in times of industrial depression. Then, either stockholders are forced to retire in order to let bondholders step in as owners, or bondholders are induced to make some concession, such as accepting securities bearing a lower interest rate, or both.

(2) Inability to maintain adequate working capital. This, experience shows, is one of the conditions arising out of bad management which is very likely to become an occasion of insolvency. It is too frequently the case that a badly launched establishment struggles along, borrowing funds from season to season to finance its operations, only to go under at the first tight money market. A certain amount of cash, varying with the business, is absolutely essential, and dependerice upon the money market for that cash is a precarious condition.

(3) A rather similar occasion is inability to fund floating debt. It is estimated that the railway companies of the country in 1903 had outstanding over $250,000,000 of floating indebtedness which they were anxious to fund, — that is, they owed that much money on short-time obligations for supplies, and other current accounts, and their creditors were pressing them for payment. Now, ordinarily they would "fund" a considerable part of such indebtedness by issuing bonds to cover it, thus translating a pressing claim for the principal into relatively small annual interest installments. In 1893, however, few people wanted to buy bonds and many people wanted to collect debts owed to them.

(4) Inability to refund bonds. Bonds, as we have seen, are promises to pay a certain sum on a certain date. Ordinarily, however, when that date comes around, the corporation merely refunds the maturing indebtedness by putting out a new bond issue in place of the old one. Like governments with their national

debts, corporations do not issue bonds with the idea of paying them off. But suppose that the date of the maturing of the issue falls in a lean year. Then it may prove impossible to sell more bonds, and the corporation must go to the wall. Ordinarily, this will mean an involuntary reorganization.

Such being the causes, in forced reorganizations it will generally be found that the immediate object is either (1) to reduce fixed charges to within a conservatively estimated amount of earnings, by some such means as retiring old bonds and issuing others bearing a lower interest; or (2) to raise cash for working capital or improvements; or (3) to pay off or fund a floating debt.

Receivership. — The appointment of a "receiver" being so common an adjunct of reorganization, it is proper at this point to pause for a little while in order to indicate the place of a receivership in the life history of the corporate organization. An excellent definition of a receiver, slightly adapted, is contained in the following statement: "Receiver: a person appointed by the court to receive income from property which is in question between the parties to a litigation, or which belongs to one who is legally incompetent."[176] Perhaps one shortcoming may be found in this definition, however, for it is not sufficiently indicative of the active functions of receivers. These are brought out more clearly when we define a receiver as *a person appointed by a court during civil action or upon judgment to manage or dispose of property, as the court may direct.* Being purely a legal institution it is appropriate to state the general principles which govern the appointment and control of receivers in law language. In a leading case[177] the court said: —

> "A receiver is appointed upon a principle of justice for the benefit of all concerned. Every kind of property of such a nature that, if legal, it might be taken in execution, may, if equitable, be put into his possession. Hence the appointment has been said to be an equitable execution. He is virtually a representative of the court, and of all the parties in interest in the litigation wherein he is appointed. He is required to take possession of property as directed, because it is deemed more for the interests of justice that he should do so than that the property should be in the possession of either of the parties in the litigation. He is not appointed for the benefit of either of the parties, but of all concerned. Money or property in his hands is in *custodia legis.* He has only such power and authority as are given him by the court, and must not exceed the prescribed limits. The court will not allow him to be sued touching the property in his charge, nor for any malfeasance as to the parties or others without its consent; nor will it permit his possession to be disturbed by force nor violence to be offered to his person while in the discharge of his official duties. In such cases the court will vindicate its authority, and, if need be, will punish the offender by fine and imprisonment for contempt."

Thus receivers are appointed by the courts, and, while enjoy-mg the immunities of representatives of the courts, they are not to exceed the power delegated to them. They are appointed for the benefit of all concerned. So far as the immediate interests of stock and bondholders are involved, a corporation in the hands of a receiver is virtually not in existence. Interest is not paid on the bonds, nor dividends on stock. A receivership is a veritable interregnum in the life of a corporation.

Originally it was the idea that an insolvent business would naturally be wound up and its assets be distributed, a proceeding quite possible in small-scale local industry; and receiverships were resorted to mostly in case of judgments, foreclosures, trusteeships, and the dissolution of partnerships and banking corporations; but with the development of large corporations, especially railway companies, with widely scattered properties, great armies of employees, and a business affected with important public interests, such summary proceedings could not economically be tolerated.[178] The properties had to be operated continuously or decay, and loss of patronage made costly inroads; and combined operation of the parts proved

essential to economy. As a result, instead of merely receiving the property pending its distribution, and at most making small repairs, the receiver's function was extended to include everything necessary to a safe and continuous operation. The fundamental idea became and is that the receiver should conserve the property pending some adjustment; but in a situation in which rival properties are improving their plants, what is conservation? In the railway business, receivers have bought new equipment, lowered grades, acquired terminal facilities, and even built new track.

A receiver may draw funds for his operation from several different sources, (1) As he does not have to pay interest on bonds, he may retain part of the earnings which generally go to pay fixed charges. (2) By cutting expenses and perfecting operation, he can increase net earnings. It is usual to introduce the most rigid economy when a receiver is in charge, office forces being greatly reduced and the smallest details, such as stationery, being carefully scrutinized to effect saving. (3) Assessments on stockholders are resorted to when this resource is available, as it may be in the case of banks and other corporations that are subject to "double liability," and in cases in which stock has not been fully paid. (4) The typical method, however, and probably the most common one, is the issuance of "receiver's certificates." These are somewhat like bonds, but take precedence over all other securities. To the extent that such certificates exceed in value the improvements made by the receiver, they, having a prior lien, deprive other securities of income and value; and this suggests a limit to the amount that should justly be issued. But, on the other hand, to the extent that interest and dividends have been paid out of capital, and the property allowed to depreciate without a reserve, it is but just that the stockholders should be forced to stand at least a part of the expense of making good the wasted assets.

Friendly Receiverships. — Originally, a receiver was asked for by some creditor or other interest threatened by the action of the majority stockholders, and his appointment was opposed by the corporation. Now, however, the doctrine has become established that a receiver may be asked for by the corporation itself, and this is commonly done. Relatively few receivers are not friendly to the corporation. In a "friendly receivership" everything is planned in advance: some creditor who is favorably disposed toward the corporation's administration then makes complaint that the company owes him money and cannot pay, an officer of the corporation promptly confesses that such is the lamentable fact, and the parties apply to a friendly judge for a receiver; this application the judge approves, and appoints the desired man. Obviously, while the receiver's duties are highly important and while it is desirable that he should be favorably disposed toward any course that will affect a just and legitimate adjustment, such a procedure is liable to abuse. It may be too friendly. Thus it may be taken advantage of in order to put the former administration which wrecked the corporation at the wheel again, a step that will very likely block any investigation of their previous mismanage-ment, just as it did in the case of the American Asphalt Company. Or there may even be a conspiracy between an "inside" interest and some small creditor to the end that the property may be thrown into the receiver's hands and so deprive other stock and bondholders of their income. There have been cases in which railway corporations have procured the appointment of receivers merely to facilitate the construction of new line, the reason being that money could be raised by the sale of receiver's certificates when no other securities could be sold on practicable terms. This use of the receivership institution, while not so reprehensible as the preceding ones, is not legitimate.

In seeking fully to appreciate the significance of receiverships, questions which naturally occur to one are: What is the relation of the receiver to the entrepreneur? How effective is the motivation of the business under his control ? It can hardly be said that a receiver is an entrepreneur. In the first place, it has become apparent that under the corporate form, as under other forms, the entrepreneur's function is fundamentally connected with ownership, unless fraud and misrepresentation exist: in the owners is the seat of ultimate

authority. Now in case of a *bona fide* receivership, ownership is in more or less doubt. The receivership is a period of interregnum. The court represents the abstract ownership, and the receiver has possession as the representative of the court. So it is with direction. True, the receiver is the immediate source of directive decisions; but, again, he but represents the court to whom he is ultimately responsible and whose mandates have circumscribed his actions. The receiver is like a dictator, with the various security-holding interests acting as advisers, perhaps; but the dictator is made and unmade by the judiciary. Finally, and conclusively, the receiver's risks are not those of an entrepreneur, for he receives a stipulated salary regardless of profits.

As to motivation, the answer is not as simple as one would like, for the reason that the peculiar status of a business unit in the receiver's hands makes the usual tests not quite applicable in the usual way. The property not being in the hands of owners, and the risks not being those of the entrepreneur, the stimulus to activity cannot be the same as under normal conditions. The receiver's motivation is like that of a public official: it depends largely upon his desire to make a reputation for efficiency and upon his integrity, conditions which have too often proved inadequate in government. But, on the other hand, it is to be remembered that his function is not to make profits, but to conserve a plant, and that the latter function does not seem to require so sharp a spur. And, moreover, administration is admirably effective. It is concentrated, and is unhampered by complicated interests.

The upshot of this little excursion into the realms of analysis is the conclusion that the danger of abuse lies in extending a conserving and administrative function into a constructive and directive and entrepreneurial one, for which it is not fitted by the character of its motivation and responsibility. Within its proper sphere, the receivership is an admirable institution for administering the affairs of a business organization which is genuinely insolvent.

The Reorganization of the National Cordage Company. — A well-known case of reorganization is that of the National Cordage Company, and some account of it will clothe the discussion with concreteness. In that trying year, 1893, the directors and various leading stockholders and creditors of the company got together and decided that a reorganization was necessary, and that a receiver should be appointed in order to protect the interests of both creditors and stockholders. This, then, was an inevitable reorganization voluntarily initiated. Immediately upon his appointment, the receiver addressed a letter to the principal creditors and shareholders bespeaking their cooperation, and he succeeded in assembling them for a meeting, when a "reorganization committee" and an "advisory committee" were chosen. The former was to make a thorough investigation and devise a plan of reorganization; the latter, which consisted of three bank presidents, was to give advice on financial points. A firm of accountants was employed to examine the books, and an appraisal of all the company's property was made.

Finally, the reorganization committee prepared a report and plan of reorganization along the following lines: First, the two chief difficulties were stated to be a lack of working capital, and a too extravagant scale of expenditures in management and purchases. Accordingly, the committee stated that it would be necessary to provide money to pay existing debts and supply adequate cash capital, and to effect radical changes in management through concentration and the abolition of unnecessary offices. These difficulties, they observed, had not been felt until the stringent money market of 1893, when maturing obligations could not be renewed.

The most obvious point was that funds had to be raised. But how? The reorganization committee considered several schemes. They rejected the proposition to depend entirely upon additional debt in the shape of bond issues, because that would deprive the stockholders' equity of all value (and it was more than doubtful whether bonds could be disposed of on reasonable terms). They decided that foreclosure and judicial sale of the property to a new company would mean loss to the members of the existing concern. Legal

proceedings to assess the stockholders did not seem practicable. So they settled upon an agreement for cooperation between creditors and stockholders as the simplest method.

The plan of reorganization adopted embraced three main features: first, the raising of working capital mainly by voluntary contributions from the stockholders, preferred stock being issued to them in return; second, the funding of the floating debt by issuing mortgage bonds which bore an interest rate of 6 per cent, and to which stockholders were to have the first chance to subscribe; third, the purchase of those additional properties which were needed to put the company on a stronger competitive basis. The voluntary contributions of the stockholders were to be made under the form of a purchase by them of a new issue of preferred stock, in which purchase the old preferred stockholders were to take and pay cash for an amount equal to 20 per cent of the par value of their holdings, and the common stockholders an amount equal to 10 per cent of their holdings. The common stockholders, however, were given the alternative of surrendering 50 per cent of the par value of the stock held by them. The bonds provided for in the plan were to cover 65 per cent of the outstanding unsecured debt, which left 35 per cent to be taken care of. The greater part of this balance — 25 per cent — was to be covered by unpledged merchandise and cash assets; while to pay the remaining 10 per cent, "trust" liquidation certificates, secured by the company's accounts receivable and other personal property, were to be issued. The creditors who had been given security for their claims were to be settled with by a gradual liquidation of their merchandise collateral, and, in case this proved inadequate, by the issue of more trust certificates. The acquisition by outright purchase of certain new properties was an important part of the plan, and the need of this step illustrates mismanagement in making unprofitable investments. Certain mills had been operated under lease on such terms that the rental was too burdensome a fixed charge, and economy in operation was hampered by several restrictions. Accordingly, by securing title, fixed charges could be reduced, the plants could be operated with closer combination and freedom from the restrictions of the lease, and, at the same time, the security available for backing the new bond issue would be increased. The bondholders of the leased concerns were settled with by giving them stock on which dividends were guaranteed.

Any stockholders of the company who would not assent to this plan and become parties to the reorganization agreement were, by their refusal, to forfeit their right of representation and their interest in the reorganized company.

In conclusion, the committee, in one of the circulars which they sent out, said: —

> "The committee cannot too strongly urge all interested parties, both creditors and stockholders, to cooperate in this plan of reorganization. The properties must be kept together, and the rights of creditors and stockholders preserved and protected by keeping the assets intact and carrying on the business. It is equally clear that the stockholders, both preferred and common, must agree to make such proper contribution for working capital as the circumstances of the company demand. A prompt acceptance of this plan by all parties will avoid troublesome litigation between creditors and stockholders and will materially increase the future value of their property."

Various Classes of Security Holders as Sources of Funds. — Contributions more or less voluntarily made by stockholders form the common resort in those reorganizations which require the raising of funds.[179] If the property is to be retained, but two or possibly three courses are open: the sale of mortgage bonds, and the assessment of the interests already concerned. Sometimes securities are held in the treasury and are available for sale; but this is not often the case. In case it is a secured floating debt that is giving the trouble, one might think that the stocks or bonds held as collateral for that debt might be disposed of to satisfy the

creditors; but frequently such stocks or bonds are the means of controlling subsidiary plants or lines, and to part with them would let valuable properties go to competitors and impair the earnings and general standing of the company. The common resort, as in the case of the Cordage Company's reorganization, is to depend as largely as possible upon stockholder's assessments; for are the stockholders not the owners and the ones who have taken the risks of loss along with the chances of extra profits? Moreover, in this way, and in this way alone, they can hope to save something from the wreck, even though their stock may be worth less than nothing at the time. They get nothing if the property is sold, and they give the opportunity of building it up to others who make advances; whereas, if assessments are made, the company may be put on its feet and the stock take on value again. Of course the assessment must be set over against this increase in value, and, if the stockholder cannot be convinced that his new shares will be worth more than the assessment, he can hardly be persuaded to "come in." Generally such assessments are made on the installment plan so as to be least burdensome. As a rule, the great majority of the old stockholders remain with the organization. Many small holders may drop, however, either when values are declining prior to the reorganization, or when the assessment squeezes them out.

An interesting question is raised when it is asked how it is that any considerable attention is paid to stockholders and others whose claims are subordinate to those of the dominant first-mortgage bondholders. The explanation, however, is relatively simple. Often the attorneys for the stockholders would be able to delay foreclosure for years by resorting to obstructive tactics. Legal technicalities could be raised galore, and it is generally possible to find sufficient obscurity in the language of the documents concerned to form the basis of controversy. As a result, it is customary to give the interests of stockholders more or less recognition in reorganizations, and so the second-mortgage bondholders may also be assessed, the first-mortgage holders may forgo interest for a time: and other concessions may be made. Junior bondholders (second and third mortgages), too, may cause trouble and disturb plans for reorganization by bringing suit for foreclosure, hoping thus to secure some small share in assets; therefore, some attention must be paid to their claims. In protecting their interests, each class of stocks and bonds may be represented by a committee acting as trustee for the issue, which makes their voice more effective. Thus, in the reorganization of the Chicago Great Western Railroad Company (1909), there were London and New York committees for debentures, and three committees representing respectively preferred stocks A and B, and common stock.

Chapter XXII: The Development and Organization of the International Harvester Company[180]

The business organization characteristics of any industry cannot be understood, either as an existing form or as a product of evolutionary development, without a knowledge of the technical conditions found in the industry and of the environment that surrounds it. In beginning an account of the organization of the International Harvester Company, therefore, it is essential to analyze the "conditions precedent."

Character of the Industry. — To begin with, a very large capital investment, both "fixed" and "circulating," is required in the industry. The need for large "fixed capital" (*i.e.,* capital invested in machines, etc., that stay in the business for some time) arises from the volume of output, and from the use of much machinery which is essential to the economical production of agricultural implements. In short, the economies of large-scale production are important. An output of relatively complicated machines, whose numerous parts must be standardized and interchangeable, calls for a high degree of specialization; and specialization of this kind can be practiced with profit only where the mass, of material and product is great. In this respect, the harvester business resembles the more advanced stages of the iron and steel business in general.

It is more peculiar in the large "circulating capital" tied up in the shape of raw materials, goods in process, and bills receivable. This fact is due to a most important factor in determining business organization and combination, namely, variability in demand. The demand for agricultural machinery, of course, is seasonal, and notably so in the case of harvesters. But, more than this, it varies sharply from season to season; according to crop conditions, thus sharing with agriculture the distinction of being markedly dependent upon the moods of nature. All this means that'large stocks must be held till the season develops, and then may have to be carried over. Thus, the investment of the Harvester Company in inventory in 1912 was about $75,000,000. There must be months of manufacturing in advance of a short selling season, which makes a heavy investment in "works inventories," running about $25,000,000. Then, too, the varying demands of the trade, that cannot be known till the harvest is in hand, compel the accumulation of big stocks of machinery, repair parts, and twine at local points all over the world, the value of such stocks in 1912 being $9,000,000 in the United States and $14,000,000 in foreign countries.

The complexity of the marketing and the large selling expense are other notable features of the business, though these features are partly accounted for by the expense and complexity of the product. Taking the harvester business alone, we find that a large and expensive selling organization would have to be maintained, though it could be used only a few months in the year. More than this, a harvesting machine is too expensive an item for the average farmer to pay for on a cash basis; and consequently an enormous credit business early developed, requiring large cash resources. A large part of the product of the Harvester Com-

pany is sold on time, to be paid for out of the crop, and in July, 1912, $80,000,000 credit had been extended to customers. The total "receivables" was $85,000,000.

Moreover, the complexity of the machines — the binder has over 3000 separate parts and more than 1000 separately formed and listed repair parts — makes necessary much instruction, and a large expenditure for setting up, repairs, etc. The farmer, of course, is not usually a skilled mechanic, so it has been found necessary to maintain a force of experts to aid him,

This keeps the manufacturer in touch with the consumer, the farmer; and, in fact, it has been found desirable that the manufacturer should maintain an extensive marketing machinery. All this makes necessary a large capital in proportion to business done.

It will be noted that the magnitude of the marketing problem would act powerfully toward large-scale production, and probably toward combination; for at any rate great financial resources would be needed, and above all the larger the output marketed by one interest, the smaller would be the selling expense per unit of product sold. A strong tendency toward a partial industry-combination would also exist, for the simple reason that by combining several lines of agricultural implements the elaborate selling organization could be more fully utilized. By combining tillage implements, seeders, wagons, etc., with harvesters, the force could be employed throughout the year.

On the other hand, one must observe that, in some respects, the industry under consideration is not one in which combination is so powerfully impelled as in others. Certainly it cannot be called a natural monopoly. The large element of "circulating capital" differentiates it from the more emphatically "fixed, capital" industries (*e.g.,* railways); and the fixed capital is not so narrowly specialized as in many cases. The latter statement may easily be verified by a consideration of the adjustments made in various plants when the harvester combination was formed, and after. Thus, the Milwaukee harvester plant was turned to the manufacture of gasoline engines, tractors, and cream separators, and the Plano plant was converted into a factory for wagons and manure spreaders. If further illustration were necessary, the fact that the Harvester Company's Russian plant consists of a converted air-brake manufactory would be in point. This condition will be recognized as making excessive competition less likely than is the case with highly specialized industries.

On the whole, we may conclude that strong incentives to combination exist in the shape of economies in production, and notably in marketing; but that the industry can hardly be classed as one in which competition is impossible.

The element of artificial monopoly given by the possession of patents is not now an essential part of the industry, but it has been an important factor in the past. Harvesting machinery embraces reapers, mowers, rakes, and binders. During the seventies, wire binders were introduced; but it was only about 1880 that the twine binder became a success. Its use depended upon an effective twine and a practicable knotting device. The early trend in the agricultural implement industry was to specialize pretty closely in one line, this being largely due to the existence of patents on various devices and to the considerable capital required. Down to 1900, for instance, few harvester companies had other lines, such as tillage implements. The combination came after the basic patents had expired, when, as will appear, the "full line" movement began, — an illustration of how industry-combination leads to trade combination.

A word may well be added concerning the underlying business organizations and competitive conditions. The chief concerns were the McCormick and the Deering companies. McCormick had established a plant in Chicago as early as 1847. In 1879, the concern was incorporated as the McCormick Harvesting Machine Company. In 1881 it took up the manufacture of twine binders, and its activities were always confined to grain and grass harvesting machinery. The Deering company sprang from the partnership of Easter and Gammon, dealers in farm implements. In 1869, the firm went into manufacturing and in the

following year William Deering came in. After some changes in the partnership, Deering separated and went to Chicago in 1879, where he developed the twine binder, being probably the first to do so. It was in 1883 that he, too, incorporated, under the name of William Deering & Company, though the name was later changed to Deering Harvester Company. On grounds of expediency, facilitated by close family holding of securities, the concern went back to the partnership in 1899. The history of the other constituent companies is similar: beginning as one-man or partnership concerns, formed to exploit or lease patents, they expanded and incorporated between 1880 and 1890.

During the eighties competition became appreciably severe, and, though the harvester business proper was unusually free from agreements and combinations, in other lines the usual course was followed in making more or less short-lived agreements. In 1887, an attempt was made to consolidate; while in 1890, the American Harvester Company, an Illinois corporation embracing all the then existing members of the present harvester company and others, was actually formed. Contracts were made, and a "trust" was all but set agoing. The time, however, was not ripe; for the prospective members were oversuspicious, fearing overvaluation of one another's plants; and nearly all backed out, acting on legal advice that the anti-trust act — passed the same year — would make their contracts non-enforceable.

During the nineties, competition again became severe. Witnesses, in testifying in anti-trust suits, state that "unbusinesslike methods" were followed and that the struggle resembled "guerilla warfare." It appears that, not only were "list prices" cut, but bonuses were given, and old machines were accepted at excessive valuations in payment for new ones. Money was spent merely to cut out rivals — not to increase business. The steady growth of the demand for agricultural machinery, however, kept conditions from being unendurable; and, though between 1898 and 1901 profits declined, the McCormick and Deering concerns were, according to the Bureau of Corporations, making about 12 per cent on their actual investments in the latter year. The McCormick company was probably the strongest one, yet it paid no dividends during the three years 1899, 1900, 1901, and expanded its borrowing to the limit of its credit.

In 1899 an attempt was made to combine the manufacturers of wagons, and in 1901, on the eve of the formation of the Harvester Trust, a similar effort was applied toward getting the makers of plows together. Both failed.

Immediate Causes of the Combination. — With even so brief a survey of the conditions precedent in mind, the reader is in a position to understand fairly well the origin of the harvester combination. The more immediate causes were as follows:

(1) First, the existence of a consolidation craze was influential. The combination movement traced in earlier pages had culminated in the Steel Corporation, and the power of the "wizards of finance" seemed unlimited. As we will see, the same wizards who conjured up the Steel Trust were called in to preside over the harvester combination. (2) In the second place, competition while by no means so destructive in this industry as in some, had brought great pressure to bear. The elaborate selling organization required and the strain of the credit operations involved were notable phases of this competition, and the waste of money in "canvassers" was deplored by all. (3) Next, certain economies that were rather sure to follow invited the "deal." The most prominent of these seems to have concerned industry-combination, or vertical combination. And first of all, was the anticipated saving in selling expenses: it was believed that by concentrating the entire sales of the industry in a single agency a considerable reduction could be effected. Closely connected with this point was the "full line" idea, that is, that a single consolidated company could push a full line of agricultural machinery, including tillage implements and wagons as well as harvesters. At the other end of the industry, so to speak, it was probably realized that the production of raw materials, such as wood and iron, could be more efficiently prosecuted. (4) Finally, separate mention may be made of the export trade, —

an important phase of the harvester business. It is true that before the combination was formed the export business was large and growing; but the leaders appear to have believed that with a united policy and combined resources the foreign market could be more effectively worked. Mr. Cyrus H. McCormick testified in the judicial proceedings brought by Missouri against the Harvester Trust in 1908 as follows: "Another purpose was to help in regard to the foreign manufacture. The development of the business was such that it was evident that some capital would be required and this was the method of getting Mr. Perkins, the promoter, appears to have been impressed with the possibilities of the European market and to have chosen the name, "International," with that market in mind. It had become clear that to succeed abroad the same methods would have to be adopted as those used in America, — direct selling instead of jobbing, extension of credit, educational campaigns, — and this would require means in excess of those available to any one company. Certainly, the later history of the company justifies the conclusion that this was one object in forming the combination.

In many combinations one finds gross overcapitalization at the outset and a probability that one object of "floating" the organization was to profit by stock jobbery. In the case of the Harvester Company, however, overcapitalization was allowed to only a relatively small amount if at all, and certainly it cannot be classed as an object of the combination. The reasons for this fact do not necessarily bespeak any virtue on the part of the combiners, unless it be the virtue of necessity; for it is clear that little chance to profit by stock watering existed. For one thing, the stock market was not favorable in the latter part of 1902 and the year following, that being a period of undigested securities. But most important is the fact that the stocks of the chief companies concerned were closely held by certain families, and the organizers and the owners were the same parties. The main object of the combination, as we shall see, was to make money by reducing competition and increasing the margin between operating expenses and gross earnings. It seems quite probable, however, that a possibility of future stock watering was considered. In the original contracts made between the constituent companies and the party representing the combination, a fictitious value was set upon the plants to be transferred that was far in excess of their true value. This excess ($72,000,000) originally was carried as a "surplus," and, had it seemed expedient to do so, it might easily have been taken up by an issue of stock to that amount.

Promotion, Capitalization, and Form of Combination. — The International Harvester Company was organized as a New Jersey corporation in August, 1902. It was an "amalgamation" in which were fused four corporations and one partnership: McCormick Harvesting Machine Company, Deering Harvester Company (partnership), Warder, Bushnell, and Glessner Company, Piano Manufacturing Company, and Milwaukee Harvester Company. Later, other companies were merged.

Some good concrete evidence bearing upon the problems which attend the formation of a "trust" is to be found in a document unearthed by the Bureau of Corporations in the investigation of the Harvester Company. From this "statement made by Mr. Stanley McCormick and Mr. Bentley to Mr. Perkins, June 27, 1902," it appears that the parties concerned were quite willing to get together, but jealousy and disagreement stood in the way. For instance, one of the smaller companies feared that prices would have to be cut, and suggested that in case of a war, the small companies, having lower organization charges, would stand a better show. There seemed to be a general mistrust of Mr. Deering's operations, it being suspected that he was negotiating to secure control of some of the smaller concerns. At the same time, the Bureau of Corporations states that "the different interests which went into the combination were so jealous of each other, and there had been so much friction in establishing the original valuation, that these several interests were unwilling to show their original balance sheets and book values of property for fear of reviving old animosities" (p. 195). One of the principal companies claimed that the other had been conducting its collection

department in too liberal a manner. The head of the same concern was known to be opposed to the type of internal organization adopted by the other, the one keeping power in his own hands and playing his men off one against another; the other placing a large amount of independent responsibility in important men. And who should control? "The demand for control of any new company by the McCormicks has been the chief obstacle met in these negotiations with Deering," says the "Statement."

Although the members had been considering combination or some time, the actual work was done in about a month.

The firm of J. P. Morgan & Company had entire charge of the matter, one of its members, Mr. George W. Perkins, conducting all the final negotiations. The steps in the formal organization and the capitalization policy will be of interest to the one interested in promotions.

Informal understandings on such questions as what relative valuations should be allowed to the various interests and what properties should be included having been reached, the principal parties met on July 28, 1902, in the offices of a New York law firm that represented J. P. Morgan & Company. Here four of the constituent companies entered into preliminary agreements to transfer their properties to one, W. C. Lane, who acted as the agent of Morgan & Co. Also they undertook to subscribe an amount of working capital, as will appear in a moment. These agreements were, of course, subject to the performance of certain acts in the formation of the new company by the bankers, one of which was the acquirement of the fifth member, the Milwaukee Harvester Company, The next step was the organization by "dummy" incorporators of the International Harvester Company, and to a temporary board representing these incorporators Mr. Lane turned over his contracts for the properties of the four companies and the Milwaukee Harvester Company, together with the subscriptions of cash for working capital. In exchange, he received all the stock of the new amalgamation. This stock was then turned over to the stockholders of the four original companies by Lane, thus putting them in control of the International.

For their services in the premises, the bankers, J. P. Morgan & Company, acting as promoters, received $2,957,000, and a liberal expense allowance to cover "the fees and expenses of any counsel, appraisers, and expert accountants." It appears that the fee was intended to be $3,000,000, as it was provided in a contract between Lane and Morgan & Co., that, in return for $22,500,000 in cash, the bankers would receive $25,500,000 in par value of the stock of the company; but certain cash contributions became necessary that somewhat reduced the net commission. It will be observed that no underwriting obligations were assumed, as the stock was all taken by the combining companies. There was no important overcapitalization. The bankers assumed little risk, as they acted largely as the agents of parties who desired to get together and who opposed relatively little objection on the score of valuations. The cash put up was only a little over $10,000,000. It seems, therefore, that the fee was somewhat excessive. From the social point of view, too it may be said that the saving of "wastes of competition" was not as important as may be the case sometimes.

Let us now examine the capitalization policy adopted. It is a notable point that appraisals did not control the amount of capitalization in this case, though fairly close estimates of plant values played an important part. Intangible values, such as good will, were only allowed for in a very loose way, — perhaps an indication that, when stock is not to be sold to the public, the "intangibles" are not so highly regarded by financiers. It appears to have been roughly estimated that about $53,000,000 would cover the value of the four plants, and that $3,000,000 more would be needed for the Milwaukee Company. This, together with $3,000,000 for the bankers, would make $60,000,000. Then an additional $60,000,000 was arbitrarily named as the working capital requirement. Accordingly, Morgan & Company named a capitalization of $120,000,000, and $60,000,000 was issued as "plant stock" and another $60,000,000 as "cash stock."

No preferred stock was issued. It was provided, however, that in case such stock were issued it should

not exceed $120,000,000. This is clearly suggestive of the common practice of issuing preferred stock for actually existing values and "common" for "things hoped for."

The "surplus" referred to on an earlier page came about in this way. Mr. Lane, in offering the properties to the temporary directors of the newly formed trust, placed a nominal valuation on plants and good will of $132,000,000; and the $72,000,000 difference between this sum and the $60,000,000 "plant stock" was temporarily treated as a surplus on the books.

The plan suggested for determining the value of good will was to make it equal to the aggregate profit of the two years preceding

the combination plus 10 per cent, according to a well-known practice among English accountants. This item, however, remained in the background as a sort of "and-other-assets" feature. Undoubtedly a considerable element of good will exists in the agricultural implement business, and had the stock of the combination been sold to outsiders this good will would have been made more prominent.

The three preceding paragraphs throw a clear light on the ordinary methods of watering stock. Here were three doors left open for overcapitalization: (1) a possible double issue of preferred and common, the common to represent water, (2) a fictitious and nominal "surplus" arbitrarily manufactured on the books, and (3) a more or less vague element of "good will, etc." It must be remembered, however, that the Harvester Company did not use these doors.

Very soon after the original contracts, it became necessary to make important changes that throw light on the capitalization problem. As the actual appraisals were made, it became apparent that they would exceed the $53,000,000 preliminary estimate, and additional issues were provided for to meet that contingency. Overappraisal, however, still remained possible, making stock watering not unlikely. To protect themselves, therefore, the bankers secured contracts which limited the total amount of stock to be allotted to the four companies for their properties to a little over $53,000,000. Thus, it is evident that the capitalization was rather arbitrarily fixed and was not strictly based upon the appraisals.

In this connection, it is interesting to find that within five years — in 1907 — the Harvester Company put on its books an appraised value of over $67,000,000, and then charged off the difference between this amount and the $60,000,000 "plant stock." This appraised value seems clearly to have been unduly high, and the existence of a surplus is correspondingly doubtful. Indeed, the Bureau of Corporations goes so far as to charge that "this book value of $67,076,229.65 was established with a view to showing the conservative valuation of the assets as compared with the capitalization," *i.e.,* the book values were padded and then reduced to make a show of conservatism (p. 95). The Bureau found the true value, exclusive of good will, to be a little over $49,000,000, which is nearly $18,000,000 less than the company's valuation. It seems to the author, however, that good will would make up this alleged shortage; though this does not make the company's statement of *appraised* value true.

At about this time, as we will see, a change was made in the system of management, and a significant alteration in the company's capitalization policy was effected. Not only was the stock divided into preferred and common, but steps were taken for the first time to have it listed on the stock exchange. The reason for these moves may be surmised to have been a desire to get away from the old family business policy and to adopt more live business methods. The preferred stock would make it possible to accommodate members who desired to secure income without participating actively in the business; the listing would make it possible to throw the membership open to the public.

Subsequent Development: (1) *Organization for Direction.* — The development of the organization of the Harvester Company contains several lessons for the student of business affairs. We may simply note in passing that the usual executive officers, including four vice presidents, were provided; that there was a

board of directors with six members at the start, which was increased to eighteen immediately after the organization; that from this board an executive committee of seven and a finance committee of five were constituted.[181] The significant point is the development from a policy of decentralization to one of centralized administration. At the outset, it was resolved to place the direction of management of the plants of the various interests in the hands of their previous owners. This was done, each group being termed a "division." These divisions were made largely autonomous, but were somewhat subject to division conferences, and to supervision by the executive committee. That body was given power to impose some rules concerning the amount of raw materials to be purchased and the quantity and kind of output. Some greater coordination, too, was provided in the first year of the organization by the establishment of general committees to supervise manufacturing, sales, collections, etc.; but manufacturing was still carried on by the divisions. There were differences of opinion on policy, the manufacturing committee, of which Mr. Deering was head, favoring the concentration to a few standard makes; the sales committee, headed by Mr. McCormick, recommending the maintenance of numerous individual brands. The business was not prospering, and it was apparent to all that more centralization was needed if the anticipated economies were to be realized. The real movement to centralization began toward the close of the second year, when the following departments and divisions were established:

1. Accounting department.
2. Experimental department.
3. Fiber division.
4. Law department.
5. Manufacturing department.
6. Patent department.
7. Purchasing department.
8. Security department.[182]
9. Traffic department.
10. Utility division.

Manufacturing by "divisions," however, was retained.

Early in 1904, the board took two important steps. First, Cyrus H. McCormick was given "supreme power in the executive business"; second, the divisions were abolished. Even so, however, there was a clash of personal and family interests that brought friction in the direction; and it was not till 1906 that an agreement providing for a specific distribution of positions was finally reached. Cabals were removed by giving the McCormicks supreme power in direction, and allotting definite positions to the other chief stockholders and employees. Surely the lesson is obvious.

All this involved a change in the certificate of incorporation, so that it is to be noted that there was an important and rather general reorganization of the trust in 1907.

(2) *Plant Specialization.* — Beginning chiefly about 1906, the fruits of the change in direction can be seen in an increased specialization by plants, the company thus securing one of the most important of the economies of combination. For example, the manufacture of harvesting machinery was concentrated in the McCormick and Deering plants, where special advantages in skill, equipment, and large-scale economies could be secured. Thus, the production of harvesters was discontinued at the Milwaukee establishment and that plant was specialized in gasoline engines and tractors. Also, the Piano and St. Paul plants were changed from harvesters, the one being specialized in manure spreaders and wagons, the other confined to binder twine. The twine plant at Akron was discontinued after 1910. The Keystone plant, too, was largely specialized in the manufacture of hay tools.

(3) *Selling Organization.* — From the outset, the organizers of the trust planned to effect their sales through a separate organization, and the Milwaukee company was decided upon as the best one. With this end in view, the name of the concern was changed to International Harvester Company of America; and its

capital stock was fixed at $1,000,000, all of which was held by the combination, the New Jersey Harvester Company. The directors and officers of the companies were the same, and a large part of the administrative work was done by the same staff in the same offices, the expenses being divided in an arbitrary proportion. The Harvester Company of America bought the products of the combination for sale in the United States or elsewhere at schedule prices, so adjusted that little or no profit was left to the sales company. Of course the stock was not dividend paying. Agreements between the two companies were finally passed upon by Mr. McCormick as president of both.

The reasons for adopting this separate selling agency and for taking an existing corporation are much the same as those already given in favor of holding companies (*e.g.*, p. 234). The trust would not have been given access to trade in some States having stringent anti-trust laws. Some States too would have levied heavy taxes upon the large capitalization of the trust. Moreover, as a new corporation, the trust would have lost valuable time in procuring licenses. So that everything pointed to the desirability of a distinct selling agency in the shape of a lightly capitalized established corporation.

(4) *Expansion, and Relations with Competitors.* — The subject of sales naturally suggests the question, How has the trust fared in competition with rivals? Certainly the Harvester Company has pursued a policy of active expansion in many directions and by many methods. It has expanded both vertically and horizontally. It has greatly developed its production of ore, coke, and iron products, as well as timber products. It has added to its industrial railways. It has entered new lines of finished product, notably manure spreaders, wagons, plows, and seeders. At points, this line of expansion has brought new competition and parallel combinations have ensued.

In the harvester business it easily acquired a number of the most important competitors, beginning with the D. M. Osborne company of Auburn, N. Y. In this case, as in several others, control was kept secret for some time after possession was secured. For a period of two years the public was given to understand that the Osborne Company was an "independent"! The desire of the former owners to wind up collections, unembarrassed by the change, may partly explain this procedure, but not entirely. To say the least, it indicates an undue pliability of conscience. The other concerns acquired in this manner were the Minnie Harvester Company, the Aultman-Miller Company, and the Keystone Company. Several other acquisitions have been considered, but not been made, either because the terms were considered unreasonable or because the properties were not deemed important. On the whole, a conservative policy is evident, one far removed from the reckless buying of competitors practiced by some trusts.

In the new lines, a variety of methods have been followed. Some existing plants have been purchased, some leased; and some new plants have been constructed. In several cases, however, selling arrangements have been entered into, according to which the combination handles the product of the independent concerns. This is the case with the Bettendorf Axle Company, manufacturers of steel wagons, and with the Oliver Chilled Plow Company, in the Canadian market. In the latter case, the Harvester Company holds an interest in the Plow Company's Canadian works. The advantages of such selling agreements are found in the combination's superior financial resources, its elaborate selling organization, and, perhaps, in its possession of some ability to bring pressure upon local dealers to handle its lines.

The absolute growth of the Harvester Company's business has been rapid, as the following statement of sales attests: — 1903 $52,065,000 1911 $108,033,000 1907 78,206,000 1912 125,434,000

This growth has followed a generally expanding market for agricultural machinery; but, more than this, the trust has held its own with the independents fairly well. For instance, in 1903 the Harvester Company produced about 94 per cent of the binders made in this country, while in 1911 it produced 89 per cent. Of course, the proportion of "independent " binders increased from 6 per cent to 13 per cent during the same

time. The proportion of mowers shows a less marked absolute dominance and a somewhat greater decline in relative amount, the Harvester Company's product being respectively 88 per cent and 77 per cent of the production in the two years mentioned. Its proportion of other implements as roughly estimated from the 1910 census runs from 10 per cent of wheeled cultivators up to 56 per cent of corn shredders.

It seems, therefore, that while the combination controls a great part of the output of harvesting machinery it has not retained its lead in the domestic production. Indeed, there has been considerable activity on the part of competitors. Deere & Company, with a capitalization of $58,007,000, though formerly manufacturers of plows, have expanded to produce wagons, manure spreaders, etc.; and in 1912 they began the marketing of a recently developed binder. The Moline Plow Company, with an outstanding capitalization of $18,000,000, has taken up wagons, spreaders, tillage implements, and has recently acquired the Adriance-Platt harvesting plant. The great Canadian company, the Massey-Harris Company (which was considered as of the combination in 1902), has acquired the Johnston Harvester Company, and with the abolition of duties on agricultural machinery has become a direct competitor. The Emerson-Brantingham Company with an issued capitalization of over $22,000,000 produces nearly a full line, including mowers, rakes, and threshing machinery. Besides these there is the J. I. Case Threshing Machine Company, and many other competitors. The evidence taken by the defense in the recent suit against the "trust" shows that about $180,000,000 of new capital has been invested in the production of agricultural implements in the United States since the "trust" was formed, and that over one-third of this went into the harvesting-machine business.

Is the Harvester Company, then, a monopoly? The government has so contended, pointing to control of output; while the company maintains that monopoly, in a legal sense, can exist only where freedom of opportunity is destroyed by preventing competitors from entering or remaining in the business. The truth seems to be that the company has a *partial* monopoly in a *part* of the field. The company's defense is weakened by its insistence upon the narrow legal definition of monopoly; for although competitors may be allowed to remain and new concerns be legally free to enter, substantial control over prices may still exist within rather wide limits. On the other hand, the government's case would be more sound were it based upon a due recognition of the fact that there are different degrees of monopoly and that monopoly is not necessarily bad.

Certainly, the "trust" has no monopoly in cultivators, wagons, hay tools, and tractors. As to binders, it appears to have a partial monopoly; and this for the simple reason that so large a proportion of the output is controlled that a substantial power to influence prices is in its hands. Its part of the total product is so large that it might raise prices and maintain them for a considerable period of time. Monopoly is an economic fact and legal definitions must conform themselves to it if the law is to be effective.

The question remains, has the "trust" used such limited monopoly power as it possesses against the public interest. In this respect the Harvester Company appears to have been a remarkably good "trust." As to prices, the lack of full figures makes clear conclusions impossible. Prices have advanced a little since 1908; but so have expenses for wages and materials. As to earnings and dividends, they seem to show a slight element of monopoly power in certain lines. This is not seen in dividends, for they average only about 6 per cent for the ten years of the company's life. The net earnings, according to the company, have averaged 7.8 per cent during the 10 years; according to the Bureau, 8.4 per cent; but in 1909, 1910, and 1911, they were much above this average. One also finds that the net earnings on harvesting machinery have been considerably greater than on the newer lines; and in the case of corn and grain binders and of reapers, the margin of profit has been distinctly high since 1908.

The fact seems to be that the trust has let its relatively small-scale competitors set the pace, and, *being able to produce more cheaply than they*,[183] it has retained larger profits on harvesting machinery. These

profits have been used to expand its business in other lines. It is probable that if it had done otherwise it would have kept the independent companies from growing or have driven them out.

Recent Development in Capitalization and Organization. — The capitalization of the Harvester Company was not increased till 1910, when the common stock was increased from $60,000,000 to $80,000,000 by the declaration of a "stock dividend" of $20,000,000. According to the officers of the company, this increase represented a surplus accumulated out of reasonable net earnings as a result of low dividends. Thus, by a dividend issued in the form of shares of stock, the accumulated surplus was transferred to permanent capital. This made the total capitalization equal $140,000,000.

The most notable development of late years has been the division of the combination into two corporations which followed we government suit. In January 1913, a new concern, known as the "International Harvester Corporation" was organized under the laws of New Jersey. It was capitalized at $70,000,000, — just one-half of the original company's capitalization. To it was turned over about half the assets of the trust, comprising all the foreign business and those lines that had been added since the formation of the trust in 1902. The name of the original combination was changed to "International Harvester Company of New Jersey," and its capitalization reduced to $70,000,000. It retained practically all domestic plants manufacturing harvesting machinery or any products made by the company at its date of organization.

The new corporation issued to the old company of New Jersey all of its stock in return for the assets turned over to it. The stock books of the old company were closed, and the stockholders called upon to surrender their certificates of stock for cancellation. These were exchanged for new certificates of the same class to one half their par value, plus either cash or certificates of the new corporation (at the option of the holder) for the remaining half. The cash option appears not to have been used. Thus the old $140,000,000 combination was split into two $70,000,000 companies, of which the older half controls the new.

It must not be thought that this step was taken with the idea of forestalling the government's action. The idea was chiefly to sever the foreign trade from the disturbing influence of the suit. As President McCormick stated, it was deemed "necessary for the protection of our foreign trade and credit."[184] But, more than this, it seems likely that it was desired to segregate all interests that did not take part in the original combination.

Advantages of the Harvester Company. — In closing this long chapter, only a word can be added about the advantages possessed by the trust over the independent. The advantages are partly due to the larger scale of its technical operations and partly due to the combination of management. Thus, the average factory cost of binders is only $56 for the trust as compared with $70 for the independents, and the difference is largely due to the fact that the general or overhead expenses are divided among a larger number of machines. Similarly, the expenses of advertising and selling may be relatively less. These are large-scale advantages.

On the other hand, by combining the management of several plants, whatever the scale of their operations, the Harvester Company has been able to divide its labor more effectively. As we have seen, it has specialized its plants in the different lines. Also it is able so to direct the operations of its plants that they will produce nearest to the market for their products, thus saving "cross freights." Thus, the Osborne plant is convenient for the export trade, and a plant has been constructed for Canada, etc. The best methods and machines have been adopted, and the less efficient ones abandoned. Certain wastes of competition can be saved, and a member of the trust testified that in 1908 the number of canvassers had been reduced by one-half (p. 69). Also, the trust claims to have secured a better distribution of work and a steadier employment of capital and labor. These are advantages of combination.

But, in separating the two kinds of advantages, we must not overlook their interrelation. The simple truth is that combination may be the only way to secure a scale of operation large enough to give certain advantages. By combination the Harvester Company was able (1) to get the large financial resources needed

to push the sale of a full line; (2) to utilize the timber and ore resources that the Deering Company had not been able to use to good advantage, *i.e.,* to carry out an industry-combination; and (3) to operate on such a scale as to be able to specialize its plants. It is very doubtful if any one of the corporations that entered the combination could have secured the financial backing necessary to develop the foreign trade as the trust has, to say nothing of the huge burden of its credit business.

In conclusion, the author would point out that not all these advantages, whether of large scale or of combination, are of equal social importance. Some are socially productive, while others are merely acquisitive. The industry-combination will serve to illustrate both. To the extent that the production of raw materials within the organization means saving in time and energy expended (as in preventing duplication of process, and securing a certain, regular, and specially adapted supply), it is socially advantageous, and the world's work is more effectively done; but to the extent that it merely means that the Harvester Company gets the profit on the ore and timber it uses instead of paying it to the steel trust or the lumber trust, the only ones who gain are the Harvester Company's stockholders. As a matter of fact, the company charges itself the full competitive price for the raw materials furnished it by its subsidiaries, so that the prices of its finished products are no lower because of the ownership of those subsidiaries. This, of course, does not necessarily mean that they are any higher.

The advantages of an elaborate selling organization, which figure so prominently in the International Harvester Company, are chiefly acquisitive. The combination has a larger selling expense per unit than the "independents"; but this is more than offset by its larger volume of business and its stronger hold on the market. Direct selling keeps it in touch with the dealers, and a direct contact with the consumer enables the combination to shape his demands.

Book IV: Public Policy: The Corporation and Trust Problems

Chapter XXIII: Public Policy: Evils and Causes

Introductory Statement of the Problem. — Undoubtedly danger exists whenever rigid rules are laid down concerning social processes, — the danger of preventing those adjustments to changing conditions which are so essential to life and progress. At the same time, few now deny that the existence of short-time or special interests which are contrary to long-time or general interests may make regulation desirable; and that regulation actually becomes desirable whenever the dangers of encroachment by the short-time, special interests upon the general, longtime interests outweigh the dangers of rigidity or retarded industrial and social progress. Very broadly stated, the problem of public policy towards business organization is to combine prevention of abuse with progressiveness, — to secure justice and safety without hindering initiative and flexibility. Most thinkers agree that down to the present time the spur of private profit has been the most effective stimulus to economic progress; but more and more these same thinkers have also come to agree that with the growth of economic life and business organization that spur has stimulated some actions which have not been progressive in the best sense. The interests of the general public and of never-dying society have been endangered by the interests of the few in their search for private profits. There can be no doubt that it is the consensus of the best opinion that, barring public-service industries, the burden of proof is upon those who would substitute some other driving force for the spur of private Profit, and in this opinion the author concurs. The question, then, is: to what extent can the stimulus of the old spur safely be retained? How can rules and regulations be applied without deadening it?

When one comes to examine carefully the great problem to which the various abuses of business organization give rise, one finds that this problem is made up of many minor problems, some of which are legal, others economic, others political, while some may be called ethical. It will be impossible here to take up these various aspects in detail. By holding to the economic point of view, and sketching in the more essential outlines with care for the perspective, we may be able to see the fundamental part of the problem in a comprehensive though rough way, and to reach some general conclusions concerning the remedies to be applied.

The Evils stated and Analyzed. — Setting to work according to the method of observation, we will first seek accurately to understand the evils which constitute the problem. If one were to jot down the various evils retailed in newspapers, magazines, and reports to legislatures, a somewhat confused list similar to the following one would be the result: —

1. Exorbitant prices.
2. Bribery of the employees of competitors.
3. Abuse of patents.
4. Secret control of so-called competitors.

5. Price discriminations.
6. Discriminations in granting credit.
7. Preventing purchasers from dealing with competitors.
8. Factors' agreements.
9. Monopoly of natural resources.
10. Retarded progress through monopoly.
11. Poor service.
12. Waste and extravagance.
13. Overcapitalization.
14. Buying plants to shut them down.
15. Overgrown corporations.
16. Fraudulent promotion.
17. Excessive promoters and underwriters' profits.
18. Inadequate financial statements.
19. Inadequate reserves.
20. Interlocking directorates.
21. Manipulation, or "inside" management.
22. "Melon cutting."
23. Abuse of proxies.
24. Abuse of minority stockholders.
25. Abuse of employees.
26. Hostility towards corporations.
27. Uncertainty as to the meaning of "reasonable restraint of trade."
28. Inability to cooperate.
29. Political corruption.

A cursory inspection of this sinister list leads one to see that it contains some overlapping and duplication, and to surmise that a little analysis might lead to a classification which would bring out the underlying causes. Obviously it will hardly be possible to act thoroughly or even intelligently by beginning with secondary and non-coordinate evils. Many of the evils in the list, in fact, are but symptoms of the disease. Instead, then, of forthwith passing a law fixing prices or forbidding overcapitalization, the wise man will go below the surface of these evils.

In the first place, it becomes evident that this long list of evils all centers in four or five main points. Thus, all the abuses which lead to the terrorism or destruction of competitors by wrongful means tend to establish, or at least to make possible, high prices through monopoly. All those which lead to waste and uneconomical production tend towards higher costs and prices, and towards poorer service. Those evils, however, which, like promotion abuses, manipulation by directors, and abuse of minority stockholdings, mean a clash of interests within corporations and a loss to investors, do not directly mean monopoly or higher prices to consumers. Other evils center in the labor problem, or in politics. These last evils will not be discussed in these pages, the one group being rather indirectly and remotely connected with business organization; the other being non-economic. We can therefore group all the evils mentioned under six heads: —

I. High prices (1–9, 10–17, 20, 28, etc.)
  1. Monopoly control (1–9, 20)
  2. Uneconomical production (10–15, 26–28, 3, 4, 9, 16, 19)
    The consuming public

II. Inefficient service (10–15)
III. Abuse of investors (12–24)
Security holders
IV. Abuse of employees (25)
Laborers
V. Uncertainty among business men (26–28)
Business Men
VI. Political corruption (29)
The state

In the second place, and closely related to the foregoing heads, several different classes of interests are clearly impinged upon by the evils listed; for some concern the "public" as *consumers,* others that small part of the public which holds stocks and bonds in corporations, *the security holders,* others the *labor class,* Finally, the *political public,* or *government,* has been attacked by corruption in its legislatures and courts.

One can hardly go this far in the analysis of particular evils without noticing that it points to the existence of two separate but interrelated problems, one the problem of combination organization and its relation to the public, the other the problem of simple corporate organization and its relation to corporation members. To the author it seems that this distinction is a point of capital importance. In these days we hear too much of the "trust problem" and too little of the *corporation problem.* The former is the problem of monopoly, and involves broad questions of economic policy. The evils which come under it are economic conditions, and can be remedied only by modifying economic forces. It touches the masses of consumers very directly. The corporation problem, on the other hand, concerns the form of business organization, and is largely concerned with legal institutions. Its evils are attributable to corporations as such, regardless of combination or monopoly; and they can be remedied only by altering corporation law. They concern the investing class most obviously. But the corporation problem is no mere investors' problem. For one thing, it should be clear that whatever so effects investors that they are hindered in supplying the funds that are needed adequately to equip business organization will also hinder production and injure the general public. Those directors or officers of corporations who abuse their trusts, manipulate their organizations, and "hold up" minority stockholders, are helping to discredit the corporation as a form of business organization, and to retard investment. But more than this: the corporation problem is intimately wrapped up with the "trust problem." Years ago a well-known American economist wrote: "At the bottom of every monopoly may be traced the insidious influence of the peculiar privileges which the law grants to corporations."[185] This fact we are too prone to forget. While the corporation is not to be thought of as being a necessarily sinister institution, nor as being necessarily monopolistic, still it is true that the power to amass great capital with limited liability, and to administer it with inadequate responsibility either to the stockholders or the State, which power the joint-stock business corporation possesses, may facilitate the formation of monopolies and the perpetration of monopoly abuses. The corporation is the leading form of business organization, and it is of the highest importance that it should be used, not for the exploitation of the public and the enrichment of the "insider," but for the honest, efficient, and democratic administration of production. No small part of the "trust problem" would be solved if this were the case.

Causes: I. The "Trust Problem" and Prices. — Such being the classes of evil associated with business organization, the next question that logically arises is, what are the causes? Keeping the "trust problem" separate from the corporation problem for the present, one may well approach the former first. Take high prices, for example. As indicated in the outline above, they may be due either to monopoly or to uneconomi-

cal production. But it takes no great study to arrive at that conclusion, and one merely wonders, then, what causes monopoly and uneconomical methods.

(1) *Monopoly.* — The chief aspect of the "trust problem" in the popular sense is monopoly. Indeed, in that sense, a trust is nothing but a combination for limiting competition. We do not ordinarily speak of trusts unless the industry is one in which competition once existed and was later restricted by a combination. Generally, then, to learn the causes of combination as it figures in the trusts is also to learn the causes of monop-oly as it figures in the "trusts"; though when combination is once established the real monopoly may be due to control of patents or limited natural resources. In an earlier chapter on Combination Organization in General, the conditions driving, beckoning, and facilitating combination were analyzed, so that this ground need not be gone over again. It will be remembered that a leading cause of combination, including combination for monopoly, is *(a) intensely severe or* "*cutthroat*" *competition.* This has already been explained (p. 135). The most necessary observation in this connection is that competition may be either economical or wasteful. Also it may be either legitimate or illegitimate, whether in an ethical or a legal sense. It was observed above that the problem is to secure progress without sacrificing safety and justice. Here we may say that this problem expresses itself in the statement that it is desirable to secure the efficiency of combination without losing the benefits of competition. One must constantly remember that competition is not an end in itself. Too often shallow thinkers have spoken as if all that we need in order to secure effective production is to make men struggle with one another in the way that we call competition; but mere competition will no more produce things than will mere physical exertion, for both must be wisely directed in order to accomplish results. Such thinkers assume that some profit will always be made, or that those who fail to make it will at once drop out of the industry. Neither assumption is true. We know that certain industries, such as railways and gas plants, are not normally competitive. Furthermore, we know that under competition industry is not always wisely directed: too many plants may be built, so that some must be abandoned with great loss to society as well as to the individuals concerned; great expenditures may be made in unproductive advertising and forces of salesmen; manufacturers and railways may seek to enter distant markets in an unorganized fashion, so that waste transportation is encouraged, etc. Appalling waste of our natural resources has been one result of competitive industry: millions of tons of coal are abandoned in the mines in the struggle to make the largest immediate profits,[186] and forests are ruthlessly devastated by the same forces. Nor should the loss of life and physical deterioration of laborers be forgotten. Political regulation may pervert competition, as when a protective tariff causes an over building of plants by directing too great a flow of capital into the protected industry. The result may be cutthroat competition in the crowded field. In all such cases, competition is not economical, but wasteful. The following list of the economies which combination has brought *in some cases,* will suggest other wastes: —

1. Most efficient plants, only, used in dull times; and run at full capacity all the time.
2. Specialization of plants.
3. Comparative tests.
4.Larger capital for experiments, etc.*
5. Full use of patents and of best methods.
6. Utilization of waste for byproducts.*
7. High-priced officials dispensed with.
8. Saving in cross freights.
9. Economy in advertising and salesmen.
10. Better credit and lower discounts.*
11. Less credit given, and fewer bad debts.

12. Middlemen regulated.
13. Steady prices (supply adjusted to demand).
14. Strength for export business.
15. Cheaper raw material (bought in largest quantities and from nearest sources).
16. Strength in dealing with organized labor.

* These, and, perhaps, some of the others, may be obtained by large-scale production without combination. While not holding in all cases, and while they may often be obtained without a giant combination, or "trust," — to say nothing of monopoly, — these economies of combination and restricted competition are very real.

But competition may also be legally or ethically illegitimate. To be associated with competition are points 2–7 in the list of evils with which this chapter begins. Rebates, bribery, secret control of nominally competing plants, and the like, have existed under a system of "unrestrained" competition, and such practices are not only wrong but unlawful. Refusing to sell to retailers who also buy of competitors, and cutting prices on cer-ain special articles or certain grades of product may or may not be unlawful, but the common sense of the community or society regards such practices as wrong. Competition by terrorism is no beneficent thing. It is piracy.

The conclusion is that in judging competition, whether as a cause of monopolistic combination or as a force which it is desirable to retain, we must distinguish the good and economical from the bad and wasteful. Clearly, some regulation of competition along the lines indicated by the abuses just described, is desirable. Neither unregulated competition nor unregulated monopoly can be safely tolerated.

Another important cause of combination for monopoly is (b) the *desire of individuals to secure control of limited natural resources, generally in the shape of raw materials.* The chief reason why the steel corporation desired the Tennessee Coal & Iron Company appears to have been the latter's possession of such resources, and the exorbitant royalty paid on the Great Northern ore properties is evidence of a similar desire. Many similar illustrations might be found in the petroleum industry and elsewhere.

These causes and others actuate those who seek monopoly. From the point of view of the public, the conditions which, by facilitating their ends, aid the growth of monopolies are also causes. Such conditions are (c) *corporation law,* and (d) *protective tariffs.* The former is, to the author's way of thinking, the more important; but it will be dealt with in discussing the corporation problem. As to the tariff, it has already been indicated that protection functions chiefly in an indirect way as an occasion, facilitating and inviting combination and monopoly. Inasmuch as it narrows the market, making control easier, and reduces the sources of raw materials, facilitating dominance at that end, it encourages monopoly. Then, too, it may heighten the ill effects of an established monopoly by allowing prices to be raised higher. In the case of the sugar industry, the tariff appears to have hastened monopolistic combination by begetting a condition of abnormal competition which led to the building of the Sugar Trust.

(2.) *Uneconomical Production.* — Just as Socialists are wont to overlook the problem of production in their eagerness to solve the problem of distribution, so writers on the "trust problem" sometimes forget that uneconomical production is often associated with trusts, and is one aspect of the problem. The chief immediate causes for the use of uneconomical methods by the trusts are (a) desire for monopoly, often leading (b) to overgrown business units; (c) overcapitalization; (d) inadequate corporation laws; and (e) legal uncertainty. Both overgrown business units and overcapitalization are often caused by the effort to profit by watered stock, that is, the effort to make money by selling something for more than it is worth; for it is this

effort which actuates fraudulent and uneconomical promotions. Consequently we may say that *desire for monopoly gains and desire for unearned gains on watered stock* are the more deeply underlying causes of uneconomical trust methods.

Surely, little discussion is needed to make plain the reasons for this analysis. It is the desire for monopoly gain which leads business men to buy up plants and patents only to suppress them; or induces them to pay extravagant prices for mines, railways, and factories; and everybody knows that the security of monopoly can deaden the desire to adopt the most advanced methods. By overgrown plants are meant those which are so huge and unwieldy as to make them incapable of efficient direction by any effectively concentrated directive agency. A large part of those trusts which have not rested on monopoly have proved to be overgrown and therefore unable to stand competition with better directed plants. Either by their reorganization, or by earnings inadequate to keep up the value of their common stock, such corporations as the "Whisky Trust," the "Cordage Trust," the "Malting Trust," the International Pa-per Company, the American Writing Paper Company, the American Hide & Leather Company, the Union Bag Company, the Sole Leather Company, and the American Can Company, have shown that they are not the most economical producers.[187] Overcapitalization is now recognized as a cause of bad management in that it inevitably brings a tendency to pay dividends out of capital. More than that, it is a cause of speculative management or manipulation; for overcapitalization generally means a situation in which the value of the more stable and sure assets is covered by bonds (or preferred stock), while considerable quantities of common stock are issued as bonuses or sold to persons who are more or less in the dark as to the likelihood of receiving dividends. Thus, one group owns the great bulk of the property while another group controls the management, and, as control costs little and means little risk, the conduct of the business is dominated by the idea of raising or lowering the price of its mass of speculative stocks on the exchanges.

Under the head of inadequate corporation law as causing uneconomical production, would come the irresponsibility and unrepresentative character of directors and officers which encourage extravagance and mismanagement. As to legal uncertainty, it is now the most common complaint among business men that they are prevented from cooperating and from laying business plans by the present unsettled state of the law and of public opinion. Undoubtedly this condition adds an element of risk that retards progress and tends to increase interest rates.

II. Inefficient Service. — Inefficient service to the consumer is in part synonymous with uneconomical production, and to that extent its causes are the same. The possession of unregulated monopoly may make a business organization less progressive and less attentive to the wants of customers. On the other hand, too, unrestrained competition may result in unsafe or unwholesome service. Without further discussion, it may be concluded that public regulation is necessary in a wide range of cases in order to protect the interests of consumers.

III. The Corporation Problem and Abuse of Investors. After what has been written concerning corporations in the foregoing pages, we need only pause to mention the causes of the abuse of investors' interests. In large part, the waste and uneconomical production found in the operation of many of the trusts are a fraud upon the investor; but the chief consideration here is to ascertain why the corporate form, in which nearly all of our giant combinations are clothed, fails to work for the best interest of the stockholders or owners. This is one of the most fascinating and important problems of the day; for is not the house in which over three fourths of our industry is carried on infested with disease? In a democratic country, hundreds of thousands of citizens in their economic relations are living in an oligarchy. Corporations, for the most part, have ceased to be "little republics," in which the shareholder citizens govern through democratically elected representatives, and too often these shareholders are mere ignorant pawns in a game of high finance, — their shares the

chips of a gigantic poker game. What is the trouble?

The root of the evil is *a lack of reasonable harmony of interests within the corporation.* Instead of operating harmoniously to produce wealth, and to render a due share of interest and profits to the owners of the capital and the risk takers, — corporations too often become as gambling houses which are supported by church members with shut eyes, and are run by men who seek to extract as much money as possible from "the public" without scrupling to pocket what should go to the owners. More specifically, directors and officers too often work for their own gain and against the interests of their constituents, the shareholders. Barring monopoly, it is probable that the long-run interests of the shareholders and the public are largely identical; but this is not the case with the "insiders." Holding but a single share of stock, and knowing next to nothing of the technical processes of the industry or the wishes of the owners, directors who are interested in a dozen other businesses, not infrequently competitors, determine the policy of the corporation. They take the promoter's fiction without disclosing the facts; they manipulate the market for its stocks, profiting as individuals by the changes caused; they enter combinations and dispose of properties with all too little regard to the productive capacity the plant; and all this may happen with little or no knowledge on the part of the stockholders. The majority prey upon the minority, "freezing" them out upon occasion. So common are such clashes of interest that it is little wonder that those who have made no deep study of the corporation sometimes regard it as an evil in itself.

But merely to point to a clash of interests takes one but a little way toward the solution of the problem. Why the clash? What particular occasions for it may be removed? In answer to these questions, then, we may attempt to state the immediate causes of the corporation problem, as follows: —

(a) Perhaps not of such vital importance as some of the points to be mentioned, but worthy of distinct attention as an occasion of evil, is the element of risk which lies in the *multiplicity of corporate securities.* To mention but a few varieties, the investor is confronted with common stock, preferred stock, and bonds. This, however, is but the beginning of his difficulties: for the preferred stock may be "first preferred" or "second preferred"; it may be preferred either as to assets or as to dividends; it may receive cumulative or non-cumulative dividends;[188] and it may or may not convey voting power. Some stocks are assessable by the corporation, while others are not; some are subject to "call" at a certain price, while others are subject to no such provision; and some have a limited dividend, while others may receive an unlimited income. Also, a score of different kinds of bonds may be found on the market, differing in priority, kind of security, method of payment, and redeem-ability. This situation fosters clashes of interest among the members of corporations; for each class of security holders may profit by a course of action which immediately injures every other class. The common stockholders, for example, are apt to desire larger dividends at any cost, while the holders of preferred stock and bonds generally look more carefully to the maintenance of the property.

The existence of a variety of securities, too, facilitates manipulation especially when forms are not standardized. This is strongly suggested by the reorganization of the American Tobacco Company in 1904. In that case, by the action of a majority, a large issue of non-voting preferred stock was substituted for stock which had voting power, thus eliminating the minority vote.

Nor is this the only kind of evil which arises from multiplicity of securities. Overcapitalization is encouraged by the same cause: for, after all the securities that the true value of the corporation's assets will warrant have been issued, millions of a speculative and specious kind remain to be "floated"; and purchasers appear to be ever present among the ignorant and the adventurous.

Perhaps the most obvious evil of all is suggested by the last statement. This is the uncertainty and risk which the would-be investor encounters. Many a man has purchased securities in the belief that they were sound, only to find that some obscure clause in the security document or some unknown provision in the

corporation's certificate or by-laws had either given him but a remote and secondary claim or had deprived him of all voice in the corporation's affairs. The losses borne by holders of common stock and second-mortgage bonds in many a corporate reorganization speak eloquently on this point.

(b) *Easy Transferability of Stock.* — Considerable freedom to buy and sell corporate securities is essential to the success of the joint-stock idea and to that fluidity of investment which promotes industrial progress. This should not be forgotten. But we have seen that the joint-stock idea has its dangers. Accordingly, the ease with which men can buy into or sell out of business corporations is one of the occasions of corporation fraud and manipulation, especially in the case of the larger corporations whose securities are dealt in on the exchanges. Control for sinister purposes is rendered easy; and escape from the nearly wrecked business is assured. Would directors often injure a business unit if they could not sell its stock "short" and buy it cheap? If stockholders had to stay by the business, would not *gr*eater care be exercised in business management? Unlimited transferability encourages overcapitalization and speculative management.

(c) *Small Holdings by Directors and Officers.* — Closely allied to the foregoing point, in the way that it affects the corporation is the smallness of the stake often held by those who direct the corporation's policy. In most cases, one share will qualify any person to be a director. This facilitates the creation of "dummy directors"; and it means that the ups and downs of the corporation's business need not worry a director in so far as his personal financial affairs are concerned. The fact that few, if any, directors are required to be residents of the State which creates the corporation tends in the same direction. It is little wonder that boards of directors so frequently take no part in directing.

"Interlocking directorates" arise out of the two conditions indicated in points *(b)* and *(c),* and the interlocking in turn becomes an occasion of evil in many cases. A large corporation may place one or more of its directors on the boards of dozens of other corporations for the sake of financial influence or of business cooperation.

(d) *Remoteness of stockholders* is to some extent a cause both of the lack of participation by the owners of corporate property, and of the common clash between their interests and those of the insiders.

(e) This cause is reenforced by the *growing size and complexity of business units;* for only a small part of the stockholders have either the time or the ability to understand even the larger details of a business like that of the Steel Corporation.

Johnson, in his *American Railway Transportation,* makes the following statement which bears out the preceding points: "The control of railway properties is coming more and more into the hands of a small number of groups of capitalists, but each group of capitalists comprises a multitude of individual owners, the concentration of control being the result of the delegation of authority to the limited number of financial leaders in whom investors have especial confidence.... As the corporations become larger and the stockholders become more widely distributed, control by the individuals or groups of individuals holding a minority of the shares becomes easier " (p. 76).

(f) Doubtless, too, *the proxy has been abused,* being secured by insiders from careless or ignorant stockholders for unduly long periods of time, and for unrestricted purposes.

(g) *Inadequate Reports.* — Even if the owners or stockholders had the power to determine the general policy of the corporation, it is rarely the case that they receive information concerning their business which would be adequate to enable them to act intelligently. Probably they do not have adequate access to the books in some States; but that is a difficult question. Certainly there is crying need of better information concerning (1) promotion, (2) operation and finance, and (3) stockholders' and directors' meetings. Now, the intelligent and interested stockholder generally has no means of knowing to what extent his shares represent promoters' services and property of doubtful or speculative value; he has slight information to

enable him to form a judgment as to wasteful or corrupt management; he is an outsider. Nor do the States help much by requiring public information. It appears that in 1910 as many as eighteen States required absolutely nothing but a purely formal report containing such insignificant items as the name of the company, the amount of its stock, etc. Is it any wonder that corporations have come to be regarded as investment or speculation institutions in whose slots, as it were, so many dollars are dropped by the blind with the expectation that somehow or other dividends will be forthcoming?

(h) *Inadequate Representation of Minorities.* — At the present time a large minority may secure absolutely no representation in the direction of a corporation. Under the prevalent system of voting, each stockholder has one vote for each share of stock, and in electing directors the minority holders can have but one vote per share for each candidate. The result is that a bare majority can elect all the board. Again, small majorities, under the laws of many States, can pass measures which fundamentally affect the business. Certainly there is danger of losing efficiency by giving undue power to minorities, but the existing situation gives occasion for serious evils.

(i) *Indefinite Responsibilities; Inadequate Penalties.* — One great trouble with corporate action has been the difficulty of fixing responsibility. To some extent this is a necessary concomitant of indirect motivation and delegated management; but more largely is it due to the facility with which the responsibility for manipulation and wrongdoing has been deliberately evaded, even when the wrongful acts have not been concealed. Under the guise of agents, officers have acted against the best interests of their companies. Directors and officers have sinned against the public with personal impunity; and bare majorities, perhaps fraudulently gained, have run counter to the wishes of large minorities on important points. In short, the policy of a corporation may be decided by a few, while the responsibility for that policy rests upon many. To cap the climax comes the inadequacy of penalties which was noted in an earlier chapter (Chap. VII).

It is easily possible, here, to overemphasize the shortcomings of the law, for there can be no doubt that the legal principles concerning the liability of directors, officers, and promoters are much more deserving than is commonly supposed by the layman. Not uncommonly the trouble does not lie in the law so much as in ignorance of the law; and the malefactor escapes with little or no punishment, because the injured stockholders or creditors do not know their own rights. Thus, the author knows of a case in which a corporation officer was advised by his attorney that he had so acted as to make himself liable for the sum of $100,000. He promptly authorized the attorney to make the best settlement available, and the shrewd lawyer "settled" for $2500, a feat which was made possible by the ignorance of the claimants of their strength under the law.

Fundamental Causes. — In the case of the corporation problem, — and also, in part, of the "trust problem," — the great, fundamental, active cause is moral; the points made above have been the more immediate occasions through which the underlying moral forces work. The one great moving cause is the desire on the part of individuals to enrich themselves at the ex-pense of others, without regard to social obligations. This, of course is simply a virulent form of selfishness. It is evidence of a low moral tone, and it works through secrecy. In part, it works through bad laws; in part through a violation of existing eood laws. The more fundamental situation may be summed up by saying that our problems of business organization largely arise out of a low moral tone among business men, fostered by secrecy, and aided by faulty corporation law and other legal maladjustments. Under the latter head would come tariffs, patent laws, laws on restraint of trade, and the like, — laws formed under different business conditions than now obtain. This is not mere preaching. The significance of the ethical aspect is well stated by an eminent economist who is by no means prone to favor radical reforms; for some years ago A. T. Hadley said: —

> "I have gravely doubted the wisdom of some of the more recent measures passed by the

> National Government. But I cannot shut my eyes to the fact that these things are what business men must expect, unless business ethics is somewhat modified to meet existing conditions. Industrial corporations grew up into power because they met the needs of the past. To stay in power, they must meet the needs of the present and arrange their ethics accordingly. If they can do it by their own voluntary development of the sense of trusteeship, that is the simplest and best solution. But if not, one of two things will happen; vastly increased legal regulation, or State ownership of monopolies. Those who fear the effects of increased government activity must prove by their acceptance of ethical duties to the public that they are not blind devotees of an industrial past which has ceased to exist, but are preparing to accept the heavier burdens and obligations which the industrial present carries with it."[189]

Some progress certainly has been made towards the improvement of the ethical situation, and much more can be effected in this direction; but, nevertheless, it would be over-optimistic to rely upon this alone. We must close the doors through which evil motives work. We must remove the occasions for evil. This is the significance of the detailed statement of the more immediate causes which has preceded. An examination of the remedies is now in order.

Chapter XXIV: Public Policy: Remedies

No one can step forth and say, "Lo, here is the remedy for the trust problem." Possibly the universal adoption of the golden rule and a high degree of general intelligence would solve it; but this is like suggesting a thorough salting of the bird's tail. What we can hope for is the careful adoption of those various measures which such experience as we have, together with a scientific analysis of the cause of the trouble, shows will be best adapted to remedy the chief evils. To a considerable extent, such measures must be tentative, experimental, and subject to change; for we are standing on the edge of a new and higher plateau of business and social life.

The reader's attention is called to one general limitation upon the following discussion: namely, the fact that it primarily concerns the problem of "big business," and that much of what is written will not apply to small corporations or to "close corporations." In the hope of avoiding too much detail, it is left to others to draw the line between large and small corporations, remembering that in some cases the importance of the business is such that mere size cannot be the only criterion. The more restrictive ones of the following suggestions concerning corporation law, then, are made for those corporations which do a large or important interstate business, and whose shares are bought and sold.

A. Postulates which may be Assumed.

To begin with, there are certain fundamental truths now recognized by most unbiased thinkers.

All thoughtful men will admit that there are two sides to the immediate question. One is the general well-being of society regarded as a body of consumers; the other is the prosperity of producers, including business men. This is but another way of saying that the public interest and industrial progress are interrelated. We must take care lest we hamper industry.

Another general premise, admitted, at least tacitly, on all hands, is that any business organization which produces an essential of decent human life in our existing society is affected with a public interest; and that this interest becomes active whenever there is danger that the supply of such an essential may be controlled. The organization need not lie in the relatively narrow class of industries known to lawyers as public-service industries. The day of the public-be-damned business is passed. The sanction for all laws and industries rests ultimately upon social well-being.

There has developed a strong conviction that in all industries which are affected with a public interest a large amount of "publicity" is desirable. Especially is this true when the business is organized as a corporation. Most men, however, admit that the information published should not be such as to hamper a business unit in legitimate competition.

The last statement suggests the fact that, of late, opinion has crystallized into the conviction that certain

practices common in the competition of the past are unethical and cannot be tolerated in the future. These have been enumerated.

Again, a growing conviction exists that, in dealing with these practices and with other sources of evil, the States are powerless to meet the situation adequately. Political jealousy toward any limitation of State powers may retard industrial Federalism; it may do good by preventing hasty and extreme action; but it cannot stay the tide. Some three fourths of our business is interstate; under the Constitution, and logically, the Federal government alone can deal with interstate commerce; therefore Congress should take the steps necessary to deal with corporations and "trusts." So runs the reasoning in the minds of this generation. The States can do something, and their administrative autonomy is not to be curtailed lightly; but the common Congress of the Union must be chiefly relied upon to apply the remedies adopted.

Finally, there is the growing, if not general recognition that "administrative control" is essential. In such matters as concern us now, judicial control, or "regulation by law suit," has failed and failed again. The injured are loath to sue, and they get no adequate compensation when they do sue. The injurers are not deterred. It is impossible to lay down in advance rules which will cover multitudinous and changing conditions. The courts, from the nature of the judicial function, cannot apply general principles with sufficient breadth and special knowledge to meet a great complex social problem like this. They are too much hampered by legal precedent. They are too much confined to *remedying* wrongs accomplished, and have no adequate powers to *prevent* abuses. Therefore, the commission, acting with administrative powers, has been the recourse in nearly all cases, both here and abroad. The necessity for it has all but passed beyond the realm of debate, though the scope of its activities remains to be settled. To this body would be intrusted a large part of the task of making publicity effective; for they, rather than the mass of relatively inexpert stockholders, would necessarily be relied upon to see that logical and enlightening accounts were kept, to initiate action on the basis of reports, and to pass upon the value of property and services exchanged for stock. Affidavits as to the value or even as to the cost of property have proved futile as a safeguard, and the judgment of some unbiased body is necessary if the law is not to be nugatory.

We may therefore begin a statement of particular and more debatable remedies with the postulates (1) that business interests are to be guarded, but that the public has an interest in business and can properly demand publicity and the abolition of unethical practices; and (2) that the Federal government, acting through an administrative body in the nature of a commission, must be largely relied upon to apply the remedies.

B. Remedies for Particular Evils

I. The Corporation Problem

It is most logical to begin with the corporation problem. At the outset, in order to suggest a part of the machinery through which the proposed remedies can be applied, it seems desirable:—

(1) To provide for *a general and uniform regulation of the powers and duties of those corporations which do any interstate business of importance to society.* This is absolutely necessary to any effective solution, and history and logic show that it cannot come by State action. Therefore, we must have a national law which will bring it to pass. Compulsory Federal incorporation is open to constitutional objections. The Federal license system has also met with similar opposition. Many profess to fear that either plan would operate to give a governmental sanction to monopoly. The least objectionable way to proceed seems to be for *Congress merely to provide by law that all those corporations which are to be subject to control shall conform to certain rules as a condition prerequisite to engaging in interstate commerce.* Such a measure would act as a positive partial remedy for the present chaos of our State corporation laws; and it would serve as the force behind the "certain rules," which are to be enumerated next.

It will be observed that it is only *compulsory* Federal incorporation that seems inexpedient. It would undoubtedly do good, if constitutional, to enact a model Federal corporation law which would provide for the incorporation of those interstate business units which might desire it. The discussion of such an act would be educative. As a model law it might exert a beneficial effect upon State laws and tend towards uniformity. It would simplify the control of such corporations as might choose to come under its provisions. It would certainly be wise to intrust the draughting of such a law to a special commission of economic and legal experts.

(2) Taking up the more specific remedies somewhat in the order that the evils were presented in the preceding chapter, should touch first upon the *simplification of securities.* This may be effected by reducing the number of varieties of stocks and bonds, and by standardizing their forms. In part, the evils which arise from a multiplicity of securities will be met by other remedies: the clash of interests between different classes of security holders may be softened by making directors and officers hold more stock; and overcapitalization may be reduced by direct regulation and publicity. But a simplification of securities would help greatly to solve these problems, and is the only way to remove a source of loss to certain classes of would-be investors.

To be sure, the various classes of securities now in use have been devised to meet needs, — but not always to meet legitimate needs. Corporations should be allowed to appeal to various classes of investors through a variety of stocks and bonds. Some investors want security and no participation in the conduct of the business; and bonds meet their desire. Some want a chance for larger returns than can be paid on bonds, but are willing to forgo the privilege of voting for the sake of considerable security; and for such preferred stock is suitable. Others are willing to bear the full risk of the business in the hope of a large profit; and these persons may buy common stock. In this way, the different classes of corporate assets are logically covered by different securities; the different classes of investors are appealed to; and the largest amounts of funds are raised. But much beyond these three general classes of security there is little need to go, and a limit should be put upon variety within each class; for the existing multiplicity has become a source of confusion and jugglery, rather than a legitimate grading of risks. The student of corporation finance will appreciate the impossibility of any adequate treatment of so complicated a subject in a single paragraph. However, if a brief suggestion may be hazarded, one might reasonably defend the following program, (1) Prohibit the future issue of any but three general classes of securities: mortgage bonds, preferred stock, and common stock. (2) Within the bond class, prohibit any issues but those secured by a first mortgage, and also prohibit "blanket" and "consolidated" mortgages.[190] (3) Prohibit any but first preferred stock, and provide that all future issues of preferred stock shall have priority over common stock both as to assets and as to dividends. Also make all such stock uniformly non-voting except on a few points, such as increase of capitalization. As a result of this policy there would be no need for income and debenture bonds, and a reasonable degree of standardization might exist. (4) Provide for a standard form of common-stock certificate. If any variations are to be allowed, the non-uniform certificate should be stamped "irregular" or "not standard," and the variations be plainly indicated.

The primary point which facilitates the abuse of large business corporations is the easy transferability of shares; for, as we have seen, it opens the door in the beginning to manipulation, speculative management, etc., and facilitates overgrown units and monopoly. It works hand in hand with the small holdings required of directors and officers.

(3) A remedy for the evils just mentioned may be secured by putting *some limit (a) upon the power of officers and directors to transfer or acquire holdings of stock in the corporations which they seme, and (b) upon the transfer of stock prior to corporation elections.* Obviously we are in danger of hampering industrial

flexibility by such measures, and great caution should be used. The author would suggest very tentatively that directors and leading executive officers be prohibited from buying or selling the securities of their corporations for a reasonable period immediately preceding and following such official acts of theirs as affect the standing of such securities in the markets. The object is to do away with inside management. Also, by prohibiting those stockholders from voting who have come in just prior to elections, the purity of corporation representative government may be guarded.

(4) To *require directors and officers to hold suck reasonable amounts of stock as will insure on their part a reasonable interest in the business of the corporation.* A considerable part of this stock should be common stock. The amount required might vary with the importance of the officer in making administrative decision. Such a measure would tend to retain the interest of officers and to prevent mismanagement. Employers advocate stock ownership by their employees; why not try the shoe on the other foot?

Of course, evasion would be difficult to avoid and safeguards against it would have to be provided for carefully.

The foregoing measures will strongly tend to remove danger from "interlocking directorates." It does not seem wise to make it impossible for a man to serve on the boards of several corporations. It may prove necessary, however, to take some further step to restrict such interlocking in the case of corporations between which competition is desirable, perhaps requiring a specially large holding in such cases, or even going to the length of prohibiting it.

As to remoteness of constituency, and complexity of business, they are in large part inevitable in present-day business, and should only be modified in part. Some particular measures would be of great service, however.

(5) If we could assume that the enforcement of more uniform conditions among corporations doing an interstate business had largely removed the special attractiveness of certain States for incorporation, it might then be well to require that the main office be located in the State or the region in which the largest part of the business is done, and that *stockholders' meetings be held as near as possible to the geographical center of the stock hold-ings.* This latter suggestion, however, might not prove expedient in practice.

(6) To the same general purpose, it is of considerable importance that the use of the right to vote by proxy be safeguarded. *Reasonable limitations on the life and powers of a proxy should to be adopted.* The New Jersey law limits the life of a proxy to three years; but why not limit it to one year when regular meetings are annual? To be sure, this would put those who desire proxies to more trouble, but that should be the case. So it is with the powers given to a proxy: it would be more in keeping with carefully guarded corporate democracy not to give *carte blanche* to the proxy holder, but to require that he act upon instructions and for limited purposes.

(7) The requirement of reasonably full and intelligible annual reports should be supplemented by *the requirement of timely and enlightening announcements of all stockholders' meetings.* To the end that stockholders may take an intelligent interest and that they may be able to attend meetings, notice should reach them from ten days to two weeks prior to meetings and should state the purposes of such meetings. At any regular meeting, directors should be required to furnish a copy of all or any parts of the records of directors' meetings to any stockholder who might desire such information.

No special regulation need be adopted to meet the trouble that comes from the complexity of the business. Better information and honest management would help directly; and restrictions on holding-company organizations would simplify conditions.

(8) It is highly essential to *make the reports of corporations to stockholders adequate, to the end that they may be able* (*at least through representative attorneys or accountants*) *to protect their interests in so far*

as possible. It is not possible for stockholders to protect their property alone, but it is in accord with the ideal? of the nation that they be stimulated to help themselves in so far as the safety of society warrants. This is not the place to make detailed suggestions as to the manner of securing and presenting the desirable information; but in a general way it should be observed that full information concerning promotion must be given to prospective stockholders, covering amounts and kinds of all securities, the consideration received therefor, — cash, property, and services being plainly distinguished, — preliminary contracts, and details of promoters' and underwriters commissions. The importance of knowledge concerning deprecation, sinking funds, and reserves should also be remembered; nd information covering these points should be given.[191]

(9) With regard to giving stockholders access to the books a provision similar to the German law would be expedient, — namely, to *authorize stockholders owning at least one tenth of the shares to petition the courts* (say the district courts in such States as have them) *to appoint a committee to examine the books and accounts of their corporation for the purpose of securing information* on its promotion, operations, or financial relations. A registered office should be maintained by all corporations, at which stock and transfer books written up to date should be kept open to inspection by all stockholders.

To remedy the shortcomings in the representative government of corporations, and especially the abuse of minority holdings, some or all of the following measures are worthy of consideration.

(10) *In order to make majorities more certainly representative,* in addition to giving to stockholders fuller information and safeguarding the proxy, *larger majorities should be required for the adoption of any policy which has an important effect upon organization or upon assets or earnings; e.g.,* changing by-laws, creating a new class of stock, forming a merger, or selling or leasing an important property. Such corporate acts might be roughly classified and a three-fourths majority be required for some, while a two-thirds majority would answer for others. It has been well suggested that merger might be allowed only upon a vote of two thirds of the stock of each corporation, dissenting shareholders having the right to sell their stock for cash at an appraised value. The danger in all limitations on majorities, one should recall, lies in impeding action.

(11) In order to make considerable minorities more effective, "cumulative voting" is a tried and excellent device. The author would strongly recommend that the Federal law now contemplated be made to provide for *optional cumulative voting in all cases and to require it in all monopolistic industries and those in which the least publicity is provided.* Cumulative voting gives to each share of stock as many votes as there are men to be elected. Therefore, when more than one position is to be filled; — as is generally the case in electing directors, — a bare majority cannot elect the entire slate, for by concentrating all their votes upon one or two men the minority can always obtain some representation.

(12) Another feasible measure, one which is in force under the corporation laws of Germany, is to *give a reasonably small percentage of the stockholders power to call meetings and initiate propositions for action.* It seems fair to allow a small minority — say one twentieth of the outstanding voting securities of any class — to call a meeting of the members of that class under reasonable conditions. The purpose should be stated in writing. The general idea is similar to that of the initiative and referendum. Would it not be well to try with reasonable adaptations some of those steps towards a democratized control which have been effective in political life? The danger here, as in politics, is that the brains of the business will be diluted, and that industrial democracy will be unwieldy and unstable like the democracies of politics. The representative idea, however, seems absolutely essential to good business management of corporations.

It has also been proposed to facilitate the removal of obnoxious directors by authorizing any stockholder to circulate at his own expense both information concerning the management and petitions asking for change, such documents to be vouched for by a certified public accountant. This would be a step reminding one of "the recall"!

(13) Finally, it is very desirable to remove such clashes of interest as tempt officers and directors to misrepresentative acts, to which end there is to be recommended that *when directors or officers seek to sell to their corporation any property in which they are interested, or otherwise to cause acts to be done by which they profit, and which are voidable and must be ratified by the stockholders, the stock held or controlled by such directors or officers should either not be counted in the vote, or should be allowed to count only upon the approval of some public authority.* In all cases, full information should be given to the stockholders concerning any relations which may exist between directors or officers, and any company with which their corporation has had or will have dealings. Also, it would be well to entitle any stockholder at any time to demand a statement of all salaries paid any officer. In such cases, the reasonable cost of copying the information should be borne by the parties desiring it.

(14) The evils arising out of the lack of a definite responsibility on the part of directors and officers, and inadequate penalties for their misdeeds, would be much diminished by the various remedies proposed in the preceding pages: those designed to give corporation leaders a greater personal stake in the business, to make their actions subject to publicity, and to secure a better representation for minority interests. Nevertheless, it would strengthen the cause to take steps *formally to localize responsibility with those who make decisions and to deter them from misdeeds by making them liable to well-chosen penalties.* In corporations whose stock is largely held by women, by estates, and by others who either cannot or do not often make any real decisions concerning business policy, it seems foolish not to make the directors and officers who exercise the real power also bear the major part of the responsibility. In this respect the limited partnership form is more logical, and it would be well if it could be encouraged in some modified form in cases where investors cannot actively participate. In the corporation, individual stockholders may bring action in equity, but only in case the majority of the directors improperly refuse or neglect to sue. It seems that the fraudulent acts of directors which it is in the power of the majority to authorize can be made the object of a suit for damages by an individual only after a stockholders' vote.[192] When the damage is suffered by all the stockholders in common, it has been held that the corporation is the injured party, not any individual shareholder. Even when judgment is secured, the attempt is made merely to recompense the individual for his loss. It is tentatively suggested, in view of these facts, (a) that the individual stockholder should be definitely authorized to bring suit at law against directors or officers for fraud and negligence in pursuing any accepted general policy, by which he may suffer injury in fact, and that a simple procedure be provided; (b) that either punitive damages or imprisonment be provided for as the penalty in all cases in which directors are found guilty of gross mismangement, fraud, or negligence; and (c) that directors and high administrative officers be subjected to a double liability on their stockholdings to creditors, to the end that they may feel the responsibility for their policies more keenly. In accord with this general idea, it was proposed in a bill drawn for a New York companies' act some years ago, that if any certificate of incorporation or any public notice by the officers or directors of a corporation were false in any material respect, all the officers or directors who signed the same should be jointly and severally liable for all the debts of the corporation contracted while they were directors or officers thereof, as a penalty.

As remarked when analyzing the evils of business organization, ignorance of the law is in part to blame for the inadequate responsibility of officers, directors, and promoters; and, though a measure of difficulty is perhaps inherent in representative government or delegated management, it follows that some improvement might be effected merely by enabling stockholders to act with fuller information concerning their rights. Perhaps the most effective plan would be to provide for accountants and lawyers to represent the interests of minorities, the object being to put expert advice and skilled service on the side of those who need protection. All these suggestions are made with considerable trepidation, in the hope that corporation lawyers will see

some better way to gain the desired end.

As in the case of some of the other proposed remedies, the author would here remind the passive reader, and concede to the argumentative one, that there is grave danger to efficiency in unduly encouraging suits by stockholders. Deadening litigation would be fatal. It would be desirable, if possible, to distinguish between general policies and particular measures, leaving large freedom of initiative to the officers in the latter field.

One objection which may occur to the reader of these pages is that the various regulations here proposed would so restrict the operations of corporations that investment would be impeded and business be retarded by a lack of capital. But is it not more likely that the increased security which would be afforded to investment would swell the funds available for corporate enterprise? Every one knows of men of small savings who are loath to intrust their funds to the tender mercies of an unknown and uncontrollable corporation management. It is certain that one result of an improvement in corporation law would be to increase the number of small stockholders; and, as this would not only encourage saving on the part of men of moderate means by giving them a chance to share in the profits of industry with moderate risk, but also increase investment in corporate securities, it suggests hope rather than fear for the results of the plan.

The author has failed to express himself clearly if it does not appear from the foregoing suggestions that he desires to retain the corporation as a form of business organization in interstate commerce, and to make it more useful, by the general means of making its affairs more subject to reasonable publicity and by preventing clashes of interest both within the corporation and between it and the public, the means being applied with discrimination by an administrative commission of unbiased experts.

Chapter XXV: Public Policy: Remedies (*Continued*)

II. Overcapitalization and Holding Companies: Transition to the Trust Problem.

In the problems concerning capitalization and concerning holding companies, we find a mixture of the problems of corporation law and of "trusts," or combinations.

(1) *Overcapitalization.* — Overcapitalization by "watering" stock is an admitted evil. It makes corporation managements try to pay dividends as though the real capital were equal to the watered capitalization; it increases speculation and risk; it furnishes an incentive to unsound promotions and combinations. Three policies have been pursued in the attempt to remedy the evil: (1) the *laisser-faire* policy, according to which the State merely undertakes to insure liability on the part of those who are guilty of misrepresentation and fraud; (2) the policy of regulating the conditions back of security issues by accounting provisions and publicity, leaving the issue itself free! (3) the control of issues, with or without regulating the conditions surrounding them. The last policy has been effected in two ways: (a) either by forbidding corporations to issue securities for less than their par value, or (b) by forbidding them to issue securities in excess of the appraised value of their properties. Which policy is best?

The first policy is so discredited that it need not be discussed. In applying the two remaining policies it seems necessary to distinguish two classes of corporations; (1) those doing a competitive business, and (2) those which are monopolistic, including all public-service companies. The present tendency is strongly in the direction of a strong control of the amount of stocks and bonds of public-service corporations, and this is probably wise. It removes the danger of speculative management and facilitates rate regulation. Where rates or prices are likely to be so regulated as to yield but a reasonable return upon investment, this strict limitation of capitalization is the safest policy for a corporation to pursue. Businesses of the second class, then, should have their capitalizations controlled by valuations based upon actual investment and appraisals of tangible property.

Moreover, in such industries, less risk obtains, and there is less need of encouraging promotion by means of large speculative rewards. Instead, small investors should be encouraged by making securities safe.

But with competitive industrial corporations the case is different; and it is more in accord with the idea of encouraging an active participation by stockholders in corporate affairs to adopt the second policy. That policy is more in keeping with the ideal of retaining the largest measure of individual initiative that is consistent with the common good. Moreover, in this class of corporations risk is often greater, and the need of encouraging private promoters is real. Accordingly, the author would recommend for the present that, instead of attempting to fix the amount of stock to be issued by competing corporations, *the conditions*

surrounding stock issues be made sound (a) by regulating accounts so as to insure the proper maintenance of the plant, and (b) by facilitating true judgment through requiring full publicity as to the amount of prior-lien securities, and the exact character of the assets. Accounts should give such information that such abuses as the declaration of dividends out of capital, and the payment of exorbitant prices and salaries could be detected; intelligent prospective purchasers should be able easily to learn just what outstanding securities have a prior claim either to assets or to dividends; and, while serious difficulties are involved in its execution, all will admit that a physical appraisal would be of value in enabling a truer judgment concerning the character of a large part of the assets of most corporations.

In part, these regulations have been provided for in the preceding points. Attention should be especially called to the fact that the simplification of securities which has been advocated would operate strongly to discourage overcapitalization.

If it should be found that stronger control is necessary, and that a valuation must be made for all corporate property, very complex and difficult questions would arise, which questions should be answered by a board of economic experts.

In any event, it is important for sound financial and business organization that some further control be exerted over the payment for stock. In the capitalization of all important interstate corporations, in cases in which stock is issued for property or services, the commission should be given power to pass upon the value of such property or services and to see that payment is actually made. In cases in which stock issues are to be restricted to a property valuation, the law should require that a reasonable payment (say one fifth) be made at once, and that installments be paid thereafter at regular intervals till the total price is turned in. Interest should be collected on overdue installments and the shareholder be liable to the corporation for damages caused by his delinquency.

But all this time the reader may have been questioning the power of the Federal government to exert any control over the capitalization of State corporations. That it has the power, however, seems quite certain, — at least in the case of public-service companies.[193] Even if corporations doing an interstate business do not secure a Federal certificate of incorporation, it appears that under all rules and analogies of constitutional interpretation, "Congress assuredly may regulate and restrain the State corporation in the exercise of these as well as of other corporate powers, and may prohibit it from issuing obligations or stock for any purpose relating to interstate or foreign commerce except in accordance with rules and restrictions prescribed by it for the purpose of preventing evils."

(2) *Holding Companies.* — Up to the present time, the holding company has been the leading form of business organization in the field of combination and "big business." There can be little doubt, however, that this very form has facilitated, if not caused, the existence of some of the gravest evils in the business world.. It is well-nigh axiomatic that some limitations must be put upon interholdings of stock if competition between corporations is to be maintained. Yet, inasmuch as the holding company has been very useful in the organization of great business units, especially "industry combinations," or sequence organizations, and has certain admitted advantages, one must feel somewhat loath to banish it without a hearing, as is the desire of many reformers just now.

In the first place, the holding company is now both less desired by business men and less dangerous to the public interest: it must be remembered that the supposed advantages of the holding company as a device for legalizing combinations of competing concerns have been largely dissipated by recent decisions; and, at the same time, the possibilities of securing monopoly through secret stock ownership have been diminished by the limelight of publicity. The limitations upon economical direction and management under holding-company organization are also apparent. We must conclude that such developments will not only lessen the

likelihood of abuses in securities holding, but will also make business men less desirous of adopting the holding-company form of organization in the future. Furthermore, the danger to investors and to society from holding companies would be greatly reduced by the various remedial measures already suggested, for holding companies, of course, are corporations. The addition of the measures to be suggested for dealing with monopolistic combinations would all but eliminate the evil.

Nevertheless, following the policy of getting at specific causes and occasions, we may note some special steps which might be taken to remedy the situation without going so far as absolutely to prohibit holding companies. Perhaps the simplest and most effective plan would be to require all corporations and trusts which own or control as much as one fourth of the shares of another corporation to purchase all the remaining shares within reasonable time, or else to sell their present holdings. The commission might be called upon to appraise the value of the shares to be acquired, in case of difficulty. The cause of holding-company trouble generally lies in the power of control over subsidiaries gained by the ownership of only part of their securities. In a word, it is the minority problem in an acute form. The natural remedy, therefore, is to get rid of the "outside" minorities. This would bring about either a virtual merger or separation.

In applying this remedy, certain distinctions might be considered. Pure holding companies which do not engage directly in operation are obviously on a different footing from those operating companies which incidentally hold stocks in other concerns. Again, securities holding for the purpose of binding together the successive stages in an industry differs from the combination of parallel competing units in the same stage or trade. The pure holding company, owning but a bare majority of the stock of subsidiary corporations which are engaged in the same line of business, is the most dangerous form; and one seeking to minimize regulation might confine the application of the suggested remedy to such concerns.

The fullest publicity consistent with efficient management should be demanded of all holding-company organizations, covering the payments received for the stock in the beginning, the interrelations of the main and subsidiary companies as to stockholders and directors, net earnings of subsidiary companies, dividends paid, etc. In case the present policy of control by a bare majority is allowed to exist, *special* care should be taken to Protect minority holders and to inform them of the proceedings at directors' meetings. All stockholders in subsidiary companies should have the same right to inspect the books of the holding company that they have respecting those of the companies in which they hold stock; and, similarly, any stockholder in the holding company should have access to the accounts and records of its subsidiaries. This is of prime importance.

Finally, it may be suggested that any corporation or trust which owns considerable holdings in the corporations of States other than the one which created that corporation thereby becomes interstate in character; and such a corporation might properly be required to secure a Federal license, even if non-holding companies were subjected to no such requirement.

III. The Trust Problem, or the Problem of Combination

General Postulates. — Assuming that the adoption of a program similar to the one suggested above would remedy the chief defects of corporation law, we may now pass to that phase of the problem of business organization which concerns such combinations of corporations as are formed with the object of gaining control of the supply of goods and so controlling prices. This is part of the problem of monopoly. We may begin by laying down certain generally accepted conclusions as postulates.

Competition is desirable, not for its own sake, but for the good results which it may bring by stimulating men to put forth energy in production, and by directing industry into the lines in which men are willing and able to pay the highest prices. In a large part of the world of industry, competition, when carried on as a

healthful rivalry in which freedom of initiative is maintained and encouraged, and freedom to enter any private business is assured, stimulates and directs in this way, and consequently is desirable.

But there exists a large group of industries in which competition cannot normally exist, the so-called “natural monopolies.”

A large amount of business rivalry called competition also occurs, which, from a broad social point of view, is not healthful, and which does not encourage freedom of initiative nor the right to enter business. Such competition being unethical or obstructive or both, is harmful, and not desirable. Competition in which outsiders are interfered with in an unfair manner is not to be tolerated.

Finally, a debatable field exists in which a tendency to excessive and therefore unhealthful competition is frequently found. This field includes those industries in which large amounts of fixed and specialized capital are used and in which by-products or joint expenses are prominent. Here competition becomes destructive. Here the dangers of monopoly have to be balanced against the wastes of competition, and either may outweigh the other. Some regulation is desirable in either case.

Restraints upon competition, therefore, are of two sorts, — the reasonable and the unreasonable. A restraint upon excessive or unethical competition may be wholly reasonable; and, in the same sense, there may be reasonable and unreasonable restraints of trade, the test being found in the question: does the restraint promote production and freedom of exchange?

These preliminary distinctions may be concluded with a suggestion for an analysis of combinations according to their purposes, methods, and importance. Any broad and discriminating study of the combination problem must recognize that combinations differ in *purpose,* some seeking economies in production, others monopoly; that they differ in *methods,* there being legitimate ones which are open and fair, while others are close and unfair; that federative combinations differ from corporate combinations in important respects; and, finally, that they differ in the *degree of public interest* involved, some concerning public service, others common necessaries of life, others luxuries.

Particular Remedies for the Trust Problem. — In the light of the foregoing analysis, and with the assumption of a purified and efficient corporation organization, the logical plan for remedying the evils of combination appears to be as follows: —

1. Recognize the existence of natural monopolies, and regulate their accounts, service, and rates, in a manner similar to that now being worked out in various States for public-service corporations. A minimum of regulation would apply this policy only to those natural monopolies which supply some article of common consumption that is generally regarded as a necessity. This would include, besides interstate electric, water, and simi-lar companies, the companies engaged in the anthracite coal industry. The iron, lumber, and petroleum industries might possibly be considered in this connection.

To the conclusion that, within this limited field, price regulation may be necessary, the author is forced by a consideration of the experience of the United States with railways and other public service industries. When the industry is both monopolistic and essential to the general well-being, *what objections against the fixation of reasonable rates can be urged which have not been urged against the exercise of a similar power by the Interstate Commerce Commission?* To be sure, the ill effects of monopoly may not be quite so great as in the railway business; but that is a question of degree which does not remove the need of the regulation. It may be granted that conditions of production or supply may be subject to greater fluctuations in the case of certain ones of the industries which would be included in regulation than those which are found in the transportation service; but that only makes the remedy more difficult, not less necessary. The reasonable maximum price would have to be high enough to allow for such contingencies. Above all, the critic of the proposed price regulation must remember that that proposal applies only to those industries in which compe-

tition has already proved a failure.

2. In order to retain the largest possible amount of normal, healthful competition, it is highly important that the great natural monopolies of (1) natural resources and (2) transportation should be segregated, and that their rates of charge should be subjected to regulation. Monopolies of natural resources, embracing such products as coal, iron ore, and lumber, concern power and the raw materials of manufacturing industries. Monopolies of transportation, and notably the steam railways, furnish indispensable means of marketing products. The supply of raw materials is necessary to all, and discriminations in furnishing such materials are just as serious to producers as are railway discriminations. Steps have already been taken to divorce mines and manufacturing establishments from the railway business, and those steps should be supported. For the same reason, the ownership of coal, ore, water power, and similar resources by industrial corporations should be greatly restricted or prohibited. The United States Steel Corporation, in so far as it has monopoly power, secures it through control of mineral sources and transportation agencies; and both the realm of monopoly would be decreased and the control of monopoly he made easier if these branches were segregated and adequately emulated. The principle of the common-carrier function should be applied to limited natural resources. If they are left in private hands, the owners should be compelled to furnish products and services on equal terms to all and be made subject to a large degree of publicity.

All this could easily be combined with a policy of conservation.

3. It might be well specifically to forbid, and to penalize as criminal offenses, the practices indicated in points 2–7, and any similar devices which abridge the rights to free initiative and legitimate competition, — terrorism, discrimination, theft.[194] The object is to insure to all, freedom of initiative in business and the right to enter any competitive industry.

The chief problem under this general head is how to deal practically with local price discriminations. Just as sound public opinion has condemned the railways for hauling competitive freight for rates which are below cost, while recouping the losses so incurred by charging high rates on local traffic, so now the public is condemning the "trusts" for similar practices. By cutting prices in some few localities the big combinations can drive out little competitors without fair competition. One conclusion is obvious: if prices were everywhere on a reasonable cost basis the likelihood of such discriminations would be greatly reduced. This is true because (1) ill-considered competition would be less likely to spring up, and (2) the combination would be less likely to make reductions. Clearly, therefore, the reduction of protective tariffs and monopoly privileges which allow combinations to charge prices that are above expenses would minimize the evil.

In the railway field the problem has been partly solved by requiring public warning of rate changes, and by compelling the retention of the reduced rate for a considerable period of tune. But railways are naturally monopolistic, while many other industries are normally subject to competition and must be permitted to make reasonable adjustments to meet it in many places and at many times. The essential point to keep in mind is that for offensive purposes prices should nowhere be reduced below expense; for so to reduce prices would mean (1) that no test of the normal economic efficiency of the competing business organizations would exist, and (2) that consumers in other localities would have to pay higher prices. Of course the practical application of this general conclusion would be difficult; it would be difficult even to ascertain what expenses are in some cases. But it might be possible to enact a provision similar to the following: In case it reduces prices *below* those of a local competitor, upon complaint any "trust" shall be required to prove to the satisfaction of the proposed industrial commission that it is not selling below expense.[195] The provision might be limited in its application to business units which control 40 per cent or more of the industry in which they are engaged. This proposal has the merit of leaving no question of intent or of the reasonableness of discrimination to be passed upon; and it would allow flexibility.[196] It might simplify the

administration of such a provision to compel the quotation of prices F. O. B. at the plant, but it does not seem wise to go further along the line of price regulation in any industry in which competition can work normally, or which is not clearly a "natural" monopoly.

4. Subject to certain limitations, the proposed industrial commission should be given power to authorize agreements for cooperation and complete consolidation in case of all industries in which, while monopoly is not clearly "natural," legitimate competition tends to become excessive or "cutthroat." Obviously this is a point that demands the most careful scrutiny. In the first place, what industries would be included in this class? Here the testimony of economic experts would be valuable. Probably it would be learned that it would include those industries in which fixed capital forms a relatively large part of the investment. Here would come the iron and steel industry, for instance. Where the capital is also highly specialized, as will generally be the case, the evidence is even stronger. Industries in which net returns per unit of product increase with the amount of output would also be included. Commonly they will coincide with the fixed capital industries. Again, industries which have a large element of "joint expenses," that is, expenses which cannot be definitely allocated to a unit of product are likely to tend to cut throats when forced to compete. Here come the industries which yield large amounts of by-products. Also, where there are wide fluctuations in demand, the necessity of combination is apt to be great, as is shown by the harvester industry.

a. As to authorizing agreements, serious question is to be raised, and no unanimity of opinion is now to be hoped for. Briefly, the proposal and the reasons for it are as follows: Bearing in mind the case of the German cartels with their legalized and regulated pooling agreements and selling agencies, it is proposed to authorize producers in this country to enter into arrangements for cooperation, especially in selling. For example, in West Virginia it appears that there are many small mining companies which are at a disadvantage, as compared with the large companies, of from six to eight cents a ton in their expenses of production. This disadvantage is not due to uneconomical methods nor to inefficient management. It is partly due to the fact that the large companies can better economize labor and power by running several mines with one superintendent, one clerical force, and one power plant; but the chief disadvantage of the small companies lies in their inability to maintain a single selling agency which could fill the largest orders as promptly as do the big concerns. It is in selling, or marketing, and in buying, that the combination has its greatest economies, as is indicated by items 8 to 15. Accordingly, a witness before the Senate Committee on Interstate Commerce says: "Now what must the small men do? They must either go out of business, or there must be some means. by which they can get together, and in a reasonable way have a joint selling agent so that they can save themselves this expense and have a joint power plant, if you please, so that they may live."[197] It has already been pointed out that such agreements, by allowing buying and selling economies, may enable groups of small producers to survive and compete, while retaining individual initiative.

To be sure, agreements of this kind would involve serious dangers. The danger of secret monopoly would be ever present. And the danger of subsidizing and keeping afloat incompetent producers and uneconomic plants would have to be guarded against. Said one witness, "the profits would be assured to the stockholders, and the wages to the workingmen would probably be better"; but the statesman will realize that the agreement would be prostituted if used to insure returns to incompetents. Accordingly, in order to secure the advantages of cooperation without the dangers of combination, — if that be possible, — the following outline program is suggested: —

(a) Subject to the anti-trust law (amended) and the preceding provisions against discrimination, authorize partnerships and corporations up to a certain power (say not over 40 per cent of the business concerned) to enter legally enforceable agreements, to be filed with the industrial commission.

(b) Subject such agreements to the following limitations: —

(1) To terminate in from 3 to 5 years.

(2) To be open to any plants, both to join, and upon reasonable conditions to leave.

(3) Boycotts and discriminations to be prohibited.

(4) All agreements entered into, and minutes of all pro-ceedings of directors, to be filed with the commission.

(5) Information concerning output and markets to be given to the commission.

The experience of other countries, and the judgment of business men, seem to indicate the desirability of some such scheme.

b. In authorizing consolidations, the merger or amalagation should be favored over the holding company. Remembering that we have provided for a sound corporation law, the commission might be empowered to authorize consolidations *in industries liable to excessive competition* up to the point where not more than say 60 per cent of the business would be embraced in any one business organization, with the object of allowing the undoubted economies of large-scale production while at the same time prohibiting monopoly and guarding against unwieldy and overgrown units.

The commission would be given the power to allow or to condemn at its discretion all combinations up to a certain maximum degree of control, and beyond that all combination in competitive industries would be prohibited by law. It would be well in addition to put the burden of proof upon all business organizations which control over 50 per cent of their industry, requiring then to show why they should not be dissolved.

5. In the balance of the industrial field, honest competition may safely be intrusted with the work of stimulating and regulating production, especially if corporation law is purified and made uniform.

6. The tariff on the products of all well-established industries should be reduced to a minimum deemed essential for revenue. In judging whether an industry is well-established, the power to export and sell in competition with foreign producers under normal conditions might be considered. But here an unbiased special committee of economic experts should be retained. Such a reduction should be made gradually and in such a way as least to disturb industry. Exceptions might be made for military reasons. Of course this point takes us upon somewhat delicate political ground, but in view of the strong general trend toward freer trade, the author ventures to point out that this trend if carried out will help solve the monopoly problem. It would be a mistake, however, to think this a chief remedy; for the tariff is not a chief cause, and in any case the day of international combinations is well advanced.

The careful reader of these pages will have observed that several of these suggestions may be based upon the study of the advantages or disadvantages of the various forms of business organization. It was virtually concluded in the earlier chapters that it would be well (1) to authorize registered agreements, (2) to limit holding-company control, (3) to facilitate complete consolidation in its stead, (4) to encourage improved partnership forms.

The Sherman Anti-trust Act. — Meanwhile, what of the Sherman Anti-trust Law? A majority of the best-considered opinions seem to be that as now interpreted it — or its equity features, at least — may well be retained. If the law is so interpreted as not to prohibit all agreements and combinations, but only those which restrain trade unreasonably, then it may serve a useful purpose. Recent decisions indicate such a use. Moreover, it is undesirable to abandon an old and adjudicated law under which some good has been accomplished. But the law is not sufficient as it now stands, and is bad in its criminal provisions, (1) It must be supplemented by improvements in corporation law. (2) It should be amended or supplemented so as to make it more specific, (a) as to what agreements and combinations may be “reasonable”; (b) as to what agreements and combinations are “unreasonable”; and (c) as to what general acts constitute proof of intent to monopolize. (3) It should be amended so as to distinguish between necessary and unnecessary monopoly, and to allow monopoly where economic conditions make it necessary and “natural.” In short, if the suggestions found in the preceding pages are sound, the Sherman Act must be amended or supplemented by further legislation to incorporate the spirit of the provi-

sions above.

It will be observed that the words “reasonable” and “unreasonable” are retained to indicate the criterion or test of legality; for this seems expedient in view of the existing legal terminology. But it would be most unwise to do as many seem inclined to do and base reasonableness upon mere intent or upon size. No rational or enduring application of the law can ever he found which does not consider economic necessity and social efficiency as the basis of reasonableness. That institution or policy is reasonable which insures a net gain in the well-being of society; it is questionable if it brings no net gain; it is unreasonable if it causes a net loss or injury, or a decrease in social well-being. The application of this test is not simple; but that is the way of social truth.

General Basis of the Foregoing Plan. — In dealing both with corporations and with “trusts,” the aim has been to set forth a truly progressive plan. True progressiveness is neither radical nor “standpatical.” Instead of seeking to destroy on the one hand or preserve on the other, it aims to conserve, — that is, to utilize existing materials in building better structures. Not revolution, not petrification, but evolution, is the way of lasting progress. Therefore, the wise thing to do is to conserve the corporate institution and the combination, but to adjust them to the new social conditions. Cleanse the former, and fit it to become a good citizen in our democracy. Compel the latter to fight fairly, and harness its economies in the interest of social production.

As part of this plan, it will be wise to consider all forms of business organization in their mutual relations and realize that there are several alternatives and many possible modifications. Many have thought that the corporate form is too loosely taken on. Why not encourage improved partnership forms for small undertakings? Already business men, under pressure of exist-ing corporation laws, are canvassing the possibilities of unincorporated organizations, and this suggests that at no remote date we may be compelled to take the point of view here advocated.

It is in keeping with this spirit that, while recognizing the desirability of healthy and normal competition, we do not overlook the necessity for regulated monopoly in some fields, and for great imitations upon competition in others. In this we but follow the trend of development in the regulation of railways by the Interstate Commerce Commission, and of public utilities by State commissions. We must recognize the economic necessity of monopoly and seek to regulate it for the purpose of securing just and reasonable rates of charge.

But, if large-scale production is necessary to secure economy, and if, up to a certain extent, our great combinations have their economic justification, still that fact cannot blind us to the further fact that beyond a certain point business organizations become unwieldy and overgrown, and combinations have no advantage except for extorting high prices or watering stocks. Therefore, the wise course is to remove the incentives and opportunities which lead to these uneconomic acts, leaving intact the motives and possibilities of large-scale production and economical combination. If we take away the motive to form combinations larger than will give the maximum efficiency, and the motive to overcapitalize, and if we regulate monopolies, where they must normally exist; then we can allow combination to take its course. When we remove the possibility of profits gained by high prices, stock jobbery, and manipulation, who will want to build the huge, wasteful edifices in which those practices have been carried on?

The aim, then, has been to discover the cause, and there apply the remedy. Prohibitions do not prohibit and laws become dead letters, when fundamental forces are left to move. The remedies suggested in the foregoing pages form no haphazard list, but are based upon a study of the fundamental moving forces and of the occasions through which they work. Consequently, though at points they overlap, and all may not be needed; and though many details are omitted, and some may prove impracticable, all the proposed reforms are aimed at a definite mark, and the ground is covered.

The Alternatives. — The foregoing plan may be called one of positive constructive regulation. What are the alternative to it? The only other policies worthy of serious mention at the present time are (1) *laisser faire,* (2)

negative regulation, (3) State paternalism, and (4) State Socialism. A return to the unregulated "free" competition of *laisser-faire* days is unthinkable; but the second and third alternatives are now being considered by many, and are quite within the range of possibility.

Negative regulation is a sort of do-don't policy, enforceable by law suit. This is the course which was favored by those who in earlier days opposed the establishment of the Interstate Commerce Commission or the grant of adequate powers to that body. One great weakness of this course is that it is not sufficiently flexible. According to it, numerous acts would be prohibited in a more or less sweeping fashion, with all too little classification and distinction of differences in cause. Wherever a head might be seen it would be hit. It is not a constructive policy. Cooperation would be forbidden; combination would be prohibited; monopoly would be tabooed. A ban would be put upon watered stock. The great error in all this is that no adequate distinction is drawn between good and evil, and causes and effects are not discriminated. For example, the negative regulationists generally oppose monopoly in all cases, possibly excepting certain public-service industries; for they do not sufficiently distinguish between necessary and unnecessary monopoly, nor between beneficent and destructive competition.

By government paternalism is meant a policy of supervision in which the burden of responsibility is largely removed from investors and stockholders. The recent proposals of several prominent industrial leaders look in this direction. The State would be drawn into virtually guaranteeing profits, and would undertake to prescribe rules for the conduct of the business in such a way as to direct its course to a considerable extent. The tendency is to authorize monopoly and to endeavor to guard against its abuse by rate regulation. Such a policy, though it does not necessarily mean Socialism, is in conflict with the retention of the largest possible amount of individual activity.

To bring out clearly the difference between this policy and the plan outlined in these pages, it may be said that paternalism would favor the transformation of all investors into bondholders, whose funds would be safeguarded and whose income would be assured by government participation in the conduct of industry; whereas we have considered it highly desirable to encourage stockholders to participate to a reasonable extent and to assist them to do so intelligently. Paternalism is the concomitant of an uninformed and supine class of investors, and "boss rule" of corporations; but the plan here proposed is one which would encourage a truly representative form of corporate government. Again, as just indicated, the paternalists would give great scope to monopoly, putting their trust in government control of service and price; whereas we, while recognizing the necessity of monopoly in parts of the industrial field, would forbid it and stamp it out in the remainder.

As to State Socialism, — it may come. Who knows! But we are not ready for it yet. We can know that much remains to be done before entering upon so perilous an experiment. Mere government ownership of railways and a few other natural monopolies does not constitute Socialism, nor would such ownership solve the corporation-trust problem. Before we think of abandoning self-help and individual initiative in that part of the industrial field in which monopoly is not necessary, let us first see if they will not still work under legal conditions established in accord with industrial progress.

The one great difficulty in the scheme here advocated lies in securing *Efficient Management.* It is the same problem that confronts any democratic government: the problem of securing united, prompt, and economical action by a group. If it should be found that corporations in which the government is truly representative do not work efficiently, the next step would probably be government control, or paternalism. We need attempt to look no further into the future.

Chapter XXVI: The Limited-liability Association: A Remedy

At several points in the course of the discussion in these pages, it has been suggested that the use of the corporation should be restricted. Business men themselves are not satisfied with it in all cases; but as it appears to be the only acceptable limited-liability form available in the United States, they cling to it. Apropos of this fact, there remains one suggestion which might properly have been made among the remedies for the corporation problem; but which, on account of its breadth and importance, as well as its general significance for all business organization whether corporate or not, has been reserved for this the final chapter of the book. This suggestion concerns the creation of a new limited-liability association as a golden mean between the partnership and the corporation.

A crisis in American business organization is at hand. When every one is admitting that the partnership will not do because of its instability and the excessive liability of its members, and at the same time unbiased observers are keenly realizing the limitations of the corporation, — to say nothing of the dissatisfaction among business men on account of taxation and publicity, the need of some new form to fill the wide gap between the two is clearly suggested. The partnership is too personal; the corporation too impersonal. In the one, the individual must run the risk of losing his all by the act of his partner; in the other, he takes a chance on the faithfulness and energy of delegated direction and hired management. The partnership is generally safe only for very small businesses; the corporation is really expedient only for very large businesses. The long and short of the matter is that as the magnitude and com-plexity of business enterprise have rapidly expanded, a very large field has been left between the older simpler forms and the largest and most complicated ones. In this field we need a golden mean,— a form which will accommodate a relatively small number of investors by providing a stable form of organization for directing capital without an excessive liability.

This form the limited partnership does not seem to supply. It has been in use in this country for nearly a century; but it has found no great favor, largely because the special partners are put so much at the mercy of the general partners, — the disparity between the two classes is too great. The statutory joint-stock company is a possibility; but it is provided for by but few States, and would in any case be subject to many of the same restrictions as are corporations.

It has been suggested that a modification of the limited partnership would be desirable. In making this suggestion what the author has in mind is no mere dream, but something that has been in practical operation in Germany and Austria for years. In Prussia, since 1891, the laws have provided for *Gesellschaften mit beschränkter Haftung* (associations with limited liability), and their number has rapidly grown. There the need was felt for a form of business organization which would allow small associations to operate safely and continuously without erecting them into joint-stock corporations, which are not suitable for small enter-

prises; and forthwith that form was provided by law. In 1893 there were 183 of the new associations in Prussia; in 1907 the number had increased to 9002.

Briefly, the main outlines of the proposed limited-liability association are as follows: (1) a limited number of members; (2) a minimum firm capital — say $5000; (3) a minimum individual interest in this capital — say $200; (4) such interests to be transferable, subject to certain restrictions; (5) members to be liable only for the maintenance of the firm's capital, with no personal liability beyond that; (6) the management to be conducted through a responsible representative (not a member) who would be subject to fine and imprisonment for fraud, etc. The number of members should be limited in order that the organization might not possess such power as to make necessary the restrictions which surround the corporation. Members should not be liable for more than the amount invested except when they permit their original investments to be wasted and the firm's capital to be impaired. The words "limited liability" might be required after the firm's name. The interests held by the members need not be uniform in amount and no document in the nature of a stock certificate would exist, so that stock-exchange securities would not be swelled by the new form of organization. Transferability without the possibility of speculative manipulation would be the object. Aside from the managing representative, the internal organization of the association would be freely determined by the members. Duration would be like that of the corporation, as the individual interests would be heritable.

By means of some such form as the one thus roughly outlined, it would be possible (1) to fill a serious gap in our business organization, and (2) to conserve and utilize best our existing forms. Through the proposed limited-liability association, medium-sized business units could be formed without the expense and publicity attendant upon corporations, and with an excellent basis for credit. On the other hand, they could operate with a moderate liability and with an assured continuity of existence. At the same time, the common-law partnership might retain its place in very small enterprises, and in businesses which involve great personal confidence or in which the credit conditions are such that the maximum liability is needed. And, above all, the overworked corporation could be confined to its proper sphere in providing an organization for those undertakings which require very large amounts of capital, numerous members, and complicated administration. Thus the whole problem of business organization might be simplified.

Chapter XXVII: The Sherman Act and its Interpretation.[198]

This chapter will consist largely of a critical account of the judicial interpretation of the Federal Anti-trust Law, commonly known as the Sherman Act. But first a word about the origin and nature of the law.

Down to about 1890, there was little statutory regulation of industrial combinations. There was, however, a well-established common law doctrine on monopoly and restraint of trade. That doctrine, both in England and this country, was that contracts in general restraint of trade are contrary to public policy and void; and that contracts and combinations in restraint of the trade of third parties, or parties outside the combination, are absolutely void in all cases. When the contract merely limited the operations of one of the parties thereto, and could be regarded as auxiliary to a lawful chief purpose, it might be a "reasonable restraint" and be lawful. Thus the leading early case of Michel *v.* Reynolds (1711) says: "All total restraints of trade... are absolutely bad, and all the restraints, though only partial if nothing more appear, are presumed to be bad; but if the circumstances are set forth, that presumption may be excluded, and the courts are to judge of those circumstances and determine whether the contract be valid or not." This is an early statement of the "rule of reason."

About 1890, the growing concentration of industry added a new importance to the law on restraint of trade, and considerable statutory regulation of "trusts" was attempted, regulation which can be understood only as declarative of the common law.

Here attention will be confined to the Federal statute. That act provides as follows: —

Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal...

Every person who shall monopolize, or attempt to monopolize! or combine or conspire with any other person or persons to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor,...

The logical relation between these sections would appear to be that the second one supplements the first in two ways: it brings (1) monopoly secured by a single person, and (2) mere attempts or efforts toward monopoly, within the prohibitions of the law. No clear understanding on this point was reached, however, until 1911, and even now the interpretation does not seem entirely satisfactory from an economic point of view.

Other sections of the act provide that fine or imprisonment, or both, may be imposed for violations; and it is made the duty of the district attorneys, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain violations of the act. Any person injured by acts forbidden by the law may sue and recover threefold damages and costs.

The act was carefully drawn by eminent lawyers after due discussion between 1888–1890. It is couched

in such general terms, however, that a great deal of interpretation has been needed to make its meaning applicable; and the relation of the second section concerning "monopolizing" to the first section on "restraint of trade" has been in much doubt. The first cases under the act were not adequately drawn, and perhaps not so vigorously prosecuted as of late; but it is to be remembered that neither the law nor the trusts were so well understood in the beginning. The earlier applications of the law are open to considerable criticism. Let us, therefore, divide its history into two great periods: I. The Interpretation before the Great Trust Period; II. The Interpretation during the Trust Period.

I. Cases Preceding the Great Trust Period: 1895–1899.

— The first case decided by the Supreme Court was *United States* v. *E. C. Knight Co.* (156 U. S. 1). In this case the issue raised was, did the purchase by the American Sugar Refining Co. of competing corporations in Philadelphia constitute monopoly or restraint of trade under the act? The court was asked to set aside the purchase. This it refused to do, on the ground that such purchase did not constitute an act that directly concerned interstate commerce. First, a distinction was drawn between manufacturing and commerce: "Doubtless the power to control the manufacture of a given thing involves in a certain sense the control of its disposition, but this is a secondary and not the primary sense; and although the exercise of that power may result in bringing the operation of commerce into play, it does not control it, and affects it only incidentally and indirectly." But, secondly, it was held that the combination must exert a *direct* effect upon *interstate* commerce; while this combination, even though it resulted in monopoly, directly concerned only corporations created by States. In a later decision (175 U. S. 211) the Supreme Court said: —

> "The case was decided upon the principle that a combination simply to control manufactures was not a violation of the act of Congress, because such a contract or combination did not directly control or affect interstate commerce, but that contracts for sale and transportation to other States of specific articles were proper subjects for regulation...."

We may say that this early decision shows: (1) an illogical break made in the round of economic production, (2) a solicitude for the autonomy of the States, implied in a tendency to narrow the scope of interstate commerce, and (3) a refusal to lay emphasis upon intent or indirect results. To move a commodity through the factory, or to the warehouse, or to the railway, or to a point in the State, or to one outside the State, — all is production; and though one step precedes the other in time, all are of the same economic importance. Note, too, that an indirect result may be as important as a direct one, and may follow the cause as inevitably.

In the same year, the Supreme Court in the case *In re Debs* (158 U. S. 564) upheld a circuit court[199] in applying the act to combinations of wage earners in restraint of trade, a point that Congress had declined to settle.

One other question of application remained to be decided, namely, the inclusion of railways within the scope of the act. This question was answered in the affirmative in the *Trans-Missouri Freight Association* case (1897) and the *Joint Traffic Association Case* (1898). Here a majority of the Supreme Court definitely refused to consider the question of reasonableness of restraint in interpreting the statute. Though differences of opinion had existed in Congress on this subject, the court held that there was no predominance of opinion, and that the only question before them was one of fact: Did the associations operate to restrain trade, whether reasonably or unreasonably? To hold otherwise, said Justice Peckham, would involve "judicial legislation."

In the first of these cases, Justices White, Field, Gray, and Shiras dissented, the chief ground being that the act was intended to prohibit only unreasonable restraints, as at common law, and that it was admitted that

the restraints exercised by the associations were reasonable.

This pre-consolidation period may be said to close with the two cases *Hopkins* v. *United States* (171 U. S. 578) and *Ander-son* v. *United States* (171 U. S. 604), both decided in 1898. In both it was held that the operations of live-stock exchanges were not prohibited by the anti-trust law. In the former, it was held that the exchange merely provided a facility for interstate commerce, but was not itself engaged in such commerce, while the kind of contract condemned by the act is "one whose direct and immediate effect is a restraint upon that kind of commerce which is interstate." In the latter, the combination was held to regulate the business itself, but not interstate commerce.

In these cases, we already see the beginning of a transition, for the court made some use of the idea of reasonableness in deciding that the agreements concerned were not in "direct" restraint of interstate commerce.

For this period in general, the following statements will be found to hold: —

(1) Excepting possibly the first case, all the decisions concern the scope of the application of the act, it being successively applied to labor unions, railway traffic associations, and live-stock exchanges.

(2) The existence of no great consolidation was concerned. The nearest approach to it was the suit to set aside the absorption of the E. C. Knight Co. The other cases concerned associations and agreements.

(3) In most of the cases a marked delicacy was displayed on the subject of States' rights; and a strong tendency to expand the scope of intrastate and local commerce at the expense of interstate commerce.

(4) It was held. that restraints must be direct and immediate to come within the prohibition of the act.

(5) The "rule of reason," according to which reasonable restraints would be permitted, was specifically ruled out.

II. Cases following the Rise of Great Consolidations: 1899– 1913. — During the next period, that beginning with 1899, there was such development that none of the foregoing statements is now true. As combinations grew more numerous, larger, and more compact, it became apparent that a broader and deeper interpretation of the anti-trust act would have to prevail. At first, however, there was a rather gradual transition, reaching a climax in a case involving a great holding company; and the period may therefore be subdivided.

1. *Transitional, or Holding-company Period: 1899–1908.* — The Addyston Pipe and Steel Company, it will be remembered, was a member of the Associated Pipe Works, an income and territorial "pool." This organization was declared illegal under the Sherman Act in the case of *Addyston Pipe and Steel Co.* v. *U. S.* (175 U. S. 211), decided in 1899. Here the court held that contracts, whether between individuals or corporations, that tend directly to restrain interstate commerce, are void and may be prohibited. This was held to be true even though the primary business of the several companies was manufacturing. In reply to the argument that the power of Congress did not extend to contracts among individuals, the Court said: —

Under this grant of power to Congress, that body, in our judgment, may enact such legislation as shall declare void and prohibit the performance of any contracts between individuals or corporations, where the *natural* and direct effect of such a contact *will be, when carried out,* to directly, and not as a mere incident to other and more innocent purposes, regulate *to any substantial extent* interstate commerce.

It seems to the author not too far fetched to note that in the words italicized by him we can already see an opening for a somewhat broader construction of the act than obtained before 1899. In fact, the fundamental question was at one point in the decision stated to be whether the "necessary effect" of the combination would not be to restrain trade; and it was reasoned that this was the case, because the combination restricted business, which restriction resulted in high prices, which, in turn, restrained trade, — surely an "indirect" result.

Two other points worth noting are that the court stressed the idea that a total supression of trade is not necessary to produce restraint; and that it gave more weight to intent, Justice Holmes stating that "this general allegation of intent colors and applies to all specific charges in the bill."

It is obvious, then, that the Addyston case marks a considerable development in the interpretation of the Sherman Act.

At the end of 1904, the Supreme Court, in handing down an important decision, gave a summary of the law as it stood at that time. As this decision marks the beginning of a new sub-period, we may well pause to note the most significant points in this statement. The first point was that, although the Antitrust Act had no reference to production within a single State, it did apply to any combination in any form that directly *or necessarily* operated in restraint of interstate trade. Second, to vitiate a combination under the Act, it was not necessary to show that it totally suppressed trade or gave complete monopoly, but only that "by its necessary operation," it *tended* to do so.

Third, the courts still held that the act was not limited to unreasonable restraints, but that it embraced all restraints. Fourth, that as the "natural" effect of competition is to increase commerce, so any monopoly restrains it.

The celebrated Northern Securities Company case (*Northern Securities Co.* v. *U. S.,* 193 U. S. 197) is the one in which the preceding summary was made. It is notable as the first one that involved the existence of a holding company; and, while it may be regarded as a not entirely satisfactory attempt to apply to more highly developed combinations the doctrines worked out to meet simpler and smaller problems, it finally settled any question there may have been as to the power of the holding-company form of organization to make a trade-restraining combination legal. The main facts in the case are that the stockholders of the Great Northern and Northern Pacific railway companies were combined under the form of a holding company known as the Northern Securities Company. These two railways were parallel and presumably competing lines. Under the holding company they became one in management, and competition was virtually impossible.

In defense of the combination it was set up that the corporations were the creatures of a State and authorized by it to do as they had done; that in any case the acts were those of individuals, who had a right freely to dispose of their stocks in State corporations; and that the act was unconstitutional. These contentions, the majority of the court brushed aside, holding that no State — "still less one of its artificial creatures" — could stand in the way of the act's enforcement; and a strong statement was made concerning the power that could be legitimately used to make the act effective: "In short, the court may make any order necessary to bring about the dissolution or supression of an illegal combination that restrains interstate commerce." Also, the court was forced to lay emphasis upon the intent of the combiners as inferred from the necessary result of their action.

Perhaps the most interesting part of the case is the concurring opinion of Justice Brewer.[200] He frankly admitted that earlier cases had been decided on wrong grounds; and his words are worth quoting, for they show the line that the court was later to follow.

Instead of holding that the Anti-trust Act included all contracts, reasonable or unreasonable, in restraint of interstate trade, the ruling should have been that the contracts there presented were unreasonable... and as such within the scope of the Act.... Congress did not intend to reach and destroy these minor contracts in partial restraint of trade which the long course of decisions at common law had affirmed were reasonable and ought to be upheld.

Succeeding cases show further progress in the tendencies displayed in the Northern Securities Case. To this effect we may cite a number of cases that did not reach the Supreme Court. In *Rubber Tire Wheel Co.*

v. *Milwaukee Rubber Works,*[201] for instance, the court said: "The means of effecting and the form of the combination are immaterial; the true test of the violation of the Sherman law is whether the people are injured, whether they are deprived of something to which they have a right." And in *U. S.* v. *MacAndrews & Forbes Co.,*[202] it was stated that "Commerce among the States is not a technical legal conception, but a practical one, drawn from the course of business.... It is enough if the necessary operation tends to restrain interstate commerce and to deprive the public of the advantage flowing from free competition."[203]

In 1908, the opinion in *Anderson* v. *Shawnee Compress Co.* used very similar language to the preceding, and in addition enunciated the important idea that "the restraint upon one of the parties must not be greater than protection to the other party requires."[204] So there is evidence that the courts were looking away from a narrow construction of "direct" effects.

The idea of the rule of reason, however, remained in doubt for some years, and the situation may be found typified in the case of *Continental Wall Paper Co. v. Voight & Sons* Co.. (148 Fed. 946), where the circuit court said that "Until the Supreme Court shall otherwise hold, we feel concluded by the meaning placed upon the act in "earlier cases," and not departed from in Northern Securities Co. *v.* U. S...." All through the opinion the court bolsters up its position by arguing that in any event the restraint was actually very unreasonable.

This general situation gives rise to an interesting reflection concerning the relation between reasonableness of restraint and directness of effect. Indeed, it is suggested by a passage in the preceding case in which the court says that the reasonableness of the contract is no defense if the dominant purpose and direct result of the contract is directly, and not incidentally, to restrain interstate commerce. We may infer from this that if an important and inevitable restraint should follow, it might be defended on grounds of reasonableness, if only it were a little indirect. Clearly there is a logical connection between reasonableness and directness of effect, and if some restraints are to be recognized as reasonable, public policy would demand that broader relations of cause and effect be considered. Or, to put it another way, if only direct restraints are to be considered, the question of reasonableness or unreasonableness is relatively unimportant.

2. *The Rule of Reason: 1908 to date.—*It is now manifest that the clear logic of the case, backed by a changed industrial situation and public opinion, was driving the courts to modify the interpretation of the act that had been adopted in the nineties, and held to, albeit with misgivings, down to about 1908. In 1907, in his annual message, President Roosevelt urged that the law be amended so as to forbid only unreasonable combinations. He made public welfare the criterion, and said: "Reasonable agreements between, or combinations of, corporations should be permitted, provided they are first submitted to, and approved by, some appointed government body."

Soon Justice Hughes was added to the Supreme Court, and in 1910 and 1911, the evolution we have been tracing was completed. Two lesser cases mark its progress: The case of *U. S.* v. *Kissell and Harned,*[205] by holding that a conspiracy in restraint of trade is a continuing offense in spite of statutes of limitations, shows that direct and immediate effects were no longer considered solely; and the *Dr. Miles Medical* Co.[206] case paid no attention at all to the question of directness, the court through Justice Hughes saying: "To sustain the restraint, it must be found to be reasonable both with respect to the public and to the parties...." He appears to approve the doctrine, suggested in the Shawnee Compress case, that if a restraint is limited to what is fairly necessary to protect the contracting parties it is not bad.

Then came the great decisions in the *Standard Oil Company*[207] and the *Tobacco Company* cases.[208] Suit was brought against the Standard Oil Company in 1906, and the case for the government was carefully prepared and skillfully presented. In every sense, this is a leading case. The facts of the case will be found on an earlier page. Here it need only be said that the company was a holding company charged with conspiracy

to restrain trade and to monopolize commerce. As to the facts, it was held (1) that, by vesting stocks of companies that might be competing with one another in a single corporation, control of interstate commerce was acquired; (2) that this control had been acquired and exercised with the aim of monopolizing the industry; (3) that this had been done by abnormal and illegitimate means. The obvious intent to secure monopoly was shown by the abnormal means taken to drive out competitors. Such being the facts, the combination was held illegal and ordered dissolved.

The most notable point in the case is the full acceptance of the rule of reason. In leading up to this point, the court first reasoned that the first and second sections of the act are harmonious and supplementary, that "monopoly and the acts which produce the same results as monopoly, that is, an undue restraint of the course of trade, all came to be spoken of as, and to be indeed synonymous with, restraint of trade." The second section is to be regarded as covering attempts to reach the end prohibited by the first. Next, it observed that the acts embraced within the condemnation of the statute were not defined, so that a standard of judgment was required: "Not specifying, but indubitably requiring a standard, it follows that it was intended that the standard of reason which had been applied at the common law" should be used as a measure in determining what acts were illegal. Said the court: "it inevitably follows that the provision necessarily called for the exercise of judgment, which required that some standard should be resorted to...."

If the layman may venture to single out other points of note, they would seem to be these: The court goes back of the form, specifically stating that no form can justify acts causing illegal restraint; and it gives a list of acts which evidence intent to monopolize. Furthermore, it goes into broad general questions of intent and social result, especially noting the *general tendency* of all the acts taken together.

The *American Tobacco Co.* v. *United States* case owes its importance largely to the fact that it involved a combination under a different form from the Standard Oil Co. In this case there had been complete consolidation in part of the field, following the Northern Securities decision; and the court had to pass upon the question whether the single corporation, owning combined properties in fee, was in violation of the act. Applying the rule of reason, the court deemed the corporation to be in undue restraint of trade and ordered it dissolved. This it did, not because of the vastness of its property, nor the multitude of the constituent companies, nor even its dominion over the trade — though this last was considered. Not form; but methods and effects guided the court. It ruled against the trust because of "methods devised in order to monopolize the trade by driving competitors out of business, which were ruthlessly carried out upon the assumption that to work upon the fears or play upon the cupidity of competitors would make success possible."

The Tobacco Trust decision gave a more comprehensive application to the act than its predecessors, and it centered attention more completely upon monopoly practices and less upon mere combination.[209] It showed that amalgamation into a single corporation could not be used to defeat the purposes of the act.[210]

Acts that show Intent to Monopolize. — One of the most interesting features of these last cases, and one that may have increasing significance, is the specification of certain acts that were taken as evidencing intent to monopolize. Before taking up these acts, however, certain earlier decisions by lower courts should be noted. For example, in one case[211] we find a Federal court basing its decision partly on the existence of the following facts which were taken to show unreasonable restraint: 98 per cent of the output of the industry embraced in the combination; agreement of members to sell entire outputs to one corporation at an agreed price; certain suspicious features in the organization of the corporation, *e.g.,* small amount of stock, all held by the combined companies; the shares held by manufacturing members indorsed over to the central corporation as pledges; a rule preventing enlargement of plants; the manufacture of the machinery used in making its product, included in the combination; a rule aiming to compel jobbers to buy of the combination. Also in the case of Ware-Kramer Tobacco Co. *v.* American Tobacco Co.,[212] we find an interesting statement along

similar lines.

It may be summarized: —

I Efforts to prevent the organization of competitors:

1. Threats to destroy (made by officers to the organizers).
2. Threats to withhold products from.
3. Threats to influence third parties (to withdraw patronage from warehousemen).
4. Inducements to desist (bribes to incorporators).

II. Efforts to destroy, after organization:

1. Circulation of false statements (*e.g.,* that the company was really in the trust).
2. Espionage (spies on shipments; employe of trust buys stock and holds office).
3. Efforts to withdraw customers:
   (a) Threats to injure their business.
   (b) Refusal to sell to them.
   (c) Delaying shipments to them.
   (d) Price discriminations, etc. (giving free goods, extra discounts, coupons, selling below cost).
4. Interfering with the laborers of the competitors.

This statement is interesting as a list of illegitimate trust practices, as well as showing what the courts may consider in applying the Sherman Law.

The acts specified by the Supreme Court in the Tobacco case, however, have more significance. They are set forth by the court as showing intent to monopolize, in somewhat the following fashion: —

1. The combination arose out of a previous fierce trade war that had evidently been inspired by the combiners.

2. Immediately upon its formation it began trade conflicts with the purpose of injuring competitors.

3. Attempts to conceal control of former competitors evidenced conscious wrongdoing.

4. Control was sought over all elements in the business (*i.e.,* complete monopoly).

5. Plants were bought out merely to be shut down.

6. Numerous contracts were made, running for long periods, that bound competitors and employes not to compete.

Some Recent Decisions. — From an examination of more recent cases two conclusions may be drawn: (1) The Supreme Court may attach decisive importance to scope and potentiality, as for example in the St. Louis Terminal Association,[213] Union Pacific Railroad Co.,[214] and Reading Co.[215] cases. Here it was apparently the power of the combinations to restrain trade as evidenced by the scope of their operations that was the fundamental cause of the decrees against them, rather than actually existing restraints.

(2) Directness of effect is not necessary to bring the combination within the law; and intent to restrain trade will be inferred from the necessary effects.

In the recent Patten case, the court seems to have changed its views somewhat on the question of the relation of the produce exchange to interstate commerce. At least a further development is shown; for, while the Hopkins and Anderson cases held produce exchanges to be mere adjuncts to such commerce, concerned with internal business affairs, in the Patten case the court was not stayed by the plea that the members of the cotton exchange ("running a corner") were not engaged in interstate commerce.

Criticism of Present State of Interpretation of the Sherman Act. — The aim of this chapter has been to set forth the facts. A word of criticism, however, may not be amiss. It is the author's conclusion that the courts are involved in serious inconsistencies at several points. First, there is the old question of "intent," —

an idea that will always be difficult and unsatisfactory of application in cases where broad social issues are involved.[216] Take two recent cases for illustration. In the Patten case it is stated that the intent of the combiners will be inferred from the necessary and direct consequences of their acts, and this is the general tendency in all cases. But in the *Standard Sanitary Manufacturing Co.* case, the court states that acts restrain-ing trade cannot be defended on the ground of good motives: "The law is its own measure of right and wrong," and good intentions, even when followed by some good results, cannot be set up against it. Thus the rule of intent will not work both ways!

Secondly, there is difficulty on the score of potentiality to restrain. In the Tobacco Company case and others, it has apparently not been power but means of securing power that has decided the court; but in several of the later cases, as already noted, it appears to have been the reverse. This question is now directly before the court in the International Harvester Company case, and is peculiarly difficult, in the author's opinion, because of the merits of the Harvester Company. Certainly we must ere long go more thoroughly into the question whether mere size or control of any certain percentage of output should in all cases be a ground for dissolution.

This question suggests the third criticism, namely the failure of the court to proceed upon any logically consistent application of the idea of monopoly. The existing confusion may be illustrated by the following citations: "The mere *extent of acquisition* of business or property achieved by *fair and lawful* means cannot be the criterion of monopoly. In addition... there must be an *intent* by unlawful *means* to exclude others...."[217] The statute is directed against things that operate "to deprive the public of the *advantages* which flow *from free competition*."[218]

Now extent of acquisition, or size, is one thing; the means used is another; and the intent is still an-other; and no one of these furnishes any adequate test of monopoly. Nor do all three taken together supply it. As to competition, we can never get anywhere by assuming that free competition is always an advantage to the public. Let us examine these ideas separately.

Size may or may not have significance. The courts are right when they say that it does not necessarily mean monopoly; but they are wrong when they say that it cannot mean monopoly. If a single interest is (1) so large that (2) it controls output and price in an industry, it has a monopoly, it matters not what the intent or the means may be or have been. In some cases the courts have attempted to draw a line between what we may call statutory monopolization and economic monopolization, arguing that even complete monopoly (economic), if secured by normal legitimate means, may not be illegal under the statute.[219] The author would submit that this is a thoroughly inexpedient line to draw. Monopoly control is not to be judged by the means of its acquisition, for it might be in the interest of the public though secured by wrong means, and vice versa. It is an objective fact, depending upon the character of the industry and the degree of control, and the degree of control is a matter of size, *i.e.,* of relative size.

As to means, if in themselves in violation of the prevailing laws and morals, let them be punished on that ground; but, again, we must remember that the monopoly is the objective fact independent of the means, and it may be partial or complete, bad or good, economically necessary or unnecessary, regardless of the means.

So it is with intent. Good intentions can no more soften the evil effects of a socially injurious monopoly than bad ones can damn those of a socially beneficial combination; and little but logical jugglery results when the attempt is made to rely upon intent in great industrial matters. Let us suppose that, with the best intentions in the world, the Steel Trust has acquired an actual economic monopoly. Is it not clear that it enjoys such power that greater social responsibility is needed? But under the doctrine of intent, the courts either could not convict it or would have to set up a fictitious intent based upon the fact of monopoly. It is

this fact that should rule.

As a matter of fact, the courts loosely use these various tests conjointly, as in the above citation it is stated that the test is “extent” achieved by “fair means,” — but more than this “intent” must be considered, and not mere intent, but intent by certain means! With such a confusion of criteria we get no thoroughly logical results.

A final criticism may be suggested by the fact that the courts have failed to appreciate the economic necessity of monopoly in certain industries. Perhaps enough has been said on this point. If there is any contribution that economic science makes to this vexed question, it is that a distinction must be made among monopolies, and that some monopolies are desirable from the social point of view.[220] Economics may fairly be challenged — and the author believes it can meet the test — to show how a fairly workable line can be drawn between socially desirable and socially undesirable monopolies. It should not be necessary to destroy the good with the bad. In making this point, however, it is not to be forgotten that the courts have not considered the possibility of regulated monopoly in the field of industrial combination, and we have no commission to regulate oil, tobacco, and harvester combinations. This being the case, it is perhaps a fair question if they could properly make any distinction among monopolies, for any kind of monopoly in goods of common consumption is dangerous if unregulated. In answer we must note that the existence of the Interstate Commerce Commission seems to have made no difference in the Trans-Missouri Freight Association decision. Also the courts have made some use of a distinction between “statutory monopolization” and other kinds. They have not suggested the need of a controlling body. Their failure to make the distinction proposed above evidently rests upon ignorance of or disbelief in its existence.

From a broad social and economic standpoint, the truth would seem to be as follows. The starting point must be placed in social welfare. Then what has results that bring a balance of injury to such welfare is bad. (Where there is no question of punishing individuals for personal wrongdoing, or that ques-tion is relatively unimportant, intent must be neglected.) Then, working on the general principle of the existing social order that real freedom of exchange is a fundamental good, monopoly must be studied as an objective fact, and where its net effect is restraint of exchange (trade) it should be broken up. But, where the net effect of the monopoly is to promote exchange — as in “natural monopolies” — the monopoly is to be regulated.

Note on the Relation of Patent Monopolies to the Sherman Law.—

At points the courts appear to a layman to have pursued a wavering policy in dealing with patent monopolies. We may, however, draw a few definite conclusions, (1) Where combination has resulted incidentally and without concerted action, there being only one patentee whose intent had been good; and where the patent has been essential to the creation of the product, and has been actually the basis of control; it has been held that no ofiense is committed in fixing a price (*Indiana Machine Co.* v. *J. I. Case Mfg. Co.,* 148 Fed. 21). (2) Even where there has been combination by intent, if control has been based on the patent, not on mere combination, the patent being on an essential part of the process of production, the courts have held that, “whatever the terms courts will enforce them [license agreements], provided only that the licensee is not thereby required to violate some law outside of the patent law, like the doing of arson or treason” (*Rubber Tire Wheel Co.* v. *Milwaukee Rubber Works Co.,* 142 Fed. 531). Both the preceding cases hold that a patentee may compel licensees to form a pool for the purpose of controlling prices and output of his patented article: “If the plaintiff [patentee] were the sole maker... how could plaintiff’s control of prices and output injure the people, deprive them of something to which they have a right? Is a greater injury inflicted, if plaintiff authorize a combination or pool to do what plaintiff can do directly?” (*Ibid.*) (3) Where, however, there is combination with bad intent (to monopolize by the mere act of combination), and especially if the patent is not essential to the production of the good concerned, even though there be but one patentee, the

combination will be held illegal (*U. S. v. Standard Sanitary Mfg. Co.,* 191 Fed. 172; affirmed in 226 U. S. 20). Here the court cites the strong and compelling terms of the agreement, referring especially to the pecuniary penalty; and concludes that, "The agreement clearly, therefore, transcended what was necessary to protect the use of the patent or the monopoly which the law conferred upon it. They passed to the purpose and accomplished a restraint of trade condemned by the Sherman law." (4) Where there are several independent patentees, who combine with intent to monopolize thereby, the law is clearly against them *(Natl. Harrow Co.* v. *Hench et al.,* 76 Fed. 667; *Blount Mfg. Co. v. Yale and Towne Mfg. Co.,* 166 Fed. 555). In the latter case (1909), the court held that " combinations between owners of independent patents, whereby, as a part of a plan to monopolize the commercial field, competition is eliminated, are within the Sherman Act, for the reason that the restraint of trade or monopoly arises from combination, and not from the exercise of rights granted by letters patent." It appears that the patent gives a monopoly only of the particular invention patented, and a control combining two inventions deprives the public of due competition, and restrains trade contrary to the Anti-trust Law.

Other points that must be at least mentioned are the rights to dictate prices to dealers and to suppress patents. Though other matters will be taken into consideration, the courts appear to make the first right depend upon the nature of the relationship between patentee and dealer: if title actually passes to the dealer and he becomes unconditional owner he may charge what he will (*Bauer & Cie* v. *O'Donnell,* 229 U. S. 1); but if he buys conditionally, so that he is virtually an agent for the patentee, he must abide by all terms as to use or price on penalty for infringement (*Henry* v. *A. B. Dick Co.,* 224 U. S. 1). The question of the essentiality of the patent to the product also enters.

As to the right of a patentee to suppress his patent, he has unqualified right to do so if for no ulterior purpose of restraining trade (*Beaton Peninsular Button Fastener Co.* v. *Eureka Specially Co.,* 77 Fed. 288; *Continental Paper Bag Co.* v. *Eastern Paper Bag Co.,* 210 U. S. 405). But the patentee cannot suppress for the purpose of restraining trade. Thus, in the Blount Mfg. Co. case, the court said:

"The right of a patentee to suppress his own rests upon ordinary considerations of property rights.... When a patentee agrees, however, to restrain his own trade in... his own invention, not as an incident to a granting of rights, but for the purpose of enhancing his price by the removal of competitors, he is then quite outside the sphere of any right granted him by the government." "Now use ordinarily violates no law; but contracting with another, putting it in the power of another to compel one not to use, is a contract in restraint of trade, designed for the purpose of suppressing competition."

It may be said to be the law that the anti-trust statute takes nothing from the patent law and that patented articles are not articles of interstate commerce within the former statute; but patent rights are limited by that statute and prevented from being pushed too far to be consistent with the public welfare, on the ground of which both laws are based.

Appendices

Appendix A. Simple Articles of Copartnership[221]

This agreement made and entered into this thirty-first day of October, One thousand nine hundred and three, by and between Charles Snow of Rochester, N. Y., of the first part and Edward M. Chapin of Batavia, N. Y., of the second part, witnesseth as follows: —

1. The said parties, above named, hereby agree to become partners in the business of buying and selling dry goods under the firm name of Snow & Co., said business to be carried on in the city of Rochester, or such other place or places as the parties may hereafter determine, and to continue for the term of five years from the date hereof.

2. The capital of the said partnership shall consist of the sum of ten thousand dollars, to be contributed as follows: The party of the first part shall contribute his stock of dry goods and the good will of the business herteofore conducted by him, which are together valued by the parties hereto at the sum of five thousand dollars; and the party of the second part shall contribute the sum of five thousand dollars in cash. The capital stock so formed is to be used and employed in common between the parties hereto for the support and management of said business.

3. At all times during the continuance of their copartnership they and each of them shall give their time and attention to said business, and to the utmost of their skill and power exert themselves for their joint interest, profit, benefit, and advantage, and truly employ, buy and sell, and trade with their joint stock and the increase thereof in the business aforesaid; and they shall also at all times during the said copartnership bear, pay, and discharge equally between them all rents and expenses that may be required for the management and support of said business; and all gains, profits, and increase that shall grow or arise from or by means of their said business shall be equally divided, and all losses by bad debts or otherwise shall be borne and paid between them equally.

4. Each of said partners shall be at liberty to draw out of the funds of the firm each month for his private expenses the sum of one hundred dollars, and neither of them shall take any further sum for his own separate use without the consent in writing of the other partner. The sums so drawn shall be charged against the partners respectively, and if at the annual settlement, hereinafter provided for, the profits of any partner do not amount to the sum so drawn out in that year, he shall at once repay such deficiency to the firm.

5. All the transactions of the said copartnership shall be entered in regular books of account, and on the first day of January in each year during the continuance of this copartnership account of stock shall be taken, and an account of the expenses and profits adjusted and exhibited on said books; said profits shall then be divided, and one half carried to the separate account of each partner. Either partner shall be at liberty to

withdraw at any time the whole or any part of his share of the accrued profits thus ascertained and carried to his separate account. Each partner shall have open and free access to the books and accounts of the copartnership at all times, and no material or important changes shall at any time be made in the general business of the firm, either in the buying of stock or in any other respect, by either partner without the knowledge of the other.

6. And the said parties hereby mutually covenant and agree, to and with each other, that during the continuance of the said copartnership neither of them shall indorse any note, or otherwise become surety for any person or persons whomsoever, without the consent of the other of said copartners. And at the determination of their copartnership, the said copartners, each to the other, shall make a just and final account of all things relating to their said business, and in all things truly adjust the same; and all and every, the stock and stocks as well as the gains and increase thereof, which shall appear to be remaining, either in money, goods, wares, fixtures, debts, or otherwise, shall be divided equally between them.

In Witness Whereof, the said parties have hereunto set their hands and seals this thirty-first day of October, 1903.

Charles Snow. (1. s.)
Edward M. Chapin. (1. s.)

Appendix B. Articles of the Pierce Fordyce Oil Association,— a Joint-Stock Company

Articles of Copartnership[222]

Name

We, whose names are hereto subscribed, do hereby form a Copartnership Association to be known and styled

Pierce Fordyce Oil Association

which shall continue in existence until the 2nd day of April, 1960, unless sooner dissolved as herein provided.

Purposes

The general purpose of this Copartnership Association is: To engage in the general merchandise of petroleum and the Products thereof and other such articles as may be advantageously sold or handled in connection therewith; to purchase, own and mine lands supposed to contain or containing oils or other minerals and to construct and operate refineries or other manufacturing plants for refining or reducing such oils or min-erals and to engage in any other industrial manufacturing, min-ing or merchandising enterprise or exploitation that may be determined by the Board of Managers appointed or chosen as hereinafter provided.

Capital

The Capital is Three Million Dollars divided into Thirty Thousand Shares of One Hundred Dollars each, all of which has been paid in, by the subscribers hereto. The Capital may be increased from time to time by increasing the number of shares and the admission of new members, as may be determined by a vote of the majority of the then shares at any meeting of the shareholders called pursuant to these articles of Association or such By Laws as may be adopted hereafter by a majority of the shares.

Shares

The *Certificates of Membership* shall be issued by the President of the Board of Managers and countersigned by the Secretary of said Board and shall be in substantially the following form; viz:

PIERCE FORDYCE OIL ASSOCIATION

(Copartnership) Capital,
$3,000,000, or Thirty Thousand Shares

MEMBER'S CERTIFICATE OF INTEREST

This is to certify that— is the owner of — full paid shares of beneficial interest in the Pierce Fordyce Oil Association, transferable on the books of the Association by the owner thereof in person or by duly authorized attorney upon surrender of this certificate properly endorsed.

This certificate of interest is subject to the provisions and covenants contained in the Articles of Copartnership of the Pierce Fordyce Oil Association dated the Second day of April, 1910, and any amendment thereto and the By Laws of said Association and the provisions hereof. *No member of said Association or owner or holder of this certificate shall have any authority, power or right whatsoever to do or transact any business whatever for, on behalf of or binding on the Association or any member thereof,* and *no member of this Association shall be liable for any debts, covenants, demands or torts of this Association beyond the amount of his shares.*

This certificate shall be the sole and only evidence of membership in said Association and shall be surrendered upon the call of the Board of Governors at any time to the Association upon the payment or tender of payment to the amount of its face or par value and a premium of fifteen per cent thereof.

IN WITNESS WHEREOF the said Association has caused this certificate to be signed by its duly authorized officers and to be sealed with the seal of the Association this — day of ———

President.
Secretary.

DEATH OF MEMBER

The decease or insolvency of a member of the Association shall not work a dissolution of it or have any effect upon the same, its operation or mode of business; nor shall it entitle his legal representatives or heirs or assigns voluntary or involuntary to any account or to take any action in law or equity or otherwise against the Association, its members, officers, Board of Governors, Trustees or its property or assets; but they shall simply and only succeed to the right of the deceased, to the certificate of membership and the shares it represents, subject to this agreement, the amendments thereto and the By Laws of the Association, now or hereafter adopted.

BOARD OF GOVERNORS

The entire affairs of this Association shall be managed by a Board of Governors, consisting of seven members, each of whom shall own at least, certificate or certificates for not less than ten shares, who shall be elected by a majority of shares held by members at a regular annual meeting of the certificate holders every two years after the expiration of the term of the first Board of Governors.

The first Board of Governors shall be composed of the following named persons, viz:

H. C. PIERCE,

Samuel W. Fordyce,
Samuel W. Fordyce, Jr.,
George T. Priest,
Robert E. Moloney,
Henry W. Allen, and
John H. Holliday,
who shall continue for the period of five years, next ensuing the date of this agreement.

Each Board shall elect its own President, Vice President, Secretary and Treasurer and may create such other offices, filling them by appointments and prescribing the duties appertaining thereto as they may deem wise, necessary or convenient to carry on the business of the Association and may likewise fill any vacancy in its membership occasioned by death or resignation until the next election of a Board of Governors, The Board may also fix the salaries of all officers, including its own members, and may remove any officer and fill all vacancies which may occur in any office.

The first Board of Governors shall appoint such a number of its members as it may deem proper, not exceeding three, as *Trustees, in whose name or names all investments and title to all property are to be made and held* under a declaration of trust for and on behalf of this association.

The Board of Governors shall be held to be Trustees for and on behalf of this Association and may in that capacity be sued ana sue in any court of law or equity.

The Board of Governors shall have full power and authority in the conduct of the business of the Association to borrow money and issue mortgage debentures therefor if deemed ad-visable and any debt for money so borrowed or liability created shall be and remain until paid a lien upon all funds, moneys and properties there or thereafter belonging to or held in trust for this Association in preference to the claims or claim of any shareholders as such.

(1) *The Board of Governors shall have no power to bind the shareholders or members personally;* and in every written contract or undertaking they shall enter into relating to the business of this Association, its property or any part thereof, reference shall be made to this agreement; and the *person, firm or corporation so contracting with the Board of Governors shall look only to the funds and property legal and equitable of this Association for the payment of any debt, damage, judgment or decree* or of any money that may become due and payable in any way by reason of the contract or undertaking; and neither the Board of Governors nor the shareholders or members present or future shall be personally liable therefor or for any debt incurred or engagement or contract made by said Board of Governors.

(2) The Board of Governors may fix and regulate their own time and place of meeting and a majority thereof shall constitute a quorum and possess and exercise all the powers of a full Board.

(3) The Board of Governors shall whenever they may be so minded convene all of the registered share or certificate holders in general meeting without specifying the purpose thereof upon notice to that effect deposited in the Post Office at the place of the general offices of the Association addressed to each shareholder at his registered Post Office address, ten days before the date of the proposed meeting; and the majority of the shares present or represented at any such meeting so called, shall have and exercise the right, power and authority of the entire body of share or certificate holders.

(4) The share or certificate holders shall meet annually on the second Tuesday of each year without further notice to consider the affairs of the Association and transact such business as may then be inaugurated by them or that may be submitted for their consideration by the Board of Governors. At each meeting of the share or certificate holders, each member present or represented by duly accredited agent or attorney shall be entitled to cast as many votes upon any proposition as he may have shares of membership interest.

(5) At any meeting of members, By Laws may be passed or amended by a majority of those present or represented; and any amendment may be made to this agreement by a vote of three-fourths of those present or represented.

(6) The Board of Governors may from time to time declare and pay such dividends from the earnings of the Association as they deem expedient.

Officers and Their Duties

President and Vice President

The President or in his absence the Vice President shall sign all certificates of membership, preside at all meetings of the members of the Board of Governors and shall do and perform and render such acts and services as the Board of Governors shall prescribe and require and shall receive such compensation for services as may from time to time be fixed upon by the Board of Governors.

Secretary

The Secretary shall countersign all certificates of membership and shall keep such minutes, records and books as the Board of Governors may require, attend all meetings of the Board of Governors and render such services as may be imposed upon him.

Treasurer

The Treasurer shall perform such duties as the Board of Governors may impose upon him.

Title Trustees

The members of the Board of Governors appointed to hold the title to all property of the Association shall at all times be subject to the orders of the Board of Governors who may any time and for any cause remove any or all of them from office and appoint and devolve upon other members of the Board of Governors the duties and functions of the office. *In the case of the death, resignation or other disability of any such Trustee, the Board of Governors may fill the vacancy caused thereby.*

Dissolution

This Association shall continue for a period of Fifty years from the date of the execution hereof unless sooner dissolved by the vote of the majority of membership certificates or shares.

In Witness Whereof we have hereunto set our respective signatures and attached our several seals, this the 2nd day of April, 1910.

Henry C. Pierce, (Seal)
S. W. Fordyce, (Seal)
Samuel W. Fordyce, Jr., (Seal)
George T. Priest, (Seal)
Robt. E. Moloney, (Seal)
Henry W. Allen, (Seal)
John H. Holliday, (Seal)

Appendix C. By-laws of a New York Corporation

Article I. — Stock

1. Certificates of Stock shall be issued in numerical order from the stock certificate book, be signed by

the President and Treasurer and sealed by the Secretary with the corporate seal. A record of each certificate issued shall be kept on the stub thereof.

2. Transfers of Stock shall be made only upon the books of the Company and before a new certificate is issued the old certificate must be surrendered for cancellation. The stock books of the Company shall be closed for transfers twenty days before general elections and ten days before dividend days.

3. The Treasury Stock of the Company shall consist of such issued and outstanding stock of the Company as may be donated to the Company or otherwise acquired, and shall be held subject to disposal by the Board of Directors. Such stock shall neither vote nor participate in dividends while held by the Company.

Article II.— Stockholders

1. The Annual Meeting of the stockholders of this Company shall be held in the principal office of the Company in New York City at 12 M. on the second Monday in January of each year, if not a legal holiday, but if a legal holiday then on the day following.

2. Special Meetings of the stockholders may be called at the principal office of the Company at any time by resolution of the Board of Directors, or upon written request of stockholders holding one third of the outstanding stock.

3. Notice of Meetings, written or printed, for every regular or special meeting of the stockholders, shall be prepared and mailed to the last known post-office address of each stockholder not less than ten days before any such meeting, and if for a special meeting, such notice shall state the object or objects thereof. No failure or irregularity of notice of any regular meeting shall invalidate such meeting or any proceeding thereat.

4. A Quorum at any meeting of the stockholders shall consist of a majority of the voting stock of the Company, represented in person or by proxy. A majority of such quorum shall decide any question that may come before the meeting.

5. The election of Directors shall be held at the annual meeting of stockholders and shall, after the first election, be conducted by two inspectors of election appointed by the President for that purpose. The election shall be by ballot, and each stockholder of record shall be entitled to cast one vote for each share of stock held by him.

6. The Order of Business at the annual meeting, and, as far as possible, at all other meetings of the stockholders, shall be:

1. Calling of Roll.
2. Proof of due notice of Meeting.
3. Reading and disposal of any unapproved Minutes.
4. Annual Reports of Officers and Committees.
5. Election of Directors.
6. Unfinished Business.
7. New Business.
8. Adjournment.

Article III. — Directors

1. The Business and Property of the Company shall be managed by a Board of seven Directors, who shall be stockholders and who shall be elected annually by ballot by the stockholders for the term of one year, and shall serve until the election and acceptance of their duly qualified successors. Any vacancies may be filled by the Board for the unexpired term. Directors shall receive no compensation for their services.

2. The Regular Meetings of the Board of Directors shall be held in the principal office of the Company in New York City at 3 P.M. on the third Tuesday of each month, if not a legal holiday, but if a legal holiday, then on the day following.

3. Special Meetings of the Board of Directors to be held in the principal office of the Company in New York City may be called at any time by the President, or by any three members of the Board, or may be held at any time and place, without notice, by unanimous written consent of all the members, or with the presence of all members at such meetings.

4. Notices of both regular and special meetings shall be mailed by the Secretary to each member of the Board not less than five days before any such meeting, and notices of special meetings shall state the purposes thereof. No failure or irregularity of notice of any regular meeting shall invalidate such meeting or any proceeding thereat.

5. A Quorum at any meeting shall consist of a majority of the entire membership of the Board. A majority of such quorum shall decide any question that may come before the meeting.

6. Officers of the Company shall be elected by ballot by the Board of Directors at their first meeting after the election of directors each year. If any office becomes vacant during the year the Board of Directors shall fill the same for the unexpired term. The Board of Directors shall fix the compensation of the officers and agents of the Company.

7. The order of business at any regular or special meeting of the Board of Directors shall be:

1. Reading and disposal of any unapproved Minutes.
2. Reports of Officers and Committees.
3. Unfinished Business.
4. New Business.
5. Adjournment.

ARTICLE IV. — OFFICERS

1. The Officers of the Company shall be a President, a Vice-President, a Secretary and a Treasurer, who shall be elected for one year and shall hold office until their successors are elected and qualify. The positions of Secretary and Treasurer may be united in one person.

2. The President shall preside at all meetings, shall have general supervision of the affairs of the Company, shall sign or countersign all certificates, contracts and other instruments of the Company as authorized by the Board of Directors; shall make reports to the directors and stockholders and perform all such other duties as are incident to his office or are properly required of him by the Board of Directors. In the absence or disability of the President, the Vice-President shall exercise all his functions.

3. The Secretary shall issue notices for all meetings, shall keep their minutes, shall have charge of the seal and the corporate books, shall sign with the President such instruments as require such signature, and shall make such reports and perform such other duties as are incident to his office, or are properly required of him by the Board of Directors.

4. The Treasurer shall have the custody of all moneys and securities of the Company and shall keep regular books of account and balance the same each month. He shall sign or countersign such instruments as require his signature, shall perform all duties incident to his office or that are properly required of him by the Board, and shall give bond for the faithful performance of his duties in such sum and with such sureties as may be required by the Board of Directors.

ARTICLE V. — DIVIDENDS AND FINANCE

1. Dividends shall be declared only from the surplus profits at such times as the Board of Directors shall direct, and no dividend shall be declared that will impair the capital of the Company.

2. The moneys of the Company shall be deposited in the name of the Company in such bank or trust company as the Board of Directors shall designate, and shall be drawn out only by check signed by the Treasurer and countersigned by the President.

Article VI. — Seal

1. The Corporate Seal of the Company shall consist of two concentric circles, between which is the name of the Company, and in the center shall be inscribed "Incorporated 1905, New York," and such seal, as impressed on the margin hereof, is hereby adopted as the Corporate Seal of the Company.

Article VII. — Amendments

1. These By-Laws may be amended, repealed or altered, in whole or in part, by a majority vote of the entire outstanding stock of the Company, at any regular meeting of the stockholders, or at any special meeting where such action has been announced in the call and notice of such meeting.

2. The Board of Directors may adopt additional by-laws in harmony therewith, but shall not alter nor repeal any by-laws adopted by the stockholders of the Company.

Appendix D. Agreement Regulating Trade Conditions, Commissions and Relations Between Jobbers and Dealers: Feed Dealers' Association

Constitution and By-laws

Article I

Name

Section 1. The name of this Association shall be ———. Feed Dealers' Association.

Object

Sec. 2. This Association is formed for the mutual benefit of its members; to reform abuses and inculcate principles of justice and equity in the feed business; to facilitate speedy adjustment of business disputes; to protect its members from irresponsible customers and to encourage frequent intercourse and consultation among its members for the promotion of their common interests.

Qualifications of Members

Sec. 3. Any individual, firm or corporation of good repute and responsibility, maintaining a place of business and regularly engaged in the Hay, Grain and Feed Commission business, or regularly engaged in the buying and selling of hay, grain and feed in the City of ———, County of ———, shall be eligible to membership in this Association.

Application for Membership

Sec. 4. Every application for membership in this Association shall be made in the name of the individual, firm or corporation by whom the business is to be conducted, giving a *true and complete statement of resources and liabilities, and such other information as may be required by the Board of Directors, on* a blank form furnished by the Association for this purpose. This statement shall be sworn to and acknowledged before a notary public and shall be for the *use of the members as a basis for the allowance of credit.*

Initiation Fee

Sec. 5. Every applicant shall deposit in the hands of the Secretary, with the application, the sum *of fifty* ($50.00) *dollars, as an initiation fee,* or an unimpaired certificate of membership.

Every application for membership shall be investigated by the *Membership Committee* and their finding referred to the Board of Directors within ten days from the date same was referred to them by the Secretary. The Secretary shall at the same time notify all of the members of the Association by mail of the name of the applicant, his place of business and also the name of the membership which is sought to be transferred, and *any member having any objection to the transfer or the issuance of the certificate of membership to the applicant, must file his objection in writing with the* Secretary within five days of the receipt of said notice. *Upon the approval of the Board of Directors* (the necessary time for the filing of objections having elapsed), the *applicant shall become a member in good standing by signing the Constitution and By-Laws of the Association.*

Sec. 6. *Memberships in this Association are transferable.* Application for transfer of membership must be made to the Secretary in writing and all transfers recorded on the books of the Association, a fee of five ($5.00) dollars being charged therefor.

No application for membership shall be approved by the Board of Directors wherein the applicant is not engaged in the hay, grain or feed business in his own name and is financially interested in the profits and losses of the business.

Appropriation of Money

Sec. 7. All moneys received by the Association not otherwise provided for in these Articles of Association shall constitute a fund to be appropriated and disposed of as the Association shall direct, provided, however, that there shall be no appropriation for other than business of the Association, unless the same shall be approved by a two-thirds vote of all members present at any regular meeting and at least ten days' notice has been given of such proposed appropriation.

Quorum

Sec. 8. A quorum for the transaction of business shall consist of nine (9) members in good standing, but a less number may adjourn from time to time.

Termination of Membership

Sec. 9. In case any individual, company or corporation shall cease to be actively engaged in the hay, grain and feed business, the membership of such member shall thereupon cease and such member shall not be entitled to be present at any of the meetings of the Association or any of its committees. Provided, however, that the membership may be transferred within six months from the termination of said membership by reason aforesaid, and it shall be the duty of the Board of Directors, on learning that a member has ceased to conduct his business, to notify him that he must dispose of his membership within six months or that same shall lapse.

Sec. 10. The *annual dues shall be five* ($5.00) dollars, payable during the month of May for the ensuing year. Any member who refuses or neglects to pay the same within sixty (60) days after they become due, shall stand suspended until paid, and the Secretary shall immediately notify the members of such suspension. Upon any member paying his back dues, the Secretary shall issue to such member a reinstatement card, a fee of one ($1.00) dollar being charged therefor.

ARTICLE II

Officers

Section 1. The officers of the — Feed Dealers' Association shall be President, Vice-President, Secretary, Treasurer, a *Board of Directors* consisting of five (5) members, two of which shall be the President and Secretary and the other three members to be (1) hay receiver and two (2) feed dealers; a committee of five (5) called the *Appeals Committee,* which committee shall be composed of one (1) hay receiver and four (4) feed dealers; a committee of five (5) called the *Arbitration Committee,* which shall be composed of one (1) hay receiver and four (4) feed dealers; a committee of three (3) called the *Membership Committee;* an Auditing Committee of three (3); a Sergeant-at-Arms, and a Marshall, all to be elected annually at the regular meeting in April or as soon thereafter as possible.

Nominations

Sec. 2. Nomination for Officers must be made at the regular meeting in January of each year. In case of the withdrawal of candidates for any office previous to the election, additional nominations may be made on the evening of election.

Annual Meeting — Proxies — Vacancies

Sec. 3. The hour and place of the annual meeting shall be designated by the President. The Secretary shall mail to each member a written or printed notice of the time and place of meeting three days in advance. All elections shall be by Australian ballot, and the one receiving the highest number of votes for any office shall be declared elected. Only members personally present shall be allowed to vote. And all newly elected officers shall officially assume the duties of their respective offices on May 1st of each year, provided they are fully qualified, or as soon thereafter as they shall be. The officers of this Association shall continue in office until their successors are elected and qualified. Vacancies may be filled by the Association at any regular meeting, a majority being necessary to elect.

ARTICLE III

Regular and Special, Meetings

Section 1. The regular meetings of the Association shall be held on the second Tuesday of January, April, July and October. The time and place of said meetings to be determined by the Association from time to time. Special meetings of the Association may be called at any time by the President, and the President shall also call a special meeting whenever requested to do so by nine members in writing.

Who can Vote — Classification of Members

Sec. 2. *a.* In all matters to be determined by the Association (except such as are otherwise provided for in these Articles of Association) a majority vote of all members present shall be necessary for a decision, but these rules may be suspended upon the affirmative vote of two-thirds of the members present. *b.* Any member in arrears for dues, fines, fees, penalties or assessments shall be deprived of the right to vote until such arrears are paid. *c.* All partners in any membership may, if they desire, attend any meetings and participate in the discussion and serve on committees, but each membership shall have but one representative upon any one committee.

Sec. 3. The members of this Association shall be divided into two branches, designated as *hay receivers* and *feed dealers.*

(Article IV omitted)

Article V

Rules governing the Sale of Merchandise on Team Track

"Members of this Association shall not sell hay or straw in any quantity to be delivered on any team track or ship dock to any dealer who is not a member of this Association who is doing business within the limits as described in Section I of

"Members of this Association shall not sell grain or feed to be delivered on any team track in less than carload lots to any dealer who is not a member of this Association."

Sec. 2. Members of this Association shall not sell hay, straw, grain or any kind of feed to be delivered on any team track within the limits described in Section 1 of Article VI to any consumer in less than full carload lots.

Sec. 3. Hay receivers shall not employ feed dealers or any of their employees to sell either hay or straw, in any quantity, upon team track for them.

Rules governing the Purchase of Goods on Team Track

Sec. 4. All members of this Association classified as *feed dealers, shall purchase all hay, straw, grain and feed purchased by them on team track or ship dock, from members of the Association* or on the Chicago Board of Trade. *Feed dealers shall not solicit consignments of hay or straw, but should they receive shipments of hay or straw they shall turn the same over to a hay receiver* who is a member of this Association, to be sold in the same manner as if it were a car consigned to him.

Article VI

Consignments of Hay and Straw — To whom Sold

Section 1. All receipts of hay and straw received by hay receivers who are members of this Association shall be sold in carload lots, and no hay receiver who is a member of this Association shall either directly or indirectly sell any such carload lots of hay or straw to any consumer in ——— County, unless such consumer is a member of the ——— Board of Trade and purchases the same on the Board of Trade during the trading hours of the Board; nor to any dealer who is not a member of this Association whose place of business is located within the limts — 69th Street on the south, the city limits on the west, the city limits on the north and ——— on the east — unless such dealer is a member and purchases such hay or straw on the Board of Trade during the regular trading hours.

Charges for Selling

Sec. 2. The hay receiver selling hay and straw shall charge as brokerage $7.50 per car for any car containing ten tons or less, and 75 cents per ton for all cars containing over ten tons. Any member convicted of a violation of this section shall be fined the sum of $100 for the first offense, and for the second conviction within a year shall be expelled from membership in this Assocaition.

Sec. 3. No member of this Association who is not a hay receiver shall purchase any hay or straw in carload lots at country points to be consumed in ——— County.

Time for Rejection of Cars

Sec. 4. *a.* The buyer must examine the hay or straw in the doorway of car, and either accept or reject the same within twenty-four hours from time of purchase, if the car is on team track when purchased. If not, then within twenty-four hours from time of its arrival on team track (or if bought on the Board of Trade by 12.30

o'clock of the next business day), on all roads that give more than two days' time for unloading before charging car service, twenty-four hours additional time shall be allowed. Failure to reject or refuse in accordance with these conditions will constitute an acceptance of the car of hay or straw, *b.* The purchasers shall pay all car service charges by the railroad that may accrue after forty-eight hours from 7 A.M. following hour of purchase, should the car be on team track when purchased, provided hay or straw is according to sample.

Sec. 5. The purchaser of hay or straw hauling out last load must take all loose hay or straw contained in car at half price, and if such hay or straw is not weighed separately the weight must be estimated by the agent of the R. R. Co. hauling the shipment, and such weight must be indicated on scale ticket and load ticket.

Article VII

How to prefer Charges

Section 1. Charges against members of this Association for violation of the Rules or By-Laws shall be made by filing the same in writing with the President for approval.

Sec. 2. The President shall at once notify the Secretary of the Association to call a meeting of the proper committee before whom the complaint should be heard.

Sec. 3. The Secretary shall notify all witnesses to be present and summon the member complained of, giving him a copy of the charges, and at least three days' notice of the time and place of the meeting of the committee before whom the complaint is to be heard.

Sec. 4. A copy of the charges drawn by the Secretary shall state explicitly the article and section of the articles of Association under which the complaint is filed.

Sec. 5. Differences between members of this Association shall, upon the request of either, be submitted to the Committee of Arbitration for adjustment. The complaining member shall file his claim with the Secretary in writing, accompanied by five ($5.00) dollars to cover cost of Arbitration Committee, whereupon the Secretary shall fill out a regular blank to be signed by both parties to the arbitration, agreeing to submit to and abide by such arbitration.

Sec. 6. The cost of such trial by the Arbitration Committee to be paid by the party against whom the verdict runs. In the event of the verdict being found for the complainant, the cost shall be taxed upon the defendant, and the fee deposited by the complainant returned to him.

Sec. 7. Any member refusing to sign agreement to arbitrate may be cited before the Board of Directors to show cause in justification of such refusal.

Sec. 8. Any member of this Association who fails to meet his obligations to a member of this Association may be summoned before the Board of Directors, and if found guilty cf the offense charged against him, shall be, in the discretion of the said Board of Directors, fined not to exceed twenty-five dollars ($25.00) for such offense or suspended from the privileges of the Association until he makes satisfactory settlement of the claim against him.....

Penalties

Sec. 11. When any member of this Association has been convicted of a violation of any of the Rules and By-Laws after due trial before the Arbitration Committee, the committee must impose the following penalties, except as otherwise provided in Section 2, Article VI:

a. For the first offense a fine of twenty-five ($25.00) dollars, for the second offense a fine of fifty ($50.00) dollars, for the third offense a fine of seventy-five ($75.00) dollars, for the fourth offense the penalty shall be expulsion, provided, however, that the cumulative fines shall not be imposed unless the

offense be committed within the period of one year from the date of previous conviction.

b. A member so expelled shall not be eligible to reinstatement in this Association for the period of six months from the date of expulsion except as hereinafter provided, *c.* The several penalties are mandatory and must be imposed where the party complained of is found guilty. This Association shall not modify, abate or remit any sentence justly imposed. All fines imposed must be paid within five days from imposition of same. The money to be paid into the treasury of the Association.

Defendant may Appeal

Sec. 12. In all cases where judgment has been rendered against the defendant or complainant in any case tried before the Arbitration Committee, the defendant or complainant may appeal from the finding of said committee....

The finding of the Appeal Committee shall be final in all cases.

Directors may appoint Committee to examine Books

Sec. 13. Whenever the Board of Directors may deem it necessary or expedient they shall have the *power to designate two of their number to examine the books of account of any member of this Association* with relation to any specific charge made against such member for a violation of the Rules, and members shall permit such inspection of their books, upon the presentation by the Committee appointed to examine them an order signed by the President and Secretary.

Article VIII

Payment of Service of Arbitration and Appeals Committees — Who shall pay cost of Trials

Section 1. *Each member of the Arbitration Committee and Appeal Committee shall receive as compensation for his services in the hearing of cases before said committees one* ($1.00) *dollar in each case.* When the complainant does not appear to prosecute the charges made by him, said complainant shall pay the costs of such trial, and when the charges are sustained the defendant shall be required to pay the costs; when charges are not sustained the Association shall pay the costs of trial.

Sec. 2. *Any member who shall furnish sufficient evidence of violation of Article 5 or 6 for the conviction of another member, and the member shall be found guilty, fined and the fine paid, shall be entitled to recover from the Association one-half of the amount of the fine so paid, and two* ($2.00) *dollars for each necessary witness, not to exceed three.*

Article IX

Duties of the President

The President, when present, shall preside at all meetings of the Association. He shall maintain order and preserve the

dignity thereof. All committees shall be appointed by the President, unless otherwise ordered by the Association. At the annual meeting and at such other times as he may deem proper, the President may communicate to the Association such suggestions as will, in his opinion, tend to promote the welfare and increase the usefulness of the Association. The President shall give the Vice-President twenty-four (24) hours' notice of his inability to preside at a meeting.

Article X

Duties of the Vice-President

ARTICLE XI
Duties of the Treasurer

ARTICLE XII
Duties of Secretary

The Secretary shall keep a correct record of the proceedings of all meetings in a book provided for that purpose, which he shall produce at every meeting and transfer to his successor at the expiration of his term of office. He shall send by mail to each member the notice of every regular, adjourned or special meeting of the Association, and shall also notify members promptly, by mail or otherwise, of all dues, fines, fees, penalties and assessments, and shall pay all receipts over to the Treasurer monthly, except as otherwise provided. He shall keep an alphabetical list of all members and their addresses. He shall perform all the clerical work necessary, at the request of the President, and make a report of doings of the Association at the annual meeting. He shall notify all the members of the Association by mail of any proposed change in the Articles of Association. He shall be required to give bonds for the faithful discharge of his duties, with such security as the Association may, from time to time, require. *For his services he shall receive three hundred* ($300) *dollars annually,* or such compensation as the majority of the Association shall hereafter determine. In absence of the Secretary at any meeting, a Secretary *pro tern* may be appointed.

ARTICLE XIII
Duties of Board of Directors

The Board of Directors shall hold all property of this Association other than its cash funds, and have direction of all affairs of this Association not otherwise provided for. *All cases of uncommercial conduct shall be heard by the Board of Directors;* they shall have the *power to summon any member of the Association* before them as witness.

Their finding shall be final in all cases; and by a majority vote they shall have the power to impose a fine upon or suspend a member, or both, and may expel a member by a unanimous vote.

ARTICLE XIV
Duties of Arbitration Committee

The Arbitration Committee shall try all disputed accounts brought before it for adjustment, and all violations of the Rules of this Association not otherwise provided for, and its findings shall in all cases be final unless appealed from as herein provided. All evidence given before the Committee shall be stenographically reported, the expense to be paid by the Association.

ARTICLE XV
Duties of Appeal Committee

The Appeal Committee shall try all cases sent to it by appeals from the Arbitration Committee and its findings in all cases shall be final.

ARTICLE XVI
Duties of the Membership Committee

The Membership Committee shall see that every application is properly filled out and sworn to. They shall investigate the statements in every application and verify the same before approving.

Article XVII
Duties of Auditing Committee

Article XVIII
Duties of the Sergeant-at-Arms

Article XIX
Duties of the Marshal.

Article XX
Rules and Regulations

This Association shall have power to adopt and enforce such additional rules and regulations for the government of its members, provided such rules and regulations are not inconsistent with these Articles of Association, and all such rules and regulations so adopted shall be binding upon all the members and remain in force until altered, amended or repealed by three-fourths vote.

Article XXI
Alterations of Articles

Section 1. This Association shall have power to alter or amend these Articles of Association, but it shall require at least four weeks' notice mailed to each member, either written or printed, before any proposed alteration or amendment can be acted upon, except such as are otherwise provided for in these Articles. A two-thirds vote of all members present shall be necessary to legalize any and all amendments and alterations, except such as are otherwise provided for in these Articles.

Sec. 2. This Association may be dissolved only by a two-thirds vote or by the written consent of three-fourths of all members in good standing; and when these Articles terminate and this Association ceases to exist, then each member in good standing shall be entitled to his pro rata share of the funds in the treasury of the Association after all just claims against the Association have been paid. But should any member be indebted to this Association for any dues, fines, fees or assessments at the time of the dissolution of this Association, the amount of his indebtedness shall be deducted from his pro rata share before payment is made.

Appendix E: Extracts from Constitution and By-laws of California Coal Dealers' Association

Constitution

"Article 1. Title and Object, (a) The title of this organization shall be the 'Coal Dealers' Association of California,' with principal place of business in San Francisco. (b) It shall have for its object the furnishing of information to its members as to sales of coal made by wholesale dealers to the retail dealers, and by retail dealers to consumers, and also the names of any dealers who have been guilty of violating any of the rates or rules made from time to time by this organization, and the furnishing of as complete a list as possible of delinquent consumers, and such other matters as may be decided upon.

"Art. 2. What constitutes a Dealer, (a) Any person who engages in the sale of coal as regular business, buying to sell again, who shall own and operate a yard, keeping an office, and displaying a sign, shall be regarded as a retail dealer. (b) All miners and shippers shall be eligible to membership in this association,

provided such miner and shipper shall not make a practice of selling coal, at retail, at less price than the retail dealers.

"Art. 4. Fees — Dues — Assessments, (a) The admittance fee for membership shall be two hundred (200) dollars, and must invariably accompany the application, (b) The amount of dues shall be fifty cents per month, payable quarterly in advance, and to date from the first day of the month following the month in which the member was admitted, (c) Assessments may be levied by a two-thirds vote of the members present at a regular meeting, but only in such cases when the interests of the association as a business society require it. (d) No assessment shall be levied unless it is expressed in the notice of meeting that 'a resolution to levy an assessment will be introduced.'

"Art. 6. Failure to pay Dues, Assessments, or Fines — Charges — Right of Appeal, (a) If any member shall neglect or refuse to pay the monthly dues and assessments as provided in the constitution and by-laws of this association within three days after the same have become due, he or they shall no longer be considered members of this association, or participant in its benefits, and shall surrender certificate of membership; but a written or printed notice must be sent, at the expiration of said time, to all those members who are delinquent, and may be reinstated within ten days thereafter by paying in full all dues.

By-Laws

"Sec. 3. Officers and Their Duties.... (c) The secretary, prior to taking his office, shall be required to give a bond, for the faithful performance of his duties, in the sum of one thousand (1000) dollars, with two sureties qualifying for the sum of five hundred (500) dollars each, and satisfactory to the board of directors. He shall collect all dues, issue all communications, notices, and other correspondence not provided for. He shall keep a register of all members of the association, together with & regular set of books for the proper conduct of business; receive all moneys due the association, and pay the same over to the treasurer; sign all orders on the treasurer for the payment of such bills as may be approved by a majority of the finance and certificate purchasing committees. He shall keep a record, in a book provided for the purpose, of all transfers of certificates of membership; be the custodian of all properties of the association; receive all charges made of violation of the card rates and rules, and refer the same to the grievance committee for action, after using due diligence in securing such facts in the case as possible. He shall devote his entire time to the association, and under no circumstances is he allowed to be associated in any manner with any other business. He shall, on receipt of findings of the grievance committee, notify the wholesale dealers of such report, and request, in writing, that they impose the penalty for such violation. His compensation shall be fixed by the board of directors....

"Sec. 4. Standing Committees, (a) A grievance committee consisting of three persons shall be appointed by the president, from the board of directors, on the first Monday of every month, to serve without compensation until the first Monday of the following month, or until their successors are appointed. They shall assemble whenever requested to do so by the secretary, and receive and investigate all charges of violation of card rules or rates preferred against any coal dealer or agent in the city and county of San Francisco, and report their findings to the secretary. They shall have the power to fix the time limit for the payment of any fines imposed by them....

"Sec. 9. Advertising, Circulars, etc. (a) Dealers in advertising coal are not permitted to state prices without adding the names of coal to be had for the prices named; both names and prices to correspond exactly with those on rate card, (b) Any circulars, posters, dodgers, cards, or signs conflicting with the card rates or rules displayed, found on the streets or circulated in any manner whatsoever, shall subject the dealer or agent, who caused their distribution, to the penalties, as are provided in section 13 of these by-laws for

selling coal in violation of card rates or rules.

Sec. 10. Two or More Yards. A member having two or more yards cannot dispose of his certificate of membership in the sale of one yard, and retain his membership in the association.

Sec. 11. New Yards. Any member opening a new yard or yards after June 14th, 1895, in addition to the one that secured his admission in the association, shall be liable for an additional two hundred (200) dollars admittance fee and monthly dues for each yard so opened, in order for such yard or yards to, participate in the benefits of the association.

"Sec. 12. Standard Rules and Weights, (a) No dealer shall give more or less than 100 pounds to 1 sack; 500 pounds to 5 sacks, or ¼ ton (short); 1000 pounds to 10 sacks, or ½ ton (short); 2000 pounds to 20 sacks, or 1 ton (short); 2240 pounds to 1 ton (long), (b) All long tons must be delivered in bulk. Names of coal must appear on bill exactly as they read on rate card. A load of coal delivered in bulk shall be per ton of 2240 pounds. If handled after arrival at customer's place, an additional charge of fifty cents per ton must be made. A ton of coal delivered in twenty sacks, and put in bin, shall be 2000 pounds. No premiums or presents are permitted to be offered as inducements for purchasers to buy coal, (c) Dealers shall be permitted to sell and deliver fifty pounds of coal at one-half card rates for one hundred pounds, but in no case shall they be allowed to sell coal in quantities ranging between fifty pounds and one hundred pounds.

"Sec. 13. Violations — Penalties, (a) If a dealer or agent, member or non-member, be found guilty of selling coal in violation of the card rates or rules, he shall be subject to a fine of not less than ten (10) dollars nor more than one hundred (100) dollars for first offense, not less than twenty-five (25) dollars nor more than two hundred (200) dollars for second offense; if a member of the association, be suspended and compelled to pay retail prices for third offense until restored to membership in good standing by the board of directors....

"Sec. 14. Agreement. The following agreement between the wholesale coal dealers of the city and county of San Francisco, Cal., and this association, is hereby embodied in this section, and made a part and parcel of the by-laws of this association:

"'This agreement, made this first day of June, A.D. 1896, by and between the Coal Dealers' Association of California, an association, and the undersigned wholesale coal dealers, witnesseth: (1) That the purposes of this agreement are: First, protection to consumers in receiving full amount and kind of coal purchased; second, protection to dealers in obtaining sufficient margin to carry on a safe business with justice to consumers. (2) That said wholesale dealers will not, nor will any or either of them, during the continuance of this agreement, sell coal at trade rates to any one not having an established yard; nor will any or either of them sell coal at less than card rates to consumers, except in such cases as may be provided for by agreement among said wholesale dealers themselves. (3) That said wholesale coal dealers hereby acknowledge the request of the Coal Dealers' Association of California, made to them on the sixth day of May, 1896, to charge one dollar ($1.00) per ton additional over present trade rates for all coal sold by said wholesale dealers, or any or either of them, to the retail dealers in the city and county of San Francisco, who are not members of said association, and hereby agree to comply with said request, and will during the continuance of this agreement charge one dollar ($1.00) per ton additional over trade rates for all coal sold to dealers carrying on business in said city and county who are not members of said association. (4) That upon receiving proof from the Coal Dealers' Association of the violation by any retail coal dealer of any of the rules of business printed on the rate card issued by said association, and being satisfied that the charge is established, said wholesale coal dealers agree, and each of them agrees, to, and will, charge the dealer so violating said rules or rule consumers' rates thereafter for coal, until said retail dealer, if a member of said association, shall have been reinstated to membership in the Coal Dealers' Association of California by the vote of the

board of directors of said association, or, if not a member, until he shall have paid such reasonable penalty as may be imposed upon him by said association. (5) That the following rules and rates shall be enforced during the continuance of this agreement: That rates at which coal shall be sold to consumers shall be as shown on the rate card issued from time to time by the Coal Dealers' Association of California. A ton of coal delivered in twenty (20) sacks, and deposited in bin, will be 2000 pounds; and no more nor less than twenty sacks shall constitute a ton so delivered. A ton of coal delivered in bulk shall be 2240 pounds. For coal in bulk handled after arrival at place of delivery, an additional charge of fifty cents per ton shall be made, provided, however, if the handling after arrival at place of delivery consists only of shoveling or dumping coal in place of deposit, no additional charge shall be made. All long tons must be delivered in bulk. (6) That any member of the Coal Dealers' Association furnishing coal to another dealer who has been duly adjudged by the Coal Dealers' Association of California guilty of violation of the rules or any rule of said association printed on said rate card will himself suffer the penalty imposed by said association for violation of said rules. (7) That no member of the Coal Dealers' Association shall have the right to transfer his certificate of membership in said association until all indebtedness due to said wholesale coal dealers, or any of them, by the member of the said Coal Dealers' Association holding said certificate, shall have been paid, or until an adjustment between the debtor and creditors shall have been satisfactorily made by such debtor and creditors. (8) That in the event of the discontinuance of business by any member of said Coal Dealers' Association, and his failure to promptly settle his indebtedness due to said wholesale coal dealers, or any of them, then said Coal Dealers' Association shall have the right to declare such delinquent member's certificate forfeited to said wholesale coal dealers parties hereto, who are his creditors. That the said wholesale coal dealers for whose benefit said forfeiture takes place shall have the right to sell said membership certificate, and, upon the sale thereof, shall apply the proceeds of sale to the payment of the claims of the wholesale coal dealers parties hereto, holding claims against such delinquent member. That, after the application of the proceeds of such sale to the payment of the claims of said wholesalers, any surplus remaining shall be paid to the delinquent member. (9) And, in the event of a sale of his business, wholesale dealers shall decline to furnish coal to his successor, at the discretion of the association's directors, until the seller has paid all bills due by him to the wholesale dealers, who are parties hereto. (10) That this agreement does not apply to steam, hotel, restaurant, or church trade, nor to such trade as must be, necessarily, reserved by wholesale dealers as a means protection to steam trade, and referred to in section 2 of agreement, (11) That this agreement shall continue in full force and effect for the period of two years from date hereof, and shall apply only to said wholesale coal dealers and retail coal dealers carrying on business within the city and county of San Francisco.

"'IN WITNESS WHEREOF, the parties hereunto set their hands, the day and year first above written, said Coal Dealers' Association signing by its president and secretary, thereunto authorized by resolution of said association duly passed, and said wholesale coal dealers signing their respective names.

"'(Signed) COAL DEALERS' ASSN' OF CALIFORNIA,
"'By P. LYNCH, *President.*
"'By E. K. CARSON, *Secretary.*
"'CHARLES R. ALLEN.
"'CENTRAL COAL CO.,
"'By J. J. MCNAMARA.
"'R. D. CHANDLER.
"'GEO. RRITCH,
"'Per J. HOMER FRITCH.
"'C. WILSON & CO.,

"'Oregon Improvement Co.,
"'John L. Howard, *Manager.*
"'Oregon Coal & Navigation Co.,
"'By C. M. Goodall, *Vice-Pres.*
"'W. G. Stafford & Co.
"' R. Dunsmuir & sons,
"'By C. H. Jouett.'

"Sec. 15. Agencies or Offices, (a) Any member having agencies or offices other than those located at his yard, for the sale of coal, shall be compelled to have a certificate of membership for each of said agencies or offices, (b) In the event of the failure of any member to secure a certificate of membership for each agency or office, as referred to in paragraph (a) of this section, within five days after a written notice shall have been sent him by the secretary, he shall immediately cause the same to be closed, or subject himself to a fine of not less that ten (10) dollars nor more than one hundred (100) dollars for each agency or office that is known to be operated by him or for his benefit.

"Sec. 16. Sales to Nonmember Dealers or Agents, (a) No member of this association shall be permitted to sell dealers or agents, who are nonmembers, coal for less than consumers' prices...."

Appendix F: "International Agreement" Between American Gunpowder Association and European Competitors, 1897

Cited by Stevens, *The Powder Trust,* from a government exhibit in the suit of the U. S. *v*. E. I. du Pont de Nemours Powder Co. *et al.*

1. In regard to detonators the "European Factories"[223] agreed to abstain from erecting works in the United States, and to abandon the project begun at Jamesburg. The expenses so far incurred in the construction of this plant were to be shouldered by the "American Factories"[224] which also agreed to take of the "European Factories" five million detonators per year.[225]

2. As to black powder both parties bound themselves to erect no factories, the Americans in Europe, the Europeans in the United States. Each, however, was free to ship into the territory of the other.[226]

3. The arrangements in regard to smokeless sporting powder were the same as in regard to black powder.[227]

4. Smokeless military powder factories were not to be erected by the Americans in Europe or the Europeans in America. It was agreed that European factories upon receipt of an inquiry from the Government of the United States in regard to explosives, should first ascertain the price quoted or fixed by the American factories and were then bound to neither quote nor sell below that figure. Reciprocally the American factories on receiving an inquiry from governments other than their own, should, in like manner, obtain the price the European factories were quoting or had fixed and were bound not to quote or sell below it.[228]

5. For the sale of high explosives the world was divided into four districts. All of the United States, its territories and possessions, present and future, Mexico, Guatemala, Honduras, Nicaragua, and Costa Rica, Colombia, and Venezuela were to be exclusively American territory. All other countries in South America and the islands of the Caribbean Sea, not Spanish possessions, were to be common territory and designated as "syndicated territory." The Dominion of Canada and the Spanish possessions in the Caribbean were to be a free market unaffected by the terms of the agreement. The rest of the world was to be exclusively the territory of the European factories.

6. A chairman and vice-chairman were to be appointed by each party to the agreement. The chairmen

or in their absence the vice-chairmen were to establish the rules for the accomplishment of the terms of the syndicate arrangement, *(a)* They were to agree, from time to time, upon a basis price for each market in syndicated territory, said basis to include the cost of manufacturing, freight, insurance, etc. *(b)* They were also to establish a selling price for each market to be regarded as a convention price below which no sales were to be effected. The difference between the selling and the basis prices was to be syndicate profit to be divided equally.

7. A common syndicate fund of $50,000 was to be established by a payment of $1.00 per case upon certain grades of explosives shipped into syndicated territory. When the sum of these assessments reached that figure the payments were to be reduced to 50 cents per case and from the fund thus established fines not recoverable from the parties were to be deducted. It was permitted that the chairman should utilize two-thirds of this common fund for the purpose of protecting the common interest against outside competition.

8. Chairmen were to adjudicate all breaches of the agreement. On failure to agree they were to appoint an umpire who was to be a European or an American according as the complaint was brought by the American or European factories.

9. Fines: (a) for trading in the territory of the other, the penalty was the invoice value of the goods; (b) for cutting prices in syndicated territory, no limit was placed upon the amount of the fine; (c) for erecting a factory in the exclusive territory of the other, the penalty should not be less than $10,000.

10. The agreement was to go into effect on July 15, 1897, for a period of ten years. In the absence of six months' notice it was to continue thereafter from year to year.

Appendix G: Distillers' and Cattle Feeders' Trust Agreement, Dated May 10, 1887

1. The trust herein created is to be vested in nine trustees.

2. W. M. Hobart, Geo. K. Duckworth, L. H. Green, P. J. Hennesy, Alfred Bevis, Joseph B. Greenhut, W. H. Corning, Adolph Woolner, and J. H. Francis were appointed trustees, to hold their office until May i, 1888, or until their successors are elected.

3. The trustees shall prepare certificates showing the interests of each beneficiary in said trust, said certificates to be divided into shares of the par value of $100 each.

4. No certificates shall be issued except for stock as hereinafter provided, and the par value of the certificates issued shall represent, as nearly as possible, the actual cash value of the stock held by the trustees in trust.

5. Each subscriber to the trust agrees to assign absolutely to the trustees the number of shares of capital stock of the particular corporation or corporations indicated in article 6 of this agreement; in consideration of which said trustees do hereby agree to execute and deliver to each subscriber trust certificates as above specified for the number of shares, which certificates, at the par value thereof, shall represent the cash value of the stock so delivered. The value of the capital of any corporation whose stock shall be assigned to said trustees, shall be first agreed upon between said trustees and the stockholders willing to transfer the same, and after it is agreed upon there shall be no discrimination in the purchase price as between other stockholders of same corporation transferring at same time.

6. This agreement shall take effect as soon as those holding a majority of stock in the following corporations, formed or to be formed, to wit, The Storrs Distilling Company, by the Mill Creek Distilling Company; the Maddux-Hobart Company, by Maddux, Hobart & Co.; the White Mills Distilling Company, by Geo. K. Duckworth; the Great Western Distilling Company, Monarch Distilling Company, Woolner Bros. Distilling Company, Peoria Distilling Company, Birmingham Distilling Company, by the Chicago Distilling Company; Missouri Distilling Company, by Mound City Distilling Company, have transferred the same

to said trustees.

Thereafter said trustees and their successors shall have power to purchase other stocks of said companies, or of companies organized for conducting same business, or any of the business hereinbefore specified, and may issue therefor certificates of trust equal at par value to the cash value of the stocks so purchased, or shall have power to lease the premises of such companies, paying therefor such rental as they may deem proper, and whenever in their judgment it is for the best interests of the trust to lease rather than purchase.

7. All stocks sold and transferred to said trustees shall be held by them and their successors for the benefit of all the owners of said trust certificates. No stocks so held by said trustees shall be sold or surrendered by said trustees during the continuance of this trust without the consent of a majority, in number and value, of the trust certificates: *Provided, however,* That said trustees may from time to time assign such shares of stock as may be necessary to qualify any person or persons as directors of any companies, the stocks of which are held by said trustees.

8. Said trustees shall have power to cause corporations to be formed for the purposes and with the necessary powers for carrying on distilling and kindred business: *Provided,* That the stock of such corporations shall be issued for cash or for property at its cash value, and shall be issued or be purchased by said trustees in the manner provided in section 6 of this agreement.

9. Said trustees shall safely keep all moneys received from dividends or interest upon stocks or money held in trust, and shall distribute the same, as well as all moneys received from sales of trust property, by declaring and paying monthly dividends upon said trust certificates, as funds accumulate, which are not needed for the uses and expense of the trust. The trustees shall keep separate accounts of receipts from dividends and interest and of receipts from trust property.

10. Trustees shall render to the holders of trust certificates at each annual meeting a statement of the receipts and disbursements of the trust for the year. They shall also, whenever demanded by a majority in value of the holders of trust certificates, furnish a true and perfect inventory and appraisement of all property held in trust, and a statement, as full as possible, of the financial affairs of the various companies whose stocks are held in trust.

11. Said trustees shall exercise supervision, so far as their ownership of stock enables them to do, over the several corporations or associations whose stock is held by said trustees. They shall elect, or endeavor to elect, the directors and officers thereof, who shall be paid reasonable compensations for services; they may elect themselves as such directors and officers.

12. None of the powers of trustees can be exercised except by unanimous vote of their full number, either in person or by proxy, except in the election of officers as provided in the bylaws: *Provided,* That no proxy of a trustee can be given to any person other than a trustee; and in case of disagreement among trustees on any matter, a majority of the trustees may call a special meeting of the holders of certificates, as herein provided for, and to whom shall be submitted the matter of disagreement, and a decision of a majority in value of the holders of trust certificates present, in person or proxy, shall be final.

The trustees may appoint from their own number an executive committee and other committees composed wholly or partly of persons not trustees.

13. Trustees may employ and pay such agents and attorneys as they may find it necessary to employ in management of such trust.

14. Each trustee shall be entitled to a salary of $10 per day. Such may be increased by a majority of certificate holders.

15. Trust shall have principal office in Chicago, subject to change by vote of trustees. There should be a safe or vault for the safe deposit of the stocks held in trust.

16. All powers and duties vested in the trustees appointed shall be exercised by their successors.

17. Elections for trustees to succeed those herein appointed shall be held annually. At first annual election 3 trustees shall be elected for 1 year, 3 trustees for 2 years, and 3 trustees for 3 years. Thereafter 3 trustees shall be elected annually for a term of 3 years, to take the place of those retiring. Trustees elected to fill vacancy shall hold office only for the unexpired time of said vacancy.

18. No person eligible as trustee, unless actual owner of not less than 500 shares trust certificates at time of election, which must stand in his name on the trust books, and continue so, as well as actual ownership, during his term of service.

19. Trustees are elected by owners of trust certificates, and no stock shall be voted which has not stood in owner's name 30 days prior to election.

20. Annual meeting of owners of trust certificates for election of trustees and other business, shall be held at the office of trustees on the Wednesday nearest April 15, of each year, trustees must call meeting whenever requested by one-third in value of the trust certificates.

21. By-laws must be in conformity with this agreement.

22. Trustees may fill vacancy in their number or call meeting of owners of trust certificates for the purpose.

23. Trustee or trustees appointed by any court to fill vacancy or vacancies shall hold his or their offices only until his or their successors shall be appointed or elected in manner above provided for.

24. Trustees must attend every meeting of the board of trustees, either in person or by proxy. If any trustee is absent from 3 successive meetings, or fails to be represented by proxy at such meetings, his office shall be considered vacant, and filled as heretofore provided.

25. Whenever any change shall occur in the board of trustees the legal title to the stock or other property held in trust shall pass to and vest in successors of said trustees without any formal transfer thereof. But the board of trustees must obtain formal transfer from any retiring trustee, or from his executor, if retirement be caused by death.

26. The trust shall continue for 25 years and shall thereafter continue until terminated by a vote of two-thirds in value of the holders of certificates at meeting called for the purpose.

At same meeting the holders of certificates may decide, by a vote of 51 per cent of their number, the mode in which the trust affairs shall be wound up: the trustees continuing to hold office for that purpose.

27. This agreement was signed on May 10, 1887, by the Great Western Distilling Company, per J. B. Greenhut, secretary, capital stock of owner company, $100,000; Peoria Distilling Company, per Wm. McLean, secretary, capital stock of owner company, $100,000; Missouri Distilling Company, per Mound City Distilling Company, by A. Bevis, vice-president; Storrs Distilling Company, per Mill Creek Distilling Company, by Thomas T. Gaff, president; White Mills Distilling Company, per George K. Duckworth; Birmingham Distilling Company, per Chicago Distilling Company, P. J. Hennesy, treasurer, capital stock of owner company, $50,000; Maddux-Hobart Distilling Company, per Maddux-Hobart & Co.; Woolner Bros. Distilling Co., per A. Woolner, treasurer, original capital stock, $200,000, increased in 1885 to $350,000; Monarch Distilling Company, per George J. Gibson, treasurer, capital stock of owner company, $250,000.

Appendix H: Agreement for the Reorganization of the American Cotton Oil Trust.

This Agreement, made this sixth day of November, 1889, by and between Frederic P. Olcott, Samuel Thomas, Edward D. Adams, Nicholas Sheldon, James H. Benedict and William L. Bull, a Committee of the Certificate holders of The American Cotton Oil Trust, hereinafter called The Committee, parties of the first part; and such of the Certificate holders of the said The American Cotton Oil Trust as shall become parties to

this Agreement, parties of the second part; and The Central Trust Company of New York as Depositary, party of the third part; Witnesseth:

WHEREAS, The American Cotton Oil Trust was heretofore created under and by virtue of an Agreement or Deed of Trust, and there have been issued thereunder Trust Certificates now outstanding to the amount of $42,185,238;

AND WHEREAS, It is the desire and purpose of the parties hereto to effect a reorganization of The American Cotton Oil Trust by the merger and incorporation of the Trust and the property and assets thereof, in whole or in part, into The American Cotton Oil Company, a corporation organized and existing under the laws of the State of New Jersey, or that such Trust Certificates be sold, exchanged or transferred directly for shares of said Company, or that such other method or plan be adopted as may be considered by said Committee calculated to accomplish the following general result and basis, viz.:

GENERAL BASIS OF REORGANIZATION OF THE AMERICAN COTTON OIL TRUST

The American Cotton Oil Company to issue Six per cent., Non-cumulative Preferred Stock, redeemable at 105 per cent, secured by the shares of all companies received on such merger or acquisition, or by property or Trust Certificates, as may be determined by the Committee, and limited to $15,000,000 in amount — $4,454,000 thereof (or any balance in excess of the amount required on the exchange) to be held, used and disposed of by the Directors for the purposes of the Company; and Common Stock to the amount of $21,092,000. All such stock to be entitled to like voting power.

The American Cotton Oil Trust Certificates to be exchanged for such shares in the following proportion, viz.:

For each share of Trust Certificates,

50 per cent thereof in such Common Stock... $21,092,000 And 25 per cent thereof in such Preferred Stock. $10,546,000

NOW, THEREFORE, in consideration of the sum of one dollar each to the other in hand paid, and of their mutual agreement, and of other valuable consideration, the receipt whereof is hereby acknowledged, the parties hereto, and such other certificate holders as shall come in and participate under the terms of this Agreement, either by executing the same, or by depositing their Certificates hereunder, hereby mutually covenant and agree (each for himself and not for the other), to and with each other, and with the said Committee, parties of the first part, and with said Central Trust Company, party of the third part, as follows:

I. That they are the owners, or legal or personal representatives of the owners, of Certificates of The American Cotton Oil Trust, to the amounts set opposite their respective names, or deposited hereunder respectively; and that they will in all cases deposit said Certificates owned, or represented by them, or either of them, in good faith, on or before the twentieth day of November, 1889 (or within such further period as may be granted by said Committee), with the Central Trust Company of the City of New York, which is hereby designated as the Depositary of said Committee for said purpose, and that they will respectively accept in lieu thereof negotiable Certificate or Certificates of Deposit of said Central Trust Company, issued in such form as may be approved by the Committee; and that they and each of them will in all cases execute legal and sufficient transfers of their Trust Certificates to the Committee, parties of the first part, and deposit the same with their said Trust Certificates, so that the legal title to said Trust Certificates shall be and become vested in said Committee, for the use and subject to the control of said parties of the first part, or a majority of them, or their successors, as such Committee; provided, however, that if any holders of American Cotton Oil Trust Certificates shall fail to surrender and transfer their said Trust Certificates in accordance herewith, or in any other respect fail to comply with the terms of this Agreement, they and each of them

shall, from and after such omission or failure, have no right to participate in the benefits of this Agreement, without the express consent of said Committee.

By the acceptance of such Certificates of Deposit above referred to, the several parties of the second part respectively depositing their American Cotton Oil Trust Certificates with said Central Trust Company, become parties to this Agreement with the same force and effect as if they had severally affixed their signatures and seals at the foot of this instrument.

II. The assenting stockholders hereby constitute the Committee, said parties of the first part, and their successors and substitutes, as their Committee, Trustees and Agents to carry out the general plan of reorganization above generally set forth, in such manner, and by such methods, means and proceedings, as in their judgment may seem advisable; to possess and exercise all the title, interests, rights, powers and privileges of such certificate holders appertaining to such Certificates under the Deed of Trust, or otherwise, including the power and right to vote and act (either in person or by proxy) at any and all meetings of certificate holders of said Trust upon any measure or subject, whether previous notice thereof be given or not, and to assent to, act upon and co-operate in the dissolution and winding up of said Trust, and the transfer and sale of any or all the assets thereof — all in such manner and upon such considerations as they deem best; and to prescribe the form and provisions of such Preferred and Common Stock Certificates, and determine with what shares, property or Trust Certificates such Preferred Stock shall be secured and the manner thereof.

Also to prosecute or defend any and all legal proceedings which said certificate holders personally, or any of them, could have instituted, conducted or be parties to, and for any of the purposes or ends for which such certificate holders might have instituted or conducted the same; to employ and determine compensation of such assistants, agents, attorneys and counsel and incur such other expenses for advertising, printing and otherwise, as they may deem necessary for the accomplishment of the purposes herein generally expressed; and in general to devise and execute means for the reorganization of said Trust, and to do and perform each and every act which they may deem necessary or desirable to consummate such reorganization, and the general purposes hereinbefore recited, and full discretion is conferred upon them in the premises.

It is expressly provided and agreed, that such Committee shall not be confined to any single method of accomplishing the conversion of such Trust Certificates into shares of said corporation, but shall have and is hereby given plenary power and discretion to bring about such result by such method and in such manner as they may consider practicable and advantageous to the certificate holders; and that the enumeration of specific powers anywhere in this Agreement shall not be construed to limit or restrict the general powers herein mentioned.

III. Said Committee shall have power to add to their number from time to time, to such limit as they deem judicious, and to fill any vacancy which may arise in the Committee by death, resignation or otherwise. They shall select of their number a Chairman and Secretary, who shall perform the duties usually appertaining to such offices. They shall be and are hereby empowered to act in all respects and upon all questions and matters by the affirmative vote of a majority of their number; and all the interests, rights, duties, powers and discretion herein conferred upon the parties of the first part, shall extend to and be possessed and exercised by any successor, substitute or additional member of said Committee as fully as if such person or persons had been originally named herein. They shall have power to nominate and appoint an agent, agents or sub-committee, through whom they may act, and they may delegate any necessary authority as well as discretion to such agent, agents or sub-committees.

IV. This Agreement, and all the provisions thereof, shall be binding upon all parties hereto, and depositors of Certificates hereunder, and shall be carried out without regard to any fixed proportion or amount of

Trust Certificates that may be deposited hereunder.

The Committee shall be the sole judge as to whether the assent of the holders of such American Cotton Oil Trust Certificates has been obtained to this Agreement sufficient in amount to warrant them in carrying out the same; and they shall have power, and it shall be their duty, to execute and consummate any such plan, and the provisions of this Agreement, for and in behalf of such holders as may become parties hereto, and without any regard to any fixed proportion or amount of such Certificates; and this Agreement shall continue in full force and effect until all of its purposes and provisions are accomplished; provided, however, that said Committee, in their absolute discretion and judgment, may at any time and at any stage of their duties, bring this trust in whole or in part to a close, wind up the same in whole or in part, and distribute, *pro rata,* among the holders of such Central Trust Certificates, the shares, certificates or other property that may be in their hands at the time.

V. And it is expressly agreed that, if said Committee should consider it preferable, for any reason or cause, so to do, they are specifically authorized and empowered to sell and dispose of, from stage to stage, and at any time or times, all or any part of the American Cotton Oil Trust Certificates deposited hereunder to said American Cotton Oil Company, for its Common and Preferred Stock of the general description aforesaid, and upon such considerations as they may deem best; and they are fully empowered to enter into any agreement and make such arrangements with said Company as they may consider desirable to such end, and to determine with what shares, property or Trust Certificates such Preferred Stock shall be secured and the form and manner thereof.

And they are fully and specifically authorized and empowered to hold, manage, represent and be vested with the legal title to such shares required on any such sale or on such merger and dissolution of the Trust; and to continue therewith to pursue the purposes aforesaid, until such merger and dissolution and the purposes of this Agreement are completely accomplished, and said Trust is wound up and liquidated, or at their discretion, to make distribution thereof as hereinbefore authorized.

And the said Committee shall possess and exercise all the title, interest and rights, powers and privileges of such stockholders of said Company, including the power and right to vote and act (either in person or by proxy) upon any measure, matter or subject, in such manner as they may deem best, either in writing or at any meeting of stockholders of said Company, with or without previous notice thereof, and to represent said stock in every respect.

And all the powers anywhere in this Agreement contained are made applicable to the provisions of this Article as fully as if set forth therein.

VI. It is expressly understood and agreed that any of the provisions of this Agreement other than Article IV., and that any detail of said general basis of reorganization, may be altered, amended, or added to in any respect by the assent of the holders for the time being of at least three-fourths in amount of the said Central Trust Certificates of Deposit issued hereunder, expressed either in writing or by a vote had at a special meeting of such holders called for that purpose by such Committee in the manner hereinafter provided; and any and every such alteration, amendment or addition shall become, and be deemed to be, a part of this Agreement, as fully and effectually in every respect as if the same had been originally so provided herein.

VII. The holders of Trust Certificates of said The American Cotton Oil Trust may avail themselves of the benefits of this Agreement, by depositing their Trust Certificates hereunder on or before the twentieth day of November, 1889; and after that date the holders of Trust Certificates, who have not deposited their Certificates as aforesaid, shall be precluded from enjoying the benefits of this Agreement, unless said Committee shall extend the time within which the same may be so deposited; and said Committee is hereby

granted full power and authority to extend the time within which such Certificates shall be deposited, upon such terms and penalties, and in such cases, as they, in their absolute judgment, may consider best, and may waive penalties in any case.

VIII. Said Committee shall have power to call meetings of the holders of such Central Trust Certificates of Deposit, for any purpose and upon at least three days' notice to be given by publication of such call in two or more newspapers of general circulation published in the City of New York; and such publication shall be the only notice of such meetings requisite here-under, and shall be deemed and taken to be actual and sufficient notice thereof to the holders of such Central Trust Certificates and the respective depositors hereunder.

IX. No member of said Committee, party of the first part, nor said Depositary, party of the third part, shall be responsible or liable for any act or default of the other of them, or of any agent employed by them or either of them; and they shall respectively be entitled to proper and reasonable compensation for all services by them respectively rendered in the execution of the powers and duties herein provided for, and to reimbursement for any expenses they may deem it proper to incur in the execution of said trusts, powers and duties; and they or either of them may become pecuniarily interested in any of the properties or matters which are the subject of this Agreement.

X. And the said Committee, party of the first part, and said Depositary, party of the third part, do hereby respectively accept and agree to the trusts, powers and duties upon them respectively conferred or imposed hereunder, and will carry out the same to the best of their respective abilities; but it is expressly understood that they assume no legal responsibility for the execution of any such plan of reorganization.

XI. This Agreement may be printed and copies thereof may be signed; and all of said copies so signed shall be deemed and taken as constituting one original contract.

XII. This Agreement shall bind and extend to the parties hereto, the depositors hereunder, and their and each of their successors, executors, administrators and assigns.

In Witness whereof, the said parties have hereunto set their names or affixed their corporate seals, and have written opposite to their respective names or seals the amount of Certificates of The American Cotton Oil Trust held by them.

F. P. Olcott, Samuel Thomas, Edward D. Adams, James A. Benedict, Wm. L. Bull, Nicholas Sheldon, *Reorganization Committee.*

Signed, sealed and delivered in the presence of —
Wm. Nelson Cromwell. Central Trust Company of New York, *Depositary.*
By E. F. Hyde, 2*d Vice-Pres.,*

Appendix I: Typical Amalgamation.

Agreement Preliminary to the Formation of the American Snuff Company

Memorandum of agreement made this 15th day of February,' 1900, between George B. Wilson, Henry D. Moore and John W. Woodside, of the first part: James B. Duke of the second part, and John B. Cobb of the third part:

The parties of the first, second and third parts agree to and with each other, to forthwith organize a corporation under the laws of the State of New Jersey, by the name of The American Snuff Company, or other name to be agreed on by the parties hereto, with an authorized capital stock of twenty-five million dollars ($25,000,000), of which twelve million five hundred thousand dollars ($12,500,000), shall be six per cent non cumulative preferred stock, and twelve million five hundred thousand dollars ($12,500,000) shall

be common stock.

There shall be a provision in the charter that no mortgages, or incumbrances of any kind, shall be placed upon any of the property of such proposed corporation as a prior lien to such preferred stock, and any profits realized by such corporation to the extent of six per cent upon such preferred stock, or any part thereof, as may be earned in any year, shall be first applicable to such preferred stock. If any profits are realized by the corporation in any one year beyond the sum necessary to pay six per cent dividends, such profits shall be applicable to the common stock only.

The said parties of the first part agree to undertake to deliver to said proposed corporation, in such manner as counsel may advise, all of the issued stock of the Atlantic Snuff Company, a corporation organized under the laws of the State of New Jersey, with an authorized capital stock of ten million dollars, of which one million eight hundred and thirty-six thousand five hundred dollars is preferred, and seven million five hundred thousand two hundred dollars, common stock, or all the property real and personal (and the property of all corporations owned or controlled by it), together with its or their good-will, business and trade-marks. The party of the second part agrees to undertake to deliver and have conveyed to said proposed corporation, in such manner as counsel may advise, the snuff business and good-will of The American Tobacco Company and Continental Tobacco Company, together with all of the real and personal property of said The American Tobacco Company and Continental Tobacco Company, used by them or either of them and pertaining to the snuff business of them or either of them, and the good-will and trade-marks of the snuff business of said companies.

The party of the third part agrees to undertake and have conveyed to said proposed corporation, in such manner as counsel may advise, the snuff business and good-will of P. Lorillard Company, together with all of the real and personal property of said P. Lorillard Company, used by it, and pertaining to the snuff business of it, and the good-will and trade-marks of the snuff business of said corporation.

The consideration of such conveyance to such proposed corporation as above set forth by said parties of the first part shall be seven million five hundred thousand dollars ($7,500,000), of the preferred stock of said proposed corporation, and two million five hundred thousand dollars ($2,500,000), of the common stock of said proposed corporation applied pro rata to the total present issue of preferred and common stock of the Atlantic Snuff Company.

The consideration of such conveyance to such proposed corporation as above set forth by the said parties of the second and third parts shall be two million five hundred thousand dollars ($2,500,000) of said preferred stock of said proposed corporation and seven million five hundred thousand dollars of the common stock of said proposed corporation to be issued to The American Tobacco Company, Continental Tobacco Company and P. Lorillard Company, in such proportions as the parties of the second and third parts hereto shall hereafter notify said proposed corporation.

It is agreed that the parties of the first part shall deliver and convey to said proposed corporation all of the assets of the Atlantic Snuff Company, which (exclusive of good-will and trade-marks) shall be of the fair value of at least one" million eight hundred and thirty-six thousand five hundred dollars ($1,836,500), all of which shall be good, useful and available, and free of debts, liens and liabilities. All real estate and machinery, tobacco, raw, wrought and in process, supplies and materials are to be taken at book value, not exceeding cost. The book accounts included in such assets are to be satisfactorily guaranteed.

It is agreed that the parties of the second and third parts shall deliver and convey to such proposed corporation all of the assets of The American Tobacco Company, Continental Tobacco Company and P. Lorillard Company, pertaining to the snuff business of said companies respectively, which said assets, ex-

clusive of good-will and trade-marks, shall in the aggregate be of the fair value of at least one million five hundred thousand dollars ($1,500,000), all of which shall be good, useful and available, and free of debts, liens and liabilities. All real estate and machinery, tobacco, raw, wrought and in process, supplies and material, are to be taken at book value not exceeding cost. The book accounts included in such assets are to be satisfactorily guaranteed.

The deliveries and conveyances herein contemplated shall be as of March 1st, 1900. Said proposed corporation shall accept and assume such contracts of the Atlantic Snuff Company, The American Tobacco Company, Continental Tobacco Company and P. Lorillard Company, as Messrs. Henry D. Moore, George B. Wilson, James B. Duke and John B. Cobb shall agree that it is advisable for said proposed corporation to accept and assume.

If said proposed corporation shall pay any money, or deliver any article or thing on account of any obligation, by way of rebate or otherwise issued or undertaken by the Atlantic Snuff Company, or The American Tobacco Company, or Continental Tobacco Company or P. Lorillard Company, prior to March 1st, 1900, the amount so paid by said proposed corporation, or the value of the article or thing so delivered by said proposed corporation, in performance of such obligation, shall be refunded to said proposed corporation by the corporation, or party, whose obligation was thus performed by said proposed corporation-though this shall not be construed as binding on said proposed corporation to pay any such obligation unless it elects to do so; if any manufactured goods sold by the Atlantic Snuff Company, The American Tobacco Company, Continental Tobacco Company or P. Lorillard Company have to be taken or transferred by said proposed corporation, the amount of loss or injury sustained by said proposed corporation by such taking or transfer shall be paid to it by the corporation or party who sold such goods.

There shall be a committee of four to determine the available assets, exclusive of real estate and machinery, of the Atlantic Snuff Company, The American Tobacco Company, P. Lorillard Company and Continental Tobacco Company. Two members of this committee shall be appointed by Henry D. Moore and two by James B. Duke. If the decision of such committee as to the availability of any such assets shall not be satisfactory to its owner, and cannot be made satisfactory within three days after the report of the committee thereon, the difference of opinion shall be settled by an arbitrator selected by said committee, whose decision shall be final and conclusive and shall be made within five days after the time of his selection.

One-half of the expenses of organization of said proposed corporation, which have to be paid in advance of said organization, shall be advanced by the parties of the first part and the other half by the parties of the second and third parts, and all such advances shall, immediately after its organization, be refunded by said proposed corporation.

Said proposed corporation shall be organized by and under the advice of the firm of Jones, Carson & Beeber and W. W. Fuller, none of whom shall make any charge to said proposed corporation for any services rendered by them; the said firm of Jones, Carson & Beeber to look for their compensation solely to the parties of the first part, and the said W. W. Fuller to look for his compensation solely to the parties of the second and third parts. It is understood, however, that the new corporation shall pay a fee to Jones, Carson & Beeber, in the event of its securing, through their advice, the acquisition, upon satisfactory terms, of Geo. W. Helme Company, it being understood that such compensation shall be twenty-five thousand dollars ($25,000) if said Geo. W. Helme Company agrees to sell to such proposed corporation, upon satisfactory terms to it, within 60 days hereafter; or, only twelve thousand five hundred dollars ($12,500) if after 60 days, and within four months of this date, and if not agreeing *so* to sell within at least four months, then no fee to be paid to the said Jones, Carson & Beeber.

The parties of the first, second and third parts hereto, respectively, undertake to have made known and

imparted to the designated agents of said proposed corporation, the processes, formulae and recipes for the preparation and manufacture of snuff, employed by the Atlantic Snuff Company, The American Tobacco Company, Continental Tobacco Company and P. Lorillard Company.

The parties of the first part agree that each of the directors of the Atlantic Snuff Company shall enter into contracts with the proposed corporation not to go into the business of manufacturing snuff, in the United States, for a period of ten years, either directly or indirectly, or to take any interest in manufacturing snuff in said country, during the said time, without the written consent of the said proposed corporation; and that similar contracts shall be entered into by The American Tobacco Company, Continental Tobacco Company and P. Lorillard Company.

It is agreed that the property and business of the corporation shall be managed by a board of fifteen directors divided into classes as the committee above named shall agree. Shares of Preferred and common stock shall have equal powers of voting.

The by-laws shall provide that the President, as such, shall receive a salary not exceeding fifteen thousand dollars a year; that the Vice-President shall receive a salary not exceeding five thousand dollars a year; that the Treasurer shall receive a salary not to exceed five thousand dollars a year, and that the Secretary shall receive a salary not exceeding five thousand dollars a year.

The by-laws shall not be amended except by at least two-thirds of the whole Board of Directors. A quorum of said board shall consist of five directors.

The by-laws shall provide that the stock shall forthwith be listed on the New York Stock Exchange.

The charter shall provide, if counsel conclude that such provision can be legally introduced into the same, that the preferred stock shall not be increased beyond the amount of twelve million five hundred thousand dollars ($12,500,000) without the assent of, at least, seventy per cent of the preferred stock.

The details of organizing said proposed corporation, and the carrying out of this agreement, shall be determined by a committee composed of Henry D. Moore, George B. Wilson, Chas. E. Halliwell and John B. Cobb. They shall proceed forthwith to carry into effect the same, and to prepare by-laws to be submitted for adoption, and any question that may arise between the contracting parties hereto, in the formation of the proposed corporation, and the conveying of any property the settlement for which is not provided for herein, shall be determined by the decision of three-fourths of such committee after the consideration of such disputed question.

To the performance of the agreements hereinbefore made, the parties hereto each pledges his earnest, bona fide efforts, but it is to be understood that no signer hereto incurs any personal liability for non-performance of any part of this agreement.

Witness our hands and seals, at the City of New York, this 15th day of February, 1900.

Geo. B. Wilson. (Seal.)
Henry D. Moore. (Seal.)
John W. Woodside. (Seal.)
J. B. Duke. (Seal.)
J. B. Cobb. (Seal.)

Witness all signatures
Geo. M. Gales.

Appendix J: Typical Merger.

The Merger Agreement of the American Tobacco Company, Continental Tobacco Company, and Consolidated Tobacco Company[229]

An agreement made and entered into this ninth day of September, in the year nineteen hundred and four, between The American Tobacco Company, a corporation of the State of New Jersey, by its directors; Consolidated Tobacco Company, a corporation of said State of New Jersey, by its directors; and Continental Tobacco Company, a corporation of said State of New Jersey, by its directors....

Whereas the respective boards of directors of the said corporations deem it advisable, for the purpose of greater efficiency and economy of management, as well as for the general welfare of the said corporations, to merge and consolidate them, under and pursuant to the provisions of said act entitled "An Act Concerning Corporations (revision of 1896)," and the several supplements thereto and acts amendatory thereof;

Now, therefore, in consideration of the premises and of the mutual agreements, covenants, provisions, and grants herein contained, it is hereby agreed by and between the said parties hereto as follows:

Article I. The said The American Tobacco Company, the said Consolidated Tobacco Company, and the said Continental Tobacco Company are hereby consolidated into a single corporation, under the name of "The American Tobacco Company" (hereinafter called the "merged corporation").

Article II. The said merged corporation, in addition to the powers conferred by section 1 of the act concerning corporations (revision of 1896), shall have the powers herein set out, and said merged corporation shall be subject to the limitations on said powers herein set out, to wit:

To dry and cure leaf tobacco and to buy, manufacture, sell, and otherwise *deal in tobacco* and the products of tobacco in any and all forms; to construct or otherwise acquire and hold, own maintain, and *operate warehouses, factories, offices,* and other buildings, structures, and appliances for the drying, curing, storing, manufacture, sale, and distribution of tobacco and its products; to *guarantee dividends on any shares of the capital stock of any corporation in which said merged corporation has an interest as stockholder,* and to indorse or otherwise guarantee the principal and interest, or either, of any bonds, securities, or other evidence of indebtedness created by any corporation in which said merged corporation has such an interest, provided that authority for any such indorsement or guaranty be first given by resolution adopted by vote of at least two-thirds of the whole board of directors of said merged corporation; to carry on any business operations deemed by said merged corporation to be necessary or advisable in connection with any of the objects of its incorporation or in furtherance of any thereof, or tending to increase the value of its property or stock; but nothing herein set forth is to be construed to authorize the formation hereby of an insurance, safe deposit, or trust company, banking corporation, or savings bank or corporation deemed to possess any of the powers prohibited to corporations formed under the statutory provisions aforesaid; to *conduct business in all other States, Territories, possessions,* and dependencies of the United States of America, and in all foreign countries, and to have one or more offices out of the State of New Jersey and to hold, purchase, mortgage, and convey real and personal property out of said State as well as therein. The said merged corporation shall have power to *purchase or otherwise acquire and hold, sell, assign, transfer, mortgage, pledge, or otherwise dispose of the shares of the capital stock or of any bonds, securities, or other evidences of indebtedness created by any other corporation or corporations* of this or any other State or government, and to issue its own obligations in payment or in exchange therefor, or for any purpose of its incorporation, and to secure such obligations by pledge or mortgage under deed of trust or otherwise of the shares of capital stock or bonds, securities, or other evidences of indebtedness so acquired, or of any property of the corporation. *The power to make and alter by-laws of said merged corporation is conferred upon the directors.* The directors

of said merged corporation may hold their meetings and have an office and keep the books of the corporation (except the stock and transfer books) in the city of New York or elsewhere outside of the State of New Jersey.....

ARTICLE IV. The capital stock of the said merged corporation is one hundred and eighty million ($180,000,000) dollars, divided into one million eight hundred thousand (1,800,000) shares of the par value of one hundred ($100) dollars each. One million (1,000,000) shares shall be common stock and eight hundred thousand (800,000) shares shall be preferred stock.....

ARTICLE V. The said corporations are merged and consolidated upon the undertstanding and agreement that the present indebtedness of each of said corporations shall be assumed in full by the said merged corporation.

ARTICLE VI. All property, real, personal, and mixed, of the said corporations, parties hereto, shall vest in the said merged corporation immediately upon the adoption of this agreement by the stockholders of the said corporations, as provided by the provisions of the said act entitled "An Act Concerning Corporations (Revision of 1896)" and the several supplements thereto and acts amendatory thereof; but if the said merged corporation shall deem or be advised that any further assignments, assurances in the law, or things are necessary or desirable to vest the title to such property in the said merged corporation, the said corporations parties hereto shall execute and do all such assignments, assurances in the law, and things necessary to vest title to such property in said merged corporation, and otherwise to carry out the purposes of this agreement.

ARTICLE VII. The capital stock of each of the said corporations parties hereto shall be converted into the common stock, the preferred stock, or the obligations of said merged corporation, and the common stock, preferred stock, and obligations of said merged corporations shall be apportioned among the stockholders of the said corporations parties hereto according to the shares held by the respective stockholders of said corporations and shall be delivered to them upon the surrender of their certificates of stock, as follows:

There shall be apportioned to each of the holders of the eight per cent preferred noncumulative stock of the said The American Tobacco Company, party hereto, for each share of said preferred stock of the par value of $100 held by him the obligation or bond of the said merged corporation of one hundred and thirty-three dollars thirty-three and one-third cents ($133.33 1/3), in gold coin of the United States of the present standard of weight and fineness, due and payable on the first day of October, 1944, at the office or agency of the said merged corporation in the city of New York, with interest thereon from October 1, 1904, at the rate of six (6 per cent) per centum per annum, said interest to be payable to the holder of such bond or obligation, or to the holder of a coupon representing such interest, at said office or agency in like gold coin, semi-annually, on the first days of April and October in each year. Said bonds shall be issued in such denominations as the merged corporation shall see fit, and they shall, along with the bonds provided for in the next paragraph hereof, constitute a first charge upon the income and property of the merged corporation. There shall also be paid to the holders of said preferred stock of said The American Tobacco Company, party hereto, in lieu of dividend, an amount in cash equal to two dollars for each share of said preferred stock held by him.

There shall be apportioned to each of the holders of the seven per cent noncumulative preferred stock of said Continental Tobacco Company, party hereto, for each share of said preferred stock of the par value of $100 held by him the obligation or bond of said merged corporation for one hundred and sixteen dollars sixty-six and two-thirds cents ($116.66 2/3) in gold coin of the United States of the present standard of weight and fineness, due and payable on the first day of October, 1944, at the office or agency of the said merged corporation in the City of New York, with interest thereon from October 1, 1904, at the rate of six (6 per cent) per centum per annum, said interest to be payable to the holder of such bond or obligation, or to the

holder of a coupon representing such interest, at said office or agency in like gold coin, semiannually, on the first days of April and October in each year. Said bonds shall be issued in such denominations as the merged corporation shall see fit, and they shall, along with the bonds provided for in the next preceding paragraph, constitute a first charge upon the income and property of the merged corporation. The holders of the said preferred stock of said Continental Tobacco Company, party hereto, shall also be entitled to receive and enjoy the dividend of one and three-quarters (1¾ per cent) per centum already declared on said preferred stock payable October 3, 1904.

There shall be apportioned to each of the holders of the common stock of said The American Tobacco Company, party hereto, for each two shares of said common stock of the par value of $50 each held by him one share of the common stock of said merged corporation.

There shall be apportioned to each of the holders of the common stock of said Continental Tobacco Company, party hereto, for each share of said common stock of the par value of $100 held by him, one share of the common stock of the said merged corporation.

There shall be apportioned to each holder of the stock of said Consolidated Tobacco Company, party hereto, for each share of said stock of the par value of $100 held by him, one share of the common stock of said merged corporation.

By the act of merger the stocks of all the companies parties hereto held by any of the companies parties hereto shall stand and be canceled.

The preferred stock of the merged corporation herein provided for may be issued for the redemption and retirement at par of debts that by the act of merger become the debts of said merged corporation, and such preferred stock shall be issued only for such redemption or at par for cash to be used in such redemption.

Article VIII. The Morton Trust Company, of the city of New York is hereby appointed the transfer agent of the stock and obligations of the said merged corporation in the city of New York, and the Farmers' Loan and Trust Company, of the city of New York, is hereby appointed registrar of the stock of said merged corporation; and any stockholder of any of the said corporations, parties hereto, upon presenting to the said transfer agent his certificate of stock and surrendering the same to be canceled, shall be entitled to receive a certificate for the proper number of shares of the capital stock of said merged corporation, or to the bond or obligation of said merged corporation, pursuant to Article VII of this agreement.

Article IX. The said merged corporation shall pay all expenses of consolidation and all preliminary expenses, including legal expenses.....

Appendix K: Promoter's Contract[230]

Whereas, the undersigned subscribers contemplate the organization of a corporation under the laws of the State (or territory) of.................. to be known by the name of............................ or by such other name as the subscribing stockholders therein may adopt, having an authorized capital stock of $..............., divided into............ shares of $........ each, for the purpose of (state object of corporation briefly).

It is hereby agreed by and between said subscribers and (promoter's name):

(1) That each of said subscribers will take the amount of stock in said corporation set opposite his name and pay for the same according to the terms of a subscription contract this day executed by them.

(2) That said (promoter's name) has heretofore done work and performed services of great value in preparing for the organization of said corporation and securing subscriptions to its capital stock, and is to hereafter perform additional services in perfecting its organization and securing *bona fide* subscnptions to the capital stock of said corporation aggregating (aside from the stock taken by the subscribers hereto) the

sum of $.......... or such part thereof as the subscribing stockholders may deem necessary to dispose of.

(3) Said (promoter's name) shall have........ days in which to secure subscriptions for the aforesaid $....... of capital stock of said company, and if he has failed to do so at the end of that time the subscribers, at their option, may extend his authority, or may recall it, and may, if they so elect, subscribe for the remaining portion of said $...... of capital stock which then remains unsubscribed for, or induce others to take it, or abandon the formation of said corporation.

(4) Upon the incorporation of said proposed company there shall be issued to said (promoter's name), or to any person designated by him, by indorsement on this agreement, in payment for his services in effecting such incorporation and securing the aforesaid subscriptions to the capital stock as above provided,........... shares of the capital stock of said corporation.

Provided, That if said (promoter's name) shall have failed to secure *bona fide* subscriptions to said capital stock in the full amount of $......... there shall be issued to him only such proportion of........ shares of stock as the capital stock for which he has obtained subscriptions is of $.........., the whole amount for which he hereby undertakes to solicit subscriptions.

Provided, further, That if said company be incorporated before the time allowed said (promoter's name) for obtaining subscriptions has expired and said (promoter's name) shall thereafter, under the terms of this contract secure additional *bona fide* subscriptions to the capital stock of said company, as above provided, shares of stock shall be issued within thirty days after the said time allowed for obtaining subscriptions has expired to (promoter's name), or to his assignee, as above provided, in the proportion of one share of stock for each $........ of capital stock for which subscriptions are so secured by him.

In Witness Whereof the said subscribers have hereunto attached their names and designated the number of shares taken by each of them, and said (promoter's name) has agreed to the above terms.

Shares

I agree to the above terms.

(Signed by promoter)

Appendix L: Underwriting Agreement.

The United States Shipbuilding Company

A corporation to be organized under the laws of the State of New Jersey, either by that or some similar name, proposes to acquire the plants and equipment of the following concerns, or their capital stock, free from any liens:

The Union Iron Works, San Francisco, California.

The Bath Iron Works, Limited, and The Hyde Windlass Company, Bath, Maine.

The Crescent Shipyard and The Samuel L. Moore & Sons Co., Elizabethport, New Jersey.

The Eastern Shipbuilding Company, New London, Conn.

The Harlan & Hollingsworth Co., Wilmington, Delaware.

The Canéda Manufacturing Company, Carteret, New Jersey.

Underwriting Agreement

For $9,000,000 Series A First Mortgage, Five Per Cent Sinking Fund, Gold Bonds, due 1932, part of an authorized issue of $16,000,000 Bonds of $1000 each, $5,500,000 being withdrawn from public issue for disposal under the Vendor's and Subscribers' Contracts, and $1,500,000 being Reserved in the Treasury of the Company. Additional Bonds may be issued only for the purpose of acquiring Additional Plants and Equipment and for Improvements and Betterments, upon such Terms and Conditions as shall be Approved

by the Holders of a Majority of the Bonds under the Present Issue Outstanding at the Time of such Approval.

We, the undersigned, each for himself, with The Mercantile Trust Company, for itself and for the United States Shipbuilding Company, and to and with each other, agree to subscribe to, receive and pay for the amount of five per cent first mortgage, sinking fund, gold bonds of the United States Shipbuilding Company of one thousand dollars each, set opposite our respective signatures hereto, at the price of $900 for each bond, 25 per cent to be paid upon allotment and the balance upon the demand of The Mercantile Trust Company.

We further agree to receive and pay for any smaller amount than that subscribed for which may be allotted to us respectively.

The conditions of this underwriting agreement are as follows:

(1) That this agreement shall not be binding upon the undersigned unless the entire amount of $9,000,000 of bonds shall have been underwritten.

(2) That within such reasonable time as shall be fixed by The Mercantile Trust Company the said $9,000,000 of bonds, less any amount withdrawn by the underwriters, as hereinafter set forth, will be offered to the public, through such banker or bankers or brokers as shall be designated by The Mercantile Trust Company, for subscription at not less than 95 per cent.

(3) With the consent of The Mercantile Trust Company, any other concern may be included in this combination, or others substituted therefor, provided the working efficiency or values are not lessened or impaired.

(4) That, if the amount of bonds subscribed and paid for upon such public issues be at least equal to the amount of bonds so offered to the public, then all liability under this agreement shall cease.

(5) That, in case the amount of bonds subscribed for upon such public offering shall be less than the total amount of bonds so offered to the public, or in case the bonds subscribed for upon such public issue shall not be paid for to an amount equal, at the rate of 95 per cent, to the total of such public offering, then such deficiency in subscriptions and payments will, upon the demand of The Mercantile Trust Company, be made good by the subscribers hereto in the manner aforesaid, *pro rata* in the proportion their subscriptions for bonds not withdrawn by them from public issue bear to the total amount of bonds so offered to the public.

(6) That each underwriter shall receive in preferred and common stock of the United States Shipbuilding Company 25 per cent of the par value of the bonds hereby underwritten in each kind of stock, and also that all the proceeds, not to exceed 5 per cent, realized from the sale of the bonds at public issue in excess of 90 per cent, after deducting issue expenses, shall belong to the underwriters.

(7) That any underwriter shall have the option of withdrawing from the public issue any of the bonds hereby underwritten by him, provided that he notify The Mercantile Trust Company, five days prior to the date fixed for the public issue, that he elects to purchase said bonds, provided that, in the proportion of the bonds so purchased, he waives his said right to participate in the cash proceeds realized from the public issue.

(8) That no underwriter shall sell or offer for sale the bonds so purchased, nor any of the bonus shares he receives, until twelve months after the date of payment, without the consent of The Mercantile Trust Company.

New York, April 19, 1902.

Name Address Bonds Underwritten

Appendix M: Underwriting Agreement of March 1, 1901, Between J. P. Morgan & Co. And the United States Steel Corporation.

An agreement, made this first day of March, nineteen hundred and one, by and between United States Steel Corporation, a corporation existing under the laws of the State of New Jersey (hereinafter called the "Steel Company"), party of the first part, and J. P. Morgan & Co., of the city of New York, acting in behalf of a Syndicate, party of the second part:

Whereas, the Steel Company has been organized with a capital of $3000, of which one-half is 7% cumulative preferred stock and one-half is common stock, as shown by the certificate of incorporation of the Steel Company, recorded in Hudson County, New Jersey, on the 25th day of February, 1901, which capital stock is to be increased as hereinafter provided; and

Whereas, as hereinafter stated, the board of directors of the Steel Company deem it necessary for its business now to acquire the stocks and bonds of certain other corporations and also to obtain for its corporate purposes a certain sum in cash; and

Whereas, after careful investigation and appraisement, the board of directors of the Steel Company has ascertained, adjudged and determined that the value of such bonds and stocks now so to be acquired and hereinafter specified, exclusive of such cash sum (which cash sum is to be received and treated by the Steel Company as surplus), is equal at least to the par value of the stock of the Steel Company and of the bonds of the Steel Company to be issued therefor; and

Whereas, the board of directors of the Steel Company considers that such bonds, stocks and cash may best be obtained by purchase, on the terms hereinafter stated, from the Syndicate represented by Messrs. J. P. Morgan & Co., party of the second part hereto, and managers of the said Syndicate; and

Whereas, each of the corporations, the capital stock of which it is proposed now to acquire hereunder, has been organized and now is existing under the laws of the State of New Jersey.....

Whereas, in reliance upon this contract the Syndicate is endeavoring to effect the acquisition, and the delivery of all of the bonds of the Carnegie Company, and all of the outstanding shares of the capital stock of all of said corporations, upon the terms herein provided.

Now, therefore, in consideration of the premises and of other good and valuable considerations, and of the efforts and expenses which both parties recognize will have to be made and incurred by the Syndicate in their endeavor to consummate such sale:

First. The Steel Company agrees with J. P. Morgan & Co., acting in behalf of the Syndicate, as follows:

(1) If, on or before May 31, 1901, J. P. Morgan & Co. in behalf of the Syndicate shall

(a) Sell and deliver, or cause to be sold and delivered, to the Steel Company, at least fifty-one per cent of such outstanding shares of the capital stock of each of the corporations above named, or of such of said corporations as finally shall be embraced within the operation of this agreement with the approval of the Steel Company, which fifty-one per cent of the total outstanding capital stock of each of such corporations shall include not less than fifty-one per cent of the total outstanding preferred stock, if any, of such company; and also all of the $160,000,000 of bonds of the Carnegie Company now outstanding, or such lesser amount thereof as shall be tendered by J. P. Morgan & Co.; and

(b) Shall pay, or shall cause to be paid, to the Steel Company twenty-five million dollars in cash:

(2) The Steel Company will purchase such shares and bonds, and, in payment and consideration for such stock and bonds and for such cash, will issue to such persons as J. P. Morgan & Co., in behalf of the Syndicate, shall indicate, shares of its preferred stock and shares of its common stock (all of which shall be fully paid and non-assessable), and also its five per cent gold bonds (which bonds shall be of such form and tenor, and shall be secured, as J. P. Morgan & Co. may determine), as follows:

(a) In the event that the Steel Company shall acquire all the shares of the capital stock of all of such other corporations and all such bonds of the Carnegie Company, the Steel Company will issue for all such stock, and such bonds, and such sum in cash, four million two hundred and forty-nine thousand nine hundred and eighty-five shares of its preferred stock, and four million two hundred and forty-nine thousand nine hundred and eighty-five shares of its common stock, and also three hundred and four million dollars of its said five per cent gold bonds.

(b) In the event that the Steel Company shall not acquire all the shares of the capital stock of all such other corporations and all such bonds of the Carnegie Company, the Steel Company will issue for the shares of stock and the bonds which shall be acquired, and said sum in cash, four million two hundred and forty-nine thousand nine hundred and eighty-five (4,249,985) shares of its preferred stock, and four million two hundred and forty-nine thousand nine hundred and eighty-five (4,249,985) shares of its common stock, and three hundred and four million dollars ($304,000,000) of its five per cent gold bonds, less abatement and deduction therefrom to be made as follows:

For each $100 par value of stock of such other companies mentioned in the following table, which shall not be acquired by the Steel Company, the amount of the preferred stock and common stock, or either, set opposite to such class of stock in said table shall be deducted and abated. (*Table Omitted*)

For each $1000 par value of such bonds of the Carnegie Company that shall not be acquired by the Steel Company $1000 par value of such bonds of the Steel Company shall be abated and deducted.

Second. The Steel Company further agrees that in the event of the acquisition by it pursuant to this agreement of less than the total issue of said bonds of the Carnegie Company or less than the total outstanding capital stock of each of said corporations, the Steel Company from time to time will purchase from such persons as shall be indicated by J. P. Morgan & Co., any and all additional outstanding bonds of the Carnegie Company or shares of the capital stock of any of said corporations that shall be tendered to the Steel Company prior to May 1, 1902; and in payment therefor will issue and deliver its bonds and fully paid-up shares of its preferred stock and fully paid-up shares of its common stock, at the rates at which deduction and abatement shall have been made under Article First hereof in respect of the additional bonds and shares of stock so purchased.

Third. The Steel Company shall credit and allow to J. P. Morgan & Co. on account of the cash sum payable under Article First hereof, or shall pay to J. P. Morgan & Co. a sum equal to the aggregate amount which, prior to April 1, 1901, shall have accrued upon any installments of dividends accruing, but not matured, on any such preferred stock at the date of delivery thereof to the Steel Company.

The Steel Company further agrees that the dividends on all the preferred stock of the Steel Company to be issued by it hereunder, shall begin to accrue from April 1, 1901.

Fourth. The Steel Company, without prejudice to the further exercise of its chartered rights to increase or to decrease its capital stock, agrees that it will lawfully increase its authorized capital stock to an amount sufficient to enable it to issue and to deliver its preferred stock and its common stock to the aggregate amount hereinbefore provided.

Fifth. J. P. Morgan & Co., in behalf of the Syndicate, will bear and will pay the statutory fees and taxes for the proposed increase of the capital stock of the Steel Company.

Sixth. This agreement, and any agreement in pursuance thereof, is and shall be strictly *inter partes;* and no stockholder of any of the corporations above referred to shall be deemed to have any right hereunder.

In witness whereof, these presents have been duly executed by the parties hereto the day and year first above written.

United States Steel Corporation,

By W. J. Curtis, *President,*
[L. S.] Attest:
Charles MacVeagh,
Secretary, J. P. Morgan & Co.

Appendix N: Syndicate Agreement of February 26, 1901, Between J. P. Morgan & Co. And the Syndicate Subscribers Relative to Organization of the United States Steel Corporation

An agreement, made as of the 26th day of February, nineteen hundred and one, by and between J. P. Morgan & Co., of the city of New York, parties of the first part, and the subscribers hereto (hereinafter called severally the "Subscribers" and collectively the "Syndicate"), severally, parties of the second-part:

Whereas, the United States Steel Corporation has been organized under the laws of the State of New Jersey, with a capital stock of $3000, of which one-half is seven per cent cumulative preferred stock and one-half is common stock, which capital stock presently is to be increased to such amount as shall be approved by J. P. Morgan & Co., and such corporation (hereinafter called the "Steel Company") desires now to acquire, as hereinafter provided, stocks and bonds of all or of some of the several corporations next hereinafter referred to, and certain sums in cash; and

Whereas, J. P. Morgan & Co., acting in behalf of the Syndicate, are hereby authorized to enter, and now are about to enter, into a contract or contracts with the Steel Company, by which the Steel Company is to agree to issue to such persons as J. P. Morgan & Co. in behalf of the Syndicate shall indicate, shares of its preferred stock and shares of its common stock (all of which shall be fully paid and non-assessable) and also its five per cent gold bonds, in payment and in consideration for outstanding bonds of the Carnegie Company, and shares of the outstanding preferred stock and common stock of the following named companies, or some of them, as shall be agreed upon or be provided for in such contract or contracts:

American Sheet Steel Company,
American Steel Hoop Company,
American Steel and Wire Company of New Jersey,
American Tin Plate Company,
Carnegie Company,
Federal Steel Company,
National Steel Company,
National Tube Company.

Now, therefore, in consideration of the premises and of the mutual promises herein contained, J. P. Morgan & Co. and the Syndicate have mutually agreed as follows:

First. J. P. Morgan & Co. shall have power and authority from time to time, in such manner and on such terms as from time to time, either generally or in special cases, they may deem expedient:

(1) Publicly or otherwise to offer, or to agree to deliver, or to cause to be delivered, in such amounts and at such general or special rates as, from time to time, either generally or in special cases, they may deem expedient, shares of the preferred stock, and shares of the common stock, and bonds, of the Steel Company, in exchange for or in purchase of any of the stocks of any of the other companies named in said proposed contracts, that shall be delivered to J. P. Morgan & Co., or as they may direct; and

(2) By the use of any of the stocks, or of any of the bonds, of the Steel Company, deliverable under said proposed contracts, or of moneys provided or derived under the terms of this agreement, to acquire all or any of the stocks, or of the bonds, or both, of all or of any of the other companies above referred to.

Second. From time to time, upon calls made by J. P. Morgan & Co., and within such periods as shall be specified in such calls, the Subscribers, severally and respectively, will pay to J. P. Morgan & Co. such sums in cash, as shall be called by J. P. Morgan & Co., but in the aggregate, not exceeding their respective subscriptions hereunder.

Third. J. P. Morgan & Co., in the exercise of their absolute discretion, may use the sums in cash so received from the Subscribers, for all or any of the following purposes, viz:

(1) In payment to the Steel Company of any sum in cash by it to be received under said proposed contracts, and any further sums that may become payable to the Steel Company under any agreement modifying the same or supplemental thereto.

(2) For any expenditures which J. P. Morgan & Co. in their discretion may have incurred or hereafter may incur in or about the preparation or the performance of this agreement or of said proposed contracts, or for any purpose which, in their judgment, may tend to promote the objects of this agreement or the benefit of the Syndicate hereunder.

(3) In acquiring, by purchase or otherwise, as hereinbefore authorized by clause (2) of Article First of this agreement, any of the preferred stock and common stock and bonds of the companies hereinabove referred to.

All or any of such stocks and bonds of such other companies, so acquired by J. P. Morgan & Co., may be delivered by them under the terms of said proposed contracts to the Steel Company in exchange for its stocks and bonds as therein provided; or, in their discretion, J. P. Morgan & Co. may resell to others all or any of such stocks and bonds.

Fourth. J. P. Morgan & Co. may retain all of said stocks of the Steel Company, to be received pursuant to said proposed contracts (except such of said stocks as by them shall be used or be set apart for use under Article First of this agreement) for such period as in their discretion they may deem expedient, not exceeding fifteen months from the date hereof; and, from time to time, during said period and at any time before final distribution hereunder, they may sell all or any of such stocks, at public or private sale and at such prices, and on such terms as to credit or otherwise, as they may deem expedient.

Fifth. All such stocks of the Steel Company mentioned in Article Fourth hereof, and all net proceeds resulting from sales of any of such stocks or from any other transactions of J. P. Morgan & Co., for account of the Syndicate under any of the provisions hereof, shall be applied by J. P. Morgan & Co. as follows:

(1) First, to the payment of any and all expenses and obligations incurred by J. P. Morgan & Co. under any provision of this agreement.

(2) Secondly, in repayment to the Subscribers (so far as the same may be sufficient for that purpose) of all sums by them respectively paid to J. P. Morgan & Co. pursuant to Article Second; such repayment to be made to the Subscribers ratably.

(3) One-fifth of any residue of such stocks and net proceeds remaining after payment in full of all such sums payable under clauses (1) and (2) of this article shall be retained by, and shall belong to, J. P. Morgan & Co. for their own use, as compensation for their services in forming and managing the Syndicate: and the remaining four-fifths of such residue shall be distributed by J. P. Morgan & Co. among the Subscribers ratably according to their respective interests.

Such one-fifth of any such residue shall be the only compensation to be received by J. P. Morgan & Co. for their services in forming and managing the Syndicate; and, in case there shall be no such residue, J. P. Morgan & Co. shall not receive any compensation for their services in forming or in managing the Syndicate....

All cash sums received by J. P. Morgan & Co. under any provision of this agreement shall be held by

them as bankers.

Sixth. Until the expiration of such fifteen months, or until the final distribution hereunder, J. P. Morgan & Co. in such manner, at such prices, on such terms, and in such amounts, as they may deem expedient, shall have power, for account of the Syndicate, to make purchases of the bonds and of the preferred stock and of the common stock of the Steel Company, and they may resell any such bonds and stocks which they may have purchased....

Seventh. J. P. Morgan & Co. shall issue to the Subscribers suitable receipts in respect of payments made hereunder and they may issue to the respective Subscribers certificates of interest, of such tenor and form as they may deem suitable. Such certificates of interest and all rights and obligations hereunder of the respective Subscribers may be made transferable in such manner and on such terms and conditions as J. P. Morgan & Co. may prescribe.

Eighth. J. P. Morgan & Co. shall have authority, from time to time and at any time, to incur such expenses as they may deem proper in carrying out, or in endeavoring to carry out, this agreement or said proposed contracts....

Ninth. For account of the Syndicate, J. P. Morgan & Co., from time to time, may make undertakings of any kind with any persons concerning, or for the acquisition of, bonds or shares of either or of both of the classes of stock of any of the companies hereinabove referred to, and they may make purchases thereof from the holders thereof, or in any market or otherwise, and may sell the same at such prices, on such terms and in such amounts as from time to time they may deem expedient.

Tenth. On signing this agreement each Subscriber shall indicate opposite his name the total sum of his subscription on account of the whole Snydicate obligation hereunder; and the several Subscribers shall be called upon to make payments in respect of their several subscriptions only ratably according to the respective amounts thereof, but each Subscriber shall be so responsible to the full extent of his undertaking, regardless of performance or non-performance by any other Subscriber.

When and as requested by J. P. Morgan & Co., and without reference to the receipt or the possession hereunder by J. P. Morgan & Co., or by the Subscribers of any bonds or stock, each Subscriber will make any and all payments, and will perform all of his undertakings under this agreement, and will do all things which by J. P. Morgan & Co. shall be deemed desirable to aid in the accomplishment of the purposes of this agreement.

Nothing herein contained or otherwise shall constitute the parties hereto partners, or shall render any one of the Subscribers liable to contribute more than his several proportionate amount as herein provided, or shall prevent any of the parties from contracting with each other with reference to any of their respective interests.

Eleventh. In case of any failure of any Subscriber to make any payment called for, or to perform any of his undertakings hereunder, J. P. Morgan & Co. in their sole and exclusive discretion may exclude such Subscriber from all interest in the Syndicate; and in their discretion and in such manner as they may deem proper, without any proceeding, either at law or in equity, they may dispose of such Subscriber's participatior hereunder or of any interest or right of such Subscriber hereunder or under said proposed contracts; but nevertheless such Subscriber in default shall be responsible to J. P. Morgan & Co., for the benefit of the other Subscribers hereto, for all damages caused by any failure on his part....

Twelfth. J. P. Morgan & Co. shall have full power, in their discretion, to agree with the Steel Company upon the terms and provisions of such proposed contracts, and as to the amount of the preferred stock and the common stock and bonds of the Steel Company to be issued and delivered under said proposed contracts; and, also, they shall have full power and authority, from time to time to enter into any agreements with the

Steel Company modifying the said proposed contracts as they may deem expedient. Any and all contracts with the Steel Company made by J. P. Morgan & Co. in behalf of the Syndicate shall be open to inspection by any Subscriber at the office of J. P. Morgan & Co.

Thirteenth. J. P. Morgan & Co. shall be the sole and final judges as to whether at any time it is to the interest of the Syndicate to proceed further under this agreement or under said proposed contracts; and whenever they may deem expedient, they may abandon the objects contemplated in this agreement and said proposed contracts and all further proceedings thereunder....

From time to time J. P. Morgan & Co. may sell or otherwise dispose of such stocks and other assets at such prices and on such terms as to credit or otherwise as they may deem expedient; or they may distribute the same to Subscribers ratably.

Fourteenth. The enumeration of specific powers in this agreement shall not be construed as in any way limiting any general power intended to be conferred upon or to be reserved to J. P. Morgan & Co.; it being intended to reserve to them, and hereby there are expressly conferred on them, in addition to the general and specific powers recited herein, all other general and specific powers which from time to time they may deem necessary in order fully and effectively to carry out what they may deem to be the purposes of this agreement, and of this Syndicate, whether or not such purposes be herein expressed.

J. P. Morgan & Co. in their discretion may submit to the Subscribers any proposed change or modification of this agreement, and, when assented to in writing by a majority in interest of the Subscribers, any change or modification so submitted by J. P. Morgan & Co. shall become a part of this agreement and shall be binding upon all the Subscribers and those claiming under them.

Fifteenth. J. P. Morgan & Co. shall not be liable for any error of judgment or for any mistake of law or of fact; nor shall they be liable for any act or omission while endeavoring in good faith to carry out the purposes hereof according to their judgment. No obligation or liability, in addition to those herein expressed, shall be implied against J. P. Morgan & Co.

In no event shall J. P. Morgan & Co. be responsible for the repayment to the Subscribers of the sums by them paid under Article Second hereof; but such sums shall be repayable only as herein provided, out of any stocks or other assets applicable to such payment under the provisions of this agreement.

Sixteenth. J. P. Morgan & Co. may become Subscribers hereto. As such Subscribers they shall be liable for any subscriptions made by them, and shall be entitled in all respects to the same rights and benefits as other Subscribers....

From time to time J. P. Morgan & Co. may offer, on such terms as they may deem expedient, to sell any such stocks or other assets to the Subscribers severally and ratably in amounts proportionate to their respective syndicate subscriptions; and in any such offering they may provide for the disposition of any untaken stocks or other assets in such way as they may deem expedient.

Seventeenth. J. P. Morgan & Co. may receive and may hold, or may cause to be received and to be held by any depositaries or custodians, the certificates for any stocks or any bonds of the Steel Company, and any bonds of the Carnegie Company and the certificates for any stocks of all or of any of the other companies hereinabove referred to, and they shall not be responsible for any act or any omission of any such depositary or custodian. They shall have absolute control over the disposition of all such stocks and bonds held by them....

Eighteenth. This agreement shall bind, and is for the benefit of, the parties hereto, and their respective executors and administrators; but no assignment hereunder shall be valid unless assented to in writing by J. P. Morgan & Co.

All rights and powers of J. P. Morgan & Co. hereunder shall vest in said firm as from time to time

constituted, without further act or assignment.

Nineteenth. Nothing herein contained shall be construed as creating any trust or obligation whatsoever in favor of the Steel Company, or in favor of any stockholder of any of such other companies, or in favor of any person or corporation other than the Subscribers, nor any obligation in favor of the Subscribers, excepting only as herein is expressly provided.

Twentieth. Each Subscriber shall set opposite his subscription hereunder an address to which notices, calls or other communications may be sent, and any notice, call or other communication addressed to any Subscriber at the address so given, and either left at such address or mailed, shall be deemed actually given to such Subscriber, and shall be sufficient for all the purposes hereof. If any Subscriber shall fail so to furnish his address to J. P. Morgan & Co., he shall not be entitled to any notice of calls, or offers, or any other notice hereunder, and he shall be deemed to assent to any action of J. P. Morgan & Co.

In witness whereof, the parties of the first part have hereunto affixed their signatures, and the parties of the second part at various dates have affixed their subscriptions hereto, it being understood that for convenience this agreement may be subscribed in several parts and copies, with like force and effect as if all the subscriptions were upon one part or copy thereof.

Appendix O: Proxy —Stockholders' Meeting.

Know All Men by These Presents, That I, the undersigned, being the owner of........ shares of the capital stock of the..................... Company do hereby constitute and appoint........... my true and lawful attorney, in my name, place and stead, to vote upon the stock owned by me or standing in my name, as my proxy, at the annual (or special) meeting of the stockholders of the said company, to be held at the company's principal office,...... street,............... N. J. on the...... day of........... 19.., and on such other day as the meeting may be thereafter held by adjournment or otherwise, according to the number of votes I am now or may then be entitled to cast, hereby granting the said attorney full power and authority to act for me and in my name at the said meeting or meetings, in voting for directors of the said company or otherwise, and in the transaction of such other business as may properly come before the meeting, as fully as I could do if personally present, with full power of substitution and revocation, hereby ratifying and confirming all that my said attorney or substitute may do in my place, name and stead.

In Witness Whereof, I have hereunto set my hand and seal, this.... day of............. 19..

Witness: (L. S.)

Select List of References.[231]

1. Government Reports (*U. S.*).

Report of the Industrial Commission, Vols. I, II, XIII (1900–1901).
Reports of the Commissioner of Corporations on The Beef Industry (1905).
The Petroleum Industry (two vols., 1907).
The Tobacco Industry (two parts, 1909, 1911).
The Steel Industry (two parts, 1911, 1912).
The International Harvester Company (1913).
Hearings before the (Senate) Committee on Interstate Commerce (XXXV parts and indexed Digest, 1911–1912).
Hearings before the (House) Committee on Investigation of the United States Steel Corporation (1912).
Hearings before the Special Committee (House) on the Investigation of the American Sugar Refining Company and others (4 vols., 1911–1912).
Hearings before the Committee (House) to investigate the concentration and control of money and credit (1912–1913);
Report of the committee, 62 Cong., 3 sess., no. 1593. ("Pujo committee.")

2. Books on Internal Organization and Forms of Business Units.

Robinson, *Business Organization and Management* (Chicago, 1911).
Sparling, *Business Organization.*
Conyngton, *A Manual of Corporation Management* (1911).
Clephane, *Organization and Management of Business Corporations* (St. Paul, 1905).
Purdy's *Beach on Private Corporations, Joint Stock Companies, and other unincorporated associations,* Vol. III.
Conyngton on *Partnership Relations.*

3. Books on Combinations and Trusts.

a. United States.

Ely, *Monopolies and Trusts.*
Jenks, *Trust Problem.*
Wyman, *Control of the Market.*
Clark, *The Control of Trusts* (1912).
Nolan, *Combinations, Trusts, and Monopolies* (New York, 1904).
Von Halle, *Trusts and Industrial Combinations.*
Van Hise, *Concentration and Control.*
Stevens (Ed.), *Industrial Combinations and Trusts.*
Ripley (Ed.), *Trusts, Pools, and Corporations.*
Berglund, *The United States Steel Corporation.*
Wilgus, *The United States Steel Corporation.*

b. England.
Macrosty, *The Trust Movement in British Industry.*
Levy, *Monopoly and Competition.*
Hobson, *Evolution of Modern Capitalism* (1912); chaps, v, vii, viii, ix, deal with combinations in England, United States, and Germany.

c. Germany and Austria.
Liefmann, *Die Unternehmenerbände.*
Liepmann, *Kartell und Trust.*
Baumgarten U. Meszleny, *Kartelle und Trusts.*
Walker, *Monopolistic Combinations in the German Coal Industry* (Amer. Econ. Assoc. Publications, 1904).
The standard works of Geunzel, Menzel, and Passow.

d. France.
Rousiers, P. de, *Les Syndicats Industries de Producteurs en France et à I'Étranger* (1912).
Raffalovich, *Trusts, Cartells et Syndicats.*
Durchaines, *Les Associations de Producteurs.*

Notes

1. Veblen, *Theory of Business Enterprise* (N. Y., 1904), p. 65.
2. Leroy Beaulieu, *Repartition des Richesses,* Chap. XI.
3. Vol. VII, p. liii.
4. Hobson, *The Evolution of Modern Capitalism* (London, 1901), p. 88.
5. *Percentages of total expenses incurred for materials:*

Smelting and refining lead	94.8 per cent
Smelting and refining copper	94.4 per cent
Sugar and molasses	92.6 per cent
Slaughtering and meat packing	91.3 per cent
Butter, cheese, and condensed milk	91.0 per cent
Petroleum refining	89.6 per cent
Iron and steel blast furnaces	88.4 per cent.

6.

Printing and publishing.	32 per cent
Marble and stonework	39 per cent
Lumber and timber products	51 per cent
Furniture and refrigerators	51 per cent
Clothing, women's	61 per cent
Leather goods	64 per cent
Bread and bakery products	69 per cent.

7. Unions of previously separate plants.
8. Hobson, *Evolution of Modern Capitalism,* p. 35.
9. Galloway, *Business Organization* (Chicago, 1910), p. 6.
10. *Thirteenth Census,* Bulletin on "Manufactures: United States," Abstract of Statistics for states, cities, and industries, p. 5.
11. Where a canning company raises its own products or a packing house its own live stock we have agriculture brought within the scope of integration.
12. In many cases the artisan under this system is merely a sort of piecework wage earner.
13. The census for 1910 shows that the lowest percentage of corporate establishments is found in the following industries: Bread and other bakery products; women's and men's clothing; marble and stone work; leather goods, butter, cheese, and condensed milk; and boots and shoes. Tobacco manufactures show only 4.6. per cent of establishments operated by corporations; but produced over 56 per cent of the value of the product. And a similar situation is indicated in the printing and publishing business. These facts clearly bear out the generalizations made in the text.
14. Statistics of the German Empire on Industrial Organizations

ESTABLISHMENTS PERSONS EMPLOYED

	1895	1907	1895	1907
All industrial establishments No.	*3,065	3,266	10,269	14,436
Per Cent	100	100	100	100
(*Alle Betriebe*)				
One-man establishments (No.	*1,714	1,452	1,714	1,452
Per Cent	55.9	44.4	16.7	10+
(*Allein Betriebe*)				
Establishments with helpers No.*	1,351	1,814	8,555	12,984
Per Cent	44.1	55.6	83.3	90—
(*Gekilfen Betriebe*)				
Establishments possessed by single individuals with helpers No.*	1,281	1,674	5,713	7,524
Per Cent	41.8	51.2	55.7	52.1
(*Einzelinhabern Gehilfenbetriebe*)				

* The numbers are in thousands, *i.e.,* three decimals are omitted.

15. *E.g.* Delaware, New Jersey, and a few "liberal" States authorize corporations to enter all kinds of contracts with persons and firms, including the partnership relation.
16. See Weber, *Zur Geschichte der Handelsgesellschaften im Mittelalter,* p. 62 ff.
17. Obviously to make a contract in which salaries and interest rates, shares of profits, and limitations in management are specified and to have it perfectly just and satisfactory to all, would be difficult, to say the least; but unless this is done motivation must be to some extent impeded.
18. Clephane, *Organization and Management of Business Corporations.*
19. Hibbs *v*. Brown, 190 N. Y. 167 (1907).
20. See Appendix, p. 403, for articles of Pierce-Fordyce Oil Association.
21. See Lehmann, *Geschichtliche Entwickdung des Aktienrechts* (Berlin, 1891), pp. 14–17.
22. Schmoller, "Die geschichtliche Entwickelung der Unternehmung," in *Jahrbuch für Gesetzgebung, Verwaltung, u. Volkswirtschaft,* 1893, Vol. XVIII. Cf. Weber, *Zur Geschichte der Handelsgesellschaften im Mittelalter* (Stuttgart, 1889), p. 18 ff.
23. Unwin, *Industrial Organization in the 16th and 17th Centuries.* (Oxford, 1904.)
24. Unwin, *op. cit.,* p. 157. The prospectus is interesting. "The Company of Felt-makers London thereunto moved by sundry mischiefs and miseries they have endured by the Company of Haberdashers of London have resolved for remedy thereof and for Government of the poore of their trade and profyt of such as will come with them therein to buy a Stock or bank of money for the taking in and buying up of all the wares they make into their own hands which Stock is projected to be £15,000 to be raysed by themselves and such as will adventure with them."
25. Price, *English Patents of Monopoly* (Boston, 1906), pp. 50, 131.
26. Scott, W. R., *The Constitution and Finance of English, Scottish and Irish Joint-Stock Companies to 1720.* (Cambridge, 1910.) Vol. II, p. 388.
27. See Scott, *Joint-Stock Companies to 1720,* Vol. II, p. 36 ff. The reasons given contemporaneously are interesting. "And lest any private man should bee too much oppressed or charged a course was taken, that every man willing to bee of the socitie, should disburse the portion of twentie and five pounds a piece..." The risks of trade with a new and savage country made the establishment of a joint-stock desirable.
28. Hewins, *English Trade and Finance* (London, 1892), p. 34.
29. Kahn v. Cent. Smelting Co., 102 U. S. 641 (1880). (Conyngton.)
30. Michigan, Pennsylvania, New Jersey, Ohio, Virginia. (Sullivan, *Amer. Corps.,* p. 371.)
31. Conyngton on *Partnership Relations,* p. 28.

32. *Cyclopedia of Law and Procedure,* Vol. XXIII, p. 468.
33. *Wealth of Nations,* Bk. V, Chap. I, Part III, art. 1.
34. There has been some remedial legislation on this point. See People *ex rel.* Platt *v*. Wemple, 117 N. Y. 136; Van Aerman *v.* Blustein, 7.N. E. 537; MacGeorge *v*. Harrison Chemical Mfg. Co., 21 Atl. 671; Waterbury *v*. Merchants' Union Express Co., 50 Barb. (N. Y.) 157; Platt *v.* Colvin *et al.,* 36 N. E. 733. The New York statute provides that stock companies of over seven members may sue and be sued in the name of the president or treasurer.
35. Not necessarily with "joint-stock companies." Such evils will be discussed in connection with stock corporations.
36. Bk. I, Chap. IX. Perhaps Mill states the case a little too absolutely and optimistically; but the statement has force.
37. 4 Wheat. (U. S.) 518.
38. People *v*. the Assessors of Watertown, 1 Hill (N. Y.), 620. Italics are the present writer's.
39. Sullivan, *American Corporations* (N. Y., 1910), p. 1. Good definitions may also be found in the works of Cooley, and of Angell and Ames.
40. This is not intended to exclude charitable corporations. In this statement, and the following analysis, the author wishes to acknowledge his indebtedness to Davis, *Corporations, their Origin and Development,* cf. Vol. I, Chaps. I and II; Vol. II, last two chapters.
41. The "corporation sole" (one member) is of no importance, if, indeed, the term is not a misnomer.
42. *E.g.* Attorney General *v.* Superior, etc. R.R. Co., 93 Wis. (1896). Here the company never completed its line. Held that mere non-user did not dissolve in the absence of any statute so providing.
43. Lough, *Corporation Finance* (Chicago, 1909), p. 14. Present writer's italics.
44. For an interesting presentation of another view, see Stetson, "The Government and the Corporations," *Atlantic Monthly,* July, 1912.
45. Mills *v*. Williams, 11 Iredale (N. C.), 558.
46. *Modern Law of Corporations,* Vol. I, § 32.
47. This is the illustration used by Conyneton in *The Modern Corporation* and Lough, *Corporation Finance.*
48. *E.g.* Machen, *Modern Law of Corporations,* Vol. I, §§ 451–459; Clark, *Handbook of the Law of Private Corporations,* pp. 63–66.
49. But in some States corporations can be formed for one purpose only.
50. See certificate of incorporation of U. S. Steel Corporation, art. IV.
51. The Texas statutes provide: "Corporations shall have powers to borrow money on he credit of the corporation, not exceeding its authorized capital stock, and may execute bonds or promissory notes therefor, and may pledge the property and income of the corporation," (art. 653).
52. Lawyers distinguish "corporations sole" from "corporations aggregate," the former having but one member at a time; "Ecclesiastical," "eleemosynary," and civil corporations"; "public corporations" and "private corporations," the former being created for governmental purposes and the management of public affairs.
53. The *societas* referred to in a preceding chapter, while it had not so many of the legal characteristics, had several important economic features of the modern corporation, *e.g.,* transferable shares of *societates publicanorum.*
54. The earliest royal charters conveying group privileges did not create true corporations. See Holdsworth, *History of English Law.*
55. See Gross, *Gild Merchant,* Vol. II, p. 67; Scott, *Joint-stock Companies,* Vol. I. p. 6.
56. Cawston and Keane, *Early Chartered Companies* (London, 1896), Chap. II.
57. See Scott, *Joint-stock Companies,* Vol. I, p. 371.
58. See *Two Centuries Growth oj American Law*, Yale University, article by Baldwin.
59. See Haney, *Congressional History of Railways,* Vol. I, pp. 124, 165, 91; Million, *State Aid to Railways in Missouri,* p. 29.
60. *A Century of Law Reform* (London, 1901, Macmillan & Company), Chap. XII, "The History of Joint Stock and Limited Liability Companies," by T. B. Napier.
61. Exception concerned banking corporations.
62. It is to be observed that this way of looking at the matter is that of the law. It is not in accord with the historical-

scientific analysis, but the legal conception still prevails and is none the less an important advantage to corporations.

63. *Wall Street Journal,* August 31, 1911.
64. Smith *v.* Kurd, 12 Metcalf (Mass.), 371.
65. See Hawes *v*. Oakland, 104 U. S. 450 for conditions under which a stockholder may sue: *e.g.* when the corporation cannot sue: when the proper agents refuse to sue: when the agents are the wrongdoers.
66. For a discussion of where and how to incorporate, see Lough, *Corporation Finance,* Chap. IV, and such manuals on corporation organization as that of Conyngton.
67. *Modern Law of Corporations,* Vol. I, §19.
68. See *Report of Massachusetts Tax Commissioner upon Voluntary Associations,* Boston, 1912; Chandler, *Express Trusts under the Common Law,* Boston, 1912; Stimson, Trusts," *Harvard Law Review,* I, pp. 132–143; Perry on Trusts, *passim.*
69. Corporations may act as trustees, as is the case with trust companies. In such cases, the trust is the function; the organization is a corporation.
70. *Report of Tax Commissioner,* above cited, p. 19.

The reader may be interested in a concrete example. The Terminal Hotel Trust is a Massachusetts realty trust organized in 1899, and owning lands and buildings in Boston. Its condensed balance sheet is: —

Assets	
Land and Buildings	$725,000
Cash	2,258
Payments due on Essex Street addition	162,827
Total	$800,085
Liabilities	
Preferred Stock	$359,000
Common Stock	350,000
Notes Payable	50,000
Mortgage Loan	70,000
Reserve for Depreciation	28,042
Profit and Loss	24,043
Total	$890,085

Trustees: Francis Peabody, Henry M. Williams, Leslie C. Weed.

71. Hoadley *v*. County Commissioners, 105 Mass. 519.
72. Mayo *v*. Moritz, 151 Mass. 481.
73. On car trusts, see Roberts' Appeal, 92 Pa. St. 407 ff.; McGourky *v*. Toledo, etc. Ky., 146 U. S. 536; Ricker *v*. American Loan and Trust Co., 140 Mass. 346 ff.
74. See *Rept. Indust. Com.,* Vol. I, pp. 1131, 1134, 1174.
75. See *Report of Board of Gas and Electric Light Commissioners* (Mass.), April 3, 1911. (On Bay State Gas Company.)
76. Perry on Trusts, and cases there cited.
77. If there were many trustees this would surely require some modification of the common-law rule that all the trustees must concur in an act to make it binding.
78. Williams *v*. Boston, 208 Mass. 50. See Edwards *v*. Warner Linoline, etc. Works, 168 Mass. 566, for a case which indicates that the business trust might be dealt with by the courts as a corporation.
79. Tyrrell *v*. Washburn, 6 Allen (Mass.), 474.
80. Further substantiated by the fact that the Latin word *socius* (companion) is seen in the term; and it is commonly used in connection with partnerships.
81. Cf. Meyer *v*. Johnston and Stewart, 64 Ala. 603; Powell *v*. N. Mo. R. R. Co., 42 Mo. 63.
82. A correlative fact is that the price would fall sharply with increased output, he desire to control the supply of inelastic-demand goods, then, was a closely related element in the situation.

83. *Rept. Indust. Com.,* Vol. I, p. 101.
84. Hearings, 1911, p. 1689 (Mr. C. N. Dutton).
85. See Noyes, *A Treatise on the Law of Intercorporate Relations* (Boston, 1909); Eddy on Combinations (1901); Goodnow, "Trade Combinations at Common Law," in *Pol. Sci. Quart.,* Vol. XII, pp. 212–245, also in Ripley's *Trusts, Pools, and Corporations,* Chap. XI.
86. Story on Contracts, 1649; Noyes on Intercorporate Relations (1909), p. 611.
87. For convenient summary of State anti-trust laws see Noyes, *Intercorporate Relations,* p. 763 ff., note.
88. Rourke *v*. Elk Drug Co., 75 App. Div. (N. Y.) 145 (1902); 77 N. Y. Sup. 373. See also: State *v*. Schlitz Brwg. Co., 104 Tenn. 715; Cleland *v*. Anderson, 66 Neb. 252; C. H. Albers Commission Co. *v*. Spencer, 205 Mo. 105.
89. Appendix, p. 414, for the constitution of a typical agreement organization.
90. *Report of the Industrial Commission* (1901), Vol. XIII, p. 474.
91. Evidence by J. A. Topping in recent suit to dissolve the U. S. Steel Corporation, as reported in the press May 15, 1912. Judge Gary himself said before a House Committee recently, "I do believe that if one individual is possessed of information concerning the conditions surrounding the other's business that it prevents many times, and perhaps in most cases, the extreme, the unreasonable, the bitter, and destructive competition which used to exist." This was the object of his dinners.
92. To facilitate an understanding of agreements the following attempts at classification are presented: —

A. As to scope and membership:

- I. Local.
  - 1. Trade conditions.
    - a. *Sellers* (with or without sales agency).
      - (1) Manufacturers, growers, etc.
      - (2) Wholesalers or jobbers.
      - (3) Retailers.
      - (4) Wholesalers and retailers.
      - (5) Manufacturers and jobbers.
      - (6) Manufacturers, jobbers, and retailers.
    - *b. Buyers* (as under *a;* but not so full).
  - 2. Prices.
    - *a. Sellers* (as under 1, a, "Factors' Agreements" included).
    - *b. Buyers* (as under 1, b).
  - 3. Output, and Prices and Output.
- II. State and National (as under I).
- III. International (as under I; but perhaps not I, 1, a, (3), (4), (6).

B. As to methods:

- I. Monopolistic (generally secret).
  - 1. Gentlemen's agreement (generally voluntary).
  - 2. Contract agreement.
    - a. *Voluntary* (with or without a sales association).
      - 1. Without forfeit.
      - 2. With forfeit.
        - *a.* Refusing to sell to or buy from violators.
        - *b.* Boycotting.
        - *c.* Pledge deposit.
        - *d.* Fines.
        - *e.* Use of patents.

b. *Involuntary or compelled* (with or without sales association, as under a).

- II. Open.

1. Gentlemen's agreement (generally secret and voluntary).
2. Contract agreement (as under I, 2).
    a. Secret.
    b. Public.

93. See Brand, "Commercial Organizations," *Department of Commerce and Labor, Bureau of Manufactures, Special Agents' Series,* No. 60 (Washington, D.C., 1912).
94. Macrosty, *The Trust Movement in British Industry* (London, 1907), p. 6.
95. *Report of the Industrial Commission* (1901), Vol. XIII, p. 385.
96. *Report of the Industrial Commission* (1901), Vol. XIII, pp. 121, 135, 149, 139.
97. Numerous fruit growers' associations are best classed as price agreements, and where crop output is pooled they are to that extent "pools."
98. See Appendix E.
99. See Stevens "The Powder Trust," in *Quarterly Journal of Economics,* May, 1912. The full text of the agreement may be found in *Industrial Combinations and Trusts* (edited by the same writer, 1912), p. 2. It is there wrongly classed as a pool.
100. See 115 Fed. Rep. 27 (1902); 193 U. S. 38 (1904).
101. See Ellis *v*. Inman, Poulsen & Co., 131 Fed. Rep. 182 (1904).
102. This association not only distributes produce, but also buys seed and handles claims for overcharges against transportation lines.

It is interesting to note that formerly it operated under a "general daily pool"; that is, the growers received the same price for the same grade of produce shipped on the same day, no matter from what shipping point. This system did not work very well, for it was found impossible to get a uniform grade. The produce at one point, two or three hundred miles removed from another point, might be affected by weather conditions so as to alter its carrying and keeping qualities, and consequently the stock grown under more favorable conditions would suffer in the general average. Furthermore, a delay in marketing shipments from one point held up settlements with all members of the "pool."

103. See U. S. *v*. Standard Sanitary Mfg. Co. *et al.,* 191 Fed. Rep. 172 (1911).
104. A factor is one who sells goods for their owner on a commission. On factors' agreements in general see Arbuthnot, "Factors' Agreements," *Jour. Pol. Econ.,* Vol. xv, pp. 577 seq.
    Stevens, *Industrial Combinations and Trusts* (N. Y., 1912), Chap. VII.
105. *Rept. of the Com. of Corps, on the Steel Indust.,* Part I, p. 75.
106. *Iron Age*, December 30, 1897.
107. Stevens, "The Powder Trust," above cited; U. S. *v.* E. D. du Pont de Nemours, 188 Fed. Rep. 127 (1911).
108. Post v. Railroad, 19 Pickle (Tenn.), 197. The court said: "It is sufficient to say that we do not find from the record that the proceedings took the shape of an actual contract capable of legal enforcement by either party, but it was a simultaneous declaration of the same policy, which had already been practiced by each company, and this declaration by each was made in view and in consideration of the fact that rates had already been fixed by the keenest competition; that the declaration was made solely with reference to cotton in the Memphis market; and that concert of action upon this idea of maintaining the right to route cotton was first declared at the time and after this meeting and declaration (p. 201).
109. U. S. *v*. Addyston Pipe and Steel Co., 78 Fed. Rep. 712; 173 U. S. 211.
110. See *Report of the Commissioner of Corporations on the Tobacco Industry* (1909), Part I, pp. 170, 174, 440.
111. For full details of an interesting international agreement of a similar kind, see case of the *Powder* Trust in the Appendix to this volume below, p. 434. International agreements or pools have also existed in the sulphur, nickel, and armor-plate industries, among others.
112. How this works out is indicated in a letter from one of the pipe works to its representative in the pool which left the margin above expense to be determined by bidding. "...we have been able to determine to what point we could bid on work and take contracts, and if bonus is forced above this point, let it go and take the bonus. It is useless to argue

that... shops who have been bidding bonuses of $6 and $8 per ton, can come out and make any money if they continue to bid such bonus. However, they of course calculate this bonus will be returned to them on work taken by other shops.... [But] If the others run bonus above this point let them take it, as it will be more money to us to take the bonus" (i.e., their share in the pool). *Fed. Anti-trust Decisions,* Vol. I, p. 1017.

113. See U. S. *v*. Ches. & Ohio Fuel Co. *el al.,* 105 Fed. Rep. 93 (1900).
114. Michigan Salt Association, 1876 (see *Pol. Sci. Quart.,* Vol. III, p. 78).
115. See 143 Mass. 353 (Central Shade Roller Co. *v*. Chas. H. Cushman, 1887).
116. See 164 N. Y. 401 (James V. Cummings *v*. Union Blue Stone Co., 1900).
117. See 92 Fed. Rep. 479 (Cravens *v*. Carter-Grume Co., 1899).
118. See Stevens (editor), *Industrial Combinations and Trusts* (N. Y., 1912), p. 4.
119. The following excerpt from a recent decision indicates some of the advantages that may come from pooling. "... there was from the jobbers' standpoint much that was attractive in the scheme as a whole. Competition had been fierce. It had not always been either wise or honest. A badly made article may... deceive.... When the defects were speedily discovered, the jobber might have to take back the article. The cost of doing so ate up the profit.... If every dealer signed the agreement, more of them could gain by... any ware... not standard of its kind. The lowest price the makers could take would buy a good article... friction with customers would be lessened. The reputation of the ware would be raised. Every jobber would know that he was buying and selling on the same terms as his competitors. He could tell to the traction of a cent what his gross profit on every article sold by him would be. He could regulate accordingly his expenditures for handling and advertising it." U. S. *v*. Standard Sanitary Mfg. Co. *et al.,* 191 Fed. Rep. 177 (1911).
120. *A Congressional History of Railways* (Madison, Wis., 1910), Vol. II, p. 303.
121. See Stevens, *Industrial Combinations and Trusts* (N. Y., 1919), p. 13 ff.
122. Mallory *v*. Oil Works, 86 Tenn. 602 (1888).
123. Dos Passos, *Rept. Indust. Commission,* Vol. I, p. 1142.
124. People of the State of New York (respondent) *v*. North River Sugar Refining Co. (appellant), 121 N. Y. 382 (1890).
125. 121 N. Y. 625. (Author's italics.)
126. State *ex rel. v.* Standard Oil Co., 49 Ohio St. 137 (1892).
127. State *v.* American Cotton Oil Trust, 40 La. Ann. 8 (1888), and 3 S. Rep. 400.
128. See Brief of Facts and Argument for Petitioner, in case of U. S. *v*. Standard Oil Co. of N. J. *et al.,* Circuit Court for Eastern Distr. of Mo., Vol. I, pp. 63–78.
129. *Report of the Commissioner of Corporations on the Beef Industry* (1905), pp. 16, 35. This company is now (1912) in process of dissolution as a result of the recent trial of the packers, and its assets are to be distributed *pro rota.*
130. See *Commercial, and Financial Chronicle,* November 1, 1890, p. 609.
131. *Rept. Indust. Com.,* Vol. I, pp. 109, 124.
132. Moody's *Manual of Railroads and Corporation Securities,* 1912. See also Report of Special Committee to investigate the American Sugar Refining Company, House of Reps., 62 Cong., 2 Sess.
133. See Appendix H.
134. Sect, 51, General Corporation Law.
135. In testifying before the Stanley Committee on the Steel Trust, Judge Gary recently said: —

"The reason why we have [retained the holding company form] is that we believe these subsidiary companies, having their boards of directors and their officers, consisting of presidents, vice presidents, etc., have more responsibility and reach a higher success in the management of the properties in their charge than they would if they were simply the managers of these mills as departments" (II, p. 103).

136. *Rept. of Com. of Corps, on the Tobacco Trust,* Vol. I, p. 225.
137. Machen, *Mod. Law of Carps.,* Vol. I, p. 57, and cases cited.
138. The Tobacco Trust was bound together by stockholding; some of its great branches were mergers.
139. See Pearson *v*. Concord R. R., 62 N. H. 537; Dunbar *v*. Amer. Tel., etc. Co., 224 Ill. 9; Bigelow *v.* Calumet Min.

Co., 155 Fed. Rep. 869; So. Elect. Securities Co. *v.* State, 44 So. 785 (Miss.); Burrows *v.* Interbor. Metropol. Co., 156 Fed. Rep. 389; Elkins *v.* Camden & Amboy R. R. Co., 36 N. J. Eq. 5.

140. Such a case occurred in 1911. In the particular case which the author has in mind, the object was to give an equity in the property to a number of third mortgage bondholders whose securities had been wiped out by reorganization, The International & Great Northern reorganization.
141. The fact that these later decisions by strong implication provide for reasonable restraints of trade, however, holds out some hope for the continued use of securities holding along the old lines.
142. See U. S. *v*. du Pont de Nemours & Co., 188 Fed. Rep. 127 (1911); and Stevens, "The Powder Trust," in *Quart. Jour. Econ.,* May, 1912, pp. 469–481.
143. U. S. *v*. E. I. du Pont de Nemours & Co. (1911), 188 Fed. Rep. 146, opinion of court.
144. The reader will find it both interesting and instructive to turn to Table I in the *Statistics of Railways in the United States,* compiled by the Interstate Commerce Commission, and in the "remarks" column read what changes are taking place in railway organization and see under what "terms" the various systems are held together. The former information is presented in a supplement to the main table.
145. Of course, production, distribution, and consumption are contemporaneous and parts of the circle of life; but even a circle can be approached from different "sides."
146. U. S. *v*. E. I. du Pont de Nemours & Co., 188 Fed. Rep. 153.
147. See Trenton Potteries Co. *v.* Oliphant, 58 N. J. Eq. 507 (1899); State *v.* Continental Tobacco Co., 177 Mo. 1 (1903); Dittman *v.* Distilling Co., 64 N. J. Eq. 537 (1003); Metcalf *v*. Amer. School Furn. Co., 122 Fed. 115 (1903).
148. In addition to the tobacco and powder cases cited in the text, see Shawnee Compress Co. *v*. Anderson, 28 Sup. Ct. Rep. 572 (1008); National Lead Co. *v.* Grote Paint Co., 80 Mo. App, 267 (1899); Distilling, etc. Co. *v*. People, 156 Ill. 448, 491 (1895).
149. *E.g.* American Rope and Twine Co., and Wabash R. R.
150. Executive work and management may be regarded as kinds of labor.
151. See 10 *Cyc.* 958; 4 N. J. Eq. 392, 398; Matter of Sleinway. 159 N. Y. 250 (1809).
152. "Robinson, *Modern Business Organization and Management* (Chicago, 1911), p. 86.
153. Machen, *Modern Law of Corporations,* p. 1192.
154. Sparling, *Business Organization* (N. Y., 1906), p. 111.
155. The reader who desires a detailed statement of the functions of the several departments may find it in Sparling, *Business Organization,* Chaps. V and VI, and in Robinson, *Modern Business Organization,* pp. 125–168. See Duncan, J. C., *The Economic Side of Works Management,* and *The Principles of Industrial Management.*
156. See Emerson, H., *Efficiency as a Basis for Operation* (N. Y., 1912), Chaps. III and IV.
157. This being a book of business organization, the following chapters will not emphasize financial details; but the subject will be presented as steps in organization.
158. *Rept. Indust. Com.,* Vol. XIII, p. 37 ff.
159. See also the case of a phosphate company mentioned below.
160. See *Repl. Indust. Com.,* Vol. XIII, p. 676 ff.; Receiver's Report from Transcript of Record, U. S. Circuit Court of Appeals for the 3d circuit, Sept. term, 1903, in th case of the Land Title and Trust Co. *v*. Henry Tatnall, pp. 370–380 (cited in Ripley's *Trusts, Pools, & Corporations,* Chap. X); Moody, *Truth about the Trusts* (N.Y., 1904), pp. 295–306.
161. Lough, *Corporation Finance,* p. 161.
162. For details see Conyngton, *Corporate Organization;* Clcphane, *Organization and Management of Business Corporations,* Chap. I; Sullivan, *American Corporations,* Appendix A and Chap. II.
163. For the leading United States cases on promotion see Old Dominion Copper Mining and Smelting Co. *v*. Bigelow, 89 N. E. Reporter, 193, and Old Dominion Copper Co. *v.* Lewisohn, 210 U. S. 206. In the former reference the facts are clearly stated.
164. English case: A. C. 240 (1900).
165. Clark and Marshall, *Private Corporations,* I, Sect, no 6.

166. Densmore Oil Co. *v.* Densmore *et al.,* 64 Pa. St. 43 (1870); Morawetz on Private Corporations, Sect. 293.
167. For some conflict of authority and for further information concerning remedies and other points discussed above, see: Old Dominion Copper Co. *v.* Lewisohn, 210 U. S. 206; Bigelow *v.* Old Dominion Copper Co., 203 Mass. 159; *Harvard Law Review,* Vol. XXIV, p. 356; *Illinois Law Review,* Vol. V, p. 87; *University of Pennsylvania Law Review,* Vol. LVIII, p. 226.
168. See also Appendix K and N.
169. See Appendix N.
170. Bonds having the privilege of convertibility into stock at the holder's option.
171. *Rept. of Com. of Corps, on the Steel Industry,* Vol. I, p. 244. Some $4,000,000 was in paid-up participation in a succeeding syndicate for making a bond conversion.
172. It is refreshing to note that Mr. Morgan was not without a grim sense of humor; for in a circular to stockholders he said: "It is proper to state that J. P. Morgan & company are to receive no compensation for their services as syndicate managers beyond a share in any sum which ultimately may be realized by the syndicate."
173. See Pratt, S, S., *The Work of Wall Street* (N. Y., 1912); Hirst, F. W., *The Stock Exchange* (N. Y., 1911); Emery, H. C., *Speculation on Stock and Produce Exchanges;* "Stocks and the Stock Market," in *Annals of American Academy,* May, 1910. Pratt's book contains the report of the Hughes Commission, bibliography, and is most up-to-date. Van Antwerp, *The Stock Exchange from Within* (N. Y., 1913) is a somewhat biassed defense of the Exchange.
174. A deliver ticket runs as follows: "Clearing house of the New York Stock Exchange, deliver to John Doe 100 shares X. Y. Z. Co., at $75, $7500, for account of undersigned. Richard Roe." Receive tickets are similar.
175. *Rept. Indust. Com.,* Vol. I, p. 977.
176. F. M. Burdick, *Johnson's Universal Cyclopedia.*
177. Davia *v.* Gray, 16 Wallace, 203.
178. See Swain, *Economic Aspects of Railroad Receiverships,* Amer. Econ. Assoc., "Economic Studies," 1898.
179. See Meade, "Reorganization of Railroads," in *Annals of the American Academy,* Vol. XVIII, p. 35.
180. Cf. Rept, of Bur. of Corps, on the Int. Harvester Co. (1913); files of the *Commercial and Financial Chronicle;* Statements and Briefs in the suit of the U. S. *vs.* Int. Harvester Co., 1913–1914; Opinion of Supreme Court of Missouri in State *vs.* I. H. Co., Oct. term, 1911, and evidence in that suit; Annual reports of the company. References in brackets are to Rept. of Bur. of Corps.
181. To insure the permanence and financial integrity of the combination, its stocks were placed in the hands of a voting trust (see above, p. 122), the trustees being Geo. W. Perkins (the promoter), Charles Deering and Cyrus H. McCormick. This trust was not dissolved till 1912.
182. Dealt with employees' welfare, insurance, taxation, and legislation.
183. That the Harvester Company produces more cheaply than the independents is admitted by the Bureau, which ascribes the fact to its larger scale.
184. *Com. and Fin. Chron.,* Feb. 1, 1913.
185. Adams, H. C., *The State in Relation to Industry.*
186. One witness (Mr. T. Vincent) testified before the Senate Committee on Interstate Commerce, at its recent hearings, that when competition is sharp and profits low in the West Virginia coal industry, "faults," "squeezes," or "break-downs in the mines cause fully 25 per cent of the coal to be left in the mines, and when they are abandoned this coal is a total loss. Hearings (1911), p. 26.
187. See Meade. "The Fallacy of Big Business," *Annals of Amer. Academy* July, 1912; Meade, "Economies of Combination," *Jour. Pol. Econ.,* April, 1912. Brandeis, Hearings of Sen. Com. on Interstate Commerce (1911), p. 1147 ff.
188. Cumulative preferred stock is stock which has some prior claim over common stock, and bears dividends which cumulate when not paid, *i.e.,* if passed in any one year they remain due and must be paid before any dividends can be paid on common stock.
189. *North American Review,* Vol. CLXXXIV, p. 120ff. (1907).
190. Collateral trust bonds are desirable when subjected to some restriction. Convertible bonds also appear unobjectionable. It might be well to adopt uniform rules for redeemable bonds. [It will be remembered that there is no great

difference between debentures and many income bonds and preferred stock (cumulative).]

191. The following paragraphs from a proposed New York companies' act are excellent: —

Every company and the directors and managers thereof —

1. Shall cause to be kept proper books of account in which shall be kept full, true nd complete accounts of the affairs and transactions of the company, and

2. Shall once at least in each year cause the accounts of the company to be balanced and a balance-sheet in this act referred to as the shareholders' balance-sheet to be prepared, which balance-sheet after being duly audited shall be laid before the members of the company in next general meeting; and

3. Shall cause a copy of such shareholders' balance-sheet so audited to be sent to the registered address of every member of the company at least seven days before the meeting at which it is to be laid before the members of the company and a copy to be deposited at the registered office of the company for the inspection of the members of the company during a period of at least seven days before that meeting, and every shareholder in the company or any person acting in his behalf shall be entitled to other copies thereof on payment of twenty-five cents each.

The shareholders' balance-sheet shall be in such form as is directed by the certificate of incorporation or the by-laws or by a resolution of the company and shall show in every case —

1.. The amount of share capital authorized, the amount issued, and the amount paid up thereon, distinguishing the amount of share capital paid up in money and the amount paid otherwise than in money, with statement of nature of the consideration and the arrears of calls due, and the specific amounts issued during the two years next preceding;

2. The amount of debts due by the company, specifying the security if any allocated for each debt and distinguishing the amount of mortgages, debentures and floating charges against the general assets of the company, the amount of the reserve fund, if any, and the amount of any contingent liabilities.

3. The amount of all current assets, after making a proper deduction for debts considered to be bad or doubtful; any debts due from directors or other officers to be separately stated.

4. Whether the assets other than debts due to the company are taken at cost price or by valuation, or on what other basis they are reckoned, and whether any and if so what amount of percentage has been written off and what other provision, if any, has been made for depreciation.

5. The gross amount of the year's earnings, the deductions made from the same for fixed charges of interest and taxes and the surplus, if any, available for dividends.

6. The amount by which the gross value of the assets of the company has been increased since the last balance-sheet in consequence of any increase in the valuation of real or personal property belonging to the company.

7. The amount of property, if any, for which shares were issued, which has been sold the since the last report with a full disclosure of the consideration therefor in detail, the parties to the contract and the real parties in interest.

The shareholders' balance-sheet shall be accompanied by a certificate signed by two or more of the directors on behalf of the board stating that in their opinion the balance-sheet is drawn up so as to exhibit a correct view of the state of the company's affairs and that in their opinion the statement is correct.

192. See Cook on Corporations, Sect. 740. The conditions here indicated are better in some States where statutes have been passed to meet the evils referred to; but the point is that the proposed Federal law should follow the best practice.

193. See Wickersham, George W., *Federal Control of Stock and Bond Issues by Inter-Earners;* an address before the Illinois Bar Association, June 24, 1910 (Washington, D. C., 1910).

194. Some good authorities believe that it would be wiser not to attempt to enumerate these abuses; but to leave it to the courts to apply the more general test of reasonableness of restraint after the manner of the Standard Oil and Tobacco Trust decisions. This is certainly true if to enumerate must by implication sanction all non-enumerated acts. To the author, however, it seems that we need more definite-ness just now; though the points enumerated should be considered as types, and should not preclude action against other abuses.

195. Suitable penalties would be provided. It might be salutary to provide that the injured competitor should receive compensation. The industrial commission would have to pass upon questions similar to those which come before the

Inters Commerce Commission in certain rate cases.

196. At least four States now forbid selling below cost for the purpose of destroying a competitor, — Mississippi, Nebraska, North Carolina, and Tennessee.
197. Hearings (1911), p. 32. Cf. Chesapeake & Ohio Coal Co.
198. Knauth, O. W., *The Policy of the U. S. towards Industrial Monopoly,* (N. Y., 1913); Wyman, *Control of the Market,* Chap. X; Thornton, *A Treatise on the Sherman Anti-Trust Act* (Cincinnati, 1913); Walker, A. H., *History of the Sherman Law,* (N.Y., 1910); Hearings before Senate Committee on Interstate Commerce, 1911–1912, *passim;* Article by Seager in *Pol. Sci. Quart.,* XXVI, 581–614.
199. *U. S.* v. *Debs et al.* (64 Fed. 724).
200. The court was equally divided, four condemning the holding company, and four upholding it. Justice Brewer had the deciding voice, and opposed the organization, though specifically on the ground that it exercised an unreasonable restraint.
201. 142 Fed. 531 (1906).
202. 149 U. S. 833 (1906).
203. The case of Anderson *v.* Shawnee Compress Co. (87 *Pac. Rep.*) might be quote to similar effect.
204. See 87 Pac., and 209 U. S. 435.
205. 218 U. S. 601 (1910).
206. 220 U. S. 373 (1911). This case decided that contracts for the sale of patent medicines that aimed to control the price for dealers who are not actually agents are unlawful restraints of trade.
207. Standard Oil Co. of N. J. *v.* U. S. (221 U. S. 2) May 15, 1911.
208. American Tobacco Co. *v.* U. S. (221 U. S. 106) May 29, 1911.
209. See Raymond, "Standard Oil and Tobacco Cases," in Harvard Law Rev., Nov. 11, 1911.
210. Cf. E. I. du Pont de Nemours case.
211. Continental Wall Paper Co. *v.* Voight & Sons, 148 Fed. 946–947 (1906).
212. 180 Fed. 160 (June 16, 1910) Circuit Court. Demurrer of defendant overruled.
213. U. S. *v.* Terminal Assoc. of St. Louis (197 Fed. 446; 224 U. S. 383).
214. U. S. *v.* Union Pac. Ry. Co. (226 U. S. 61, 470).
215. U. S. *v.* Reading Co. (226 U. S. 324; 228 U. S. 138).
216. The author has never been able to see why the doctrine of intent should be involved when intent is derived from harmful results to social welfare. It tends to complicate and obscure the true test of justice. When the question is one of individual personal culpability and turpitude intent is of prime importance; but when the whole social and industrial fabric is endangered we cannot regard mere intent.
217. U.S. *v.* Reading Co. 183 Fed. 427, 457; present writer's italics. Note the conflict of this statement with the recent decision of the Circuit Court against the International Harvester Co.
218. Language found in N. Securities case and others.
219. See Thornton on The Sherman Anti-Trust Act, p. 387, f.; and *U. S.* v. *Standard Oil Co.,* 173 Fed. 177, 195.
220. The so-called Murdock Bill presented in Congress during the present session is worthy of study in this connection. It contains some crudities, however.
221. Taken from Gano, *Commercial Law.* 441.
222. The capitalization has been increased and a few minor changes made in the articles since this copy was made. Certain important provisions have been italicized by the author.
223. These companies were Vereinigte Koln Rottweiler Pulver Fabriken of Cologne, and the Nobel-Dynamite Trust Company (Ltd.) of London.
224. Du Pont de Nemours and Company, Laflin and Rand, Eastern Dynamite Miami Powder Co., American Powder Mills, Ætna and Austin Powder Cos., Cal. Powder Works, Giant Powder Co., Consolidated, Judson Dynamite & Powder Co.
225. European Agreement, Gov't Exhibit No. 119, Pet. Rec. Exhibits, Vol. II, pp. 1124–1125.
226. Ibid., p. 1125.

227. Ibid., p. 1125.
228. Ibid., pp. 1155–1126.
229. Details not directly connected with the merging process are omitted.
230. From *Modern Business Corporations*, by Wm. Allen Wood and L. B. Ewbank. The Bobbs-Merrill Co.
231. See also the footnote references in this volume.