Technological Risks, Asset Partitioning, and the Organization of British Submarine Telegraph Companies, 1844-1914

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My talk will focus on one chapter in my book in progress project which is tentatively titled: ***Empire Ltd.: Law and the Rise of Multinationals in the First Era of Globalization (1844-1914),*** the chapter on the organization of the British submarine telegraph sector. The electric telegraph was the high-tech sector of the middle decades of the 19th century. As such it faced significant technological risks and encountered several failures and drawbacks. The book surveys the organization of this sector with focus on two routes, the transatlantic line from Ireland to Canada and the US, and the Britain to India line via the Mediterranean. The chapter presents a survey of the way in which companies involved in the construction and operation of these lines organized. The organization was in a series of companies all incorporated by the same group entrepreneurs and had interlocking boards of directors. My argument is that this organizational model was a learning by doing asset partitioning response to high technological risks.
In order to set this chapter in its wider setting, below you'll find first a short survey of the overall structure of the book, followed by a working outline of the chapters.
In my talk I will also refer to the preceding chapter that analyses British investment in railways overseas. I will compare the organizational model used in these two sectors. I will argue that in railways the overriding concern was expropriation and not technological risk. Their corporate governance and finance differed from that of the telegraph, to mitigate that concern. I can send the chapter on railways upon request.

Book Overview

The business corporation is one of the most defining institutions of the modern era. A huge percentage of the economic activity in advanced economies in the early 21st century is being conducted within the framework of business corporations. The largest business corporations control more employees, capital and revenues than mid-size states. Next to their tremendous benefits, business corporations harmfully affect the environment, invade individual privacy, increase inequality and undermine democratic institutions. The ability of states to regulate and direct large business corporations is considerably constraint by globalization and by

the multinational nature of these corporations. My argument, in a nutshell, is that in the last few decades of the 19th century business corporations escaped the control of states.

In the first era in the history of the business corporation, from its beginning round 1600 until the middle of the 19th century business corporations could be incorporated only through charters and were chartered only if they served well enough the interests of rulers and states. Chartered business corporations were semi-public in their functions. States regulated and restrained business corporations through the terms of their charters of incorporation. Britain introduced general incorporation by registration cum disclosure in 1844. This signaled the demise of the special chartering era in the history of business corporations and the onset of a new era. Now business corporations could be formed in the private sphere, irrespectively of whether they served state interests. They were regulated, if at all, by general regulatory acts. The premise of the General Incorporation Act of 1844 was that it deals only with companies whose center of gravity was in the UK. The drafters of the first general companies act did not envision imperial and global expansion of company laws and of companies.

In the second half of the 19th century, the conception of corporate law as domestic law rapidly changed. Beginning with Australia (New South Wales), India and Canada in 1849-51 territory after territory in the British Empire adopted general company laws. The same process of adopting general incorporation took place also in other European countries and in the US. The first part of my book project examines the policy of the British government with respect to what company law should be enacted for the colonies. It shows that official London (the Board of Trade, Colonial Office) believed in uniformity. Three reasons can be identified: a belief that British company law is the most advanced in the world, a hope that adoption of British law would strengthen the ties between the colonies and the metropole, an assertion that uniformity

among colonies simplifies doing business and flow of investments to and between various colonies. The project next surveys the transplantation of company law into some 40 different colonies and jurisdictions across the Empire. The bottom line of the survey is that what one can find throughout the Empire is anything but uniformity. Some colonies copied the British Act of 1844, some the Act of 1856, others the Act of 1862, an amended version of it, the Act of 1907 and so on. In settler colonies significant adjustments were made, in Australia to fit the needs of the mining industry, in Canada to accommodate for American connections and French legal origins, in South Africa to overcome Boer resistance. In much of Asia, from the Straits Settlements to Aden, the Indian Companies Act rather than the British Act was the Model. In various colonies in the West Indies and Africa a short and simple Act or a single section Act incorporating British law was enacted. In post-Ottoman mandates and protectorates, the preexisting French and Islamic based law had to be addressed. In Hong Kong, the existence of Chinese firms and the desire to serve as platform for investment in China led to special arrangements.

Lack of uniformity was only the beginning of complications. Once company law became global rather than domestic a new set of legal complications arose. These included the questions: how to determine which company law would apply to which company in issues such as the validity of its formation, internal disputes and insolvency; which court would litigate disputes among company constituencies; how can a company function when its shareholders (or some of them) are located in part of the Empire which is not its place of registration (Stock Registers); how to reconcile the dual listing of corporate shares in two different stock exchanges in the Empire (say Hong Kong and London); and more. While uniformity was the declared policy, the

reality on the ground was a mumble jumble. Forum shopping and legal arbitrage could be exploited. The new field of private international company law had to be formed from scratch.

What were the reasons for this mumble jumble? At its peak the British Empire controlled nearly a quarter of the world population and a quarter of Earth's land area. For a century it was the dominant superpower, "the empire on which the *sun never sets*". It governed directly and indirectly 140 distinct territories, small islands, strategically located ports, a sub-continent and a newly discovered continent; a company ruled raj turned into Viceroyalty, crown colonies, protectorates and mandates. It was too big to be governed legally and economically effectively from London. The Settler colonies (Australia, New Zealand, Canada and South Africa) demanded self-government and gradually turned into dominions with growing legal autonomy. They were not constitutionally bound to follow company law directives from London and gave primacy to adjustments to the local economic environment and political process. India and its orbits were governed from Calcutta and the India Office (rather than Colonial Office) and its large and professional judicial and legal administration took it upon a distinct path. Smaller and poorer colonies did not have the economy, legal staff and resources to justify a fully fledge company law.

The new imperial and global company law reality looked quite differently from the perspective of incorporators, investors and their lawyers. Unlike the Westminster and Whitehall government, the City of London celebrated the failure of the company law unification project. For City lawyers, bankers, accountants and investors, the mumble jumble was an opportunity for forum shopping, maneuvering, evasion of regulation and later also of taxation.

While the government was preoccupied with expanding, but not over expanding, the territorial sovereign reach of the British Empire, its administration and law, and at the same time

holding at the bay other empires, Germany and Japan, Russia and the United States, the City of London immersed itself with the largest capital export in human history. The capital that accumulated during the first industrial revolution and the early stages of the second industrial revolution was in search of investment opportunities. Many opportunities opened up overseas, in the form of exporting the new railway, steam shipping, and telegraph technology based networks, the trade in industrially produced goods and raw materials, and the services of banks, insurance companies, accountants and lawyers. Between 1865 and 1914 more than £4.1 billion of British capital were invested in shares and bonds of joint stock companies operating overseas and in in the bonds of foreign and colonial governments. More than 5% of the British GDP was invested annually overseas and of the total British capital stock a third was accumulated abroad. Never before or since has one nation committed so much of its national income and savings to capital formation abroad. It is quite astonishing that the legal and organizational tools for achieving this unprecedented capital flow were not explored systematically.

About a third of the export was through the issuing in the London Stock Exchange of governmental bonds for foreign governments in Latin America, the United States and Russia, and colonial governments in Australia, India and Canada. The investment in sovereign debts is beyond the direct scope of this project. Yet almost two thirds were exported through investment in business corporations, in the form of shares and debentures. These two thirds are at the heart of the second part of the book.

The first era of globalization was the era in which multinational corporations emerged. Who were the multinational business corporations through which this capital was invested? Where were they incorporated? This part of the book is based on case studies of over 50 early multinationals in sectors such as international trade, banking, railways, steam shipping and

telegraph, colonial governance, and mining, oil and raw materials. The case studies focus on the companies' legal decision making: where and how to incorporate, where to raise capital and on which stock exchanges to list shares, whether to form subsidiaries and where agencies and branches, whether to have stand-alone companies, corporate pyramids or loose corporate groups, where to hold board meetings, where to pay taxes, how to avoid antitrust and other regulation, when to migrate from one jurisdiction to another.

A key question to be explored is, did multinationals opt primarily for the strategy of influencing the content of law through lobbying or looked for ways to avoid and bypass the law? Did they want the British government to leave them alone or protect their investments? Could they aspire for both simultaneously? Generally speaking, post-general incorporation business corporations wanted to be left alone. They typically turned to the government only with very specific requests and in a manner that would not subject them to supervision and regulation. The best way to be left alone was to go global. Going global was achieved by combining business activities overseas, away from British regulation, incorporating in Britain and raising capital at the London Stock Exchange when suitable, while shopping around between various company laws and stock exchanges when beneficial. When it comes to investor protection overseas, one would expect British companies not only to protect themselves legally and organizationally, and coordinate organize with other British companies, but also to take the advantage of being part of the largest Empire that ever existed, at the height of *pax Brittanica,* backed by the oceans dominating Royal Navy, and of the ability to resort to gunboat diplomacy.

The answer varies by sector and region. Let us start with sectoral highlights which are based on company case studies. Merchant houses were slow in shifting from family firms and partnerships to limited companies and incorporated only in the early 20th century in order to

overcome intergenerational transfer problems. Managing agencies on the one hand used company law in order to incorporate the managed companies but on the other bypassed company law in order to control them without holding a controlling stake in their shares. The main concern of Railway companies was expropriation by the hosting country after the completion of the lumpsum investment, and the solution was a combination of corporate organization and finance devices with prevailing investor protection means. Telegraph companies, as the high-tech sector of the time, were exposed to technological failure risks and deal with them by designed in advance asset partitioning in a series of companies. Colonial companies faced a stark tension between territorial governance tasks and profit maximization goals, and as a result were short lived. The sectoral studies highlight the centrality of company law considerations and devices in organizing capital exports and in the rise of different models of multinationals.

Regionally, companies that did their business within the Empire, irrespectively of their place of incorporation and listing, enjoyed the defense of the Empire, the uniformity of the Sterling Zone, the free access to markets without tariffs, and the reliable commitment of colonial government throughout the Empire not to expropriate. Companies active in the informal Empire in Latin America, China and the Middle East, could utilize the dependency in their capital investment and sovereign loans, coordination among themselves and active political lobby on foreign government, international law and arbitration, reputational mechanisms, and in worst case scenarios to be saved by the British Empire from foreign governments by threating with or exercising the gunboat policy. On the other hand, Britain could not resort to gunboat policy against the US after 1812. The huge British investments in the US, particularly in railways, had to protect themselves legally within the American constitutional, corporate and bankruptcy legal

order, and to rely investment banks such as JS Morgan that bridged between the London Stock Exchange and the American railroad companies.

The expansion of company law to the Empire and beyond it, and the globalization of the economy in the closing decades of the 19th century dramatically change the environment in which business corporations functioned. This change opened up the opportunity for business corporations to evade and escape state control. Corporations used this opportunity pragmatically, relying on the British Empire when needed and evading it when it limited them.

Empire Ltd.: *Law and the Rise of Multinationals in the First Era of Globalization (1844-1914)*

Book Chapters Outline

Introduction

1) The Shift from the Chartering Era to the Free Incorporation Era in Britain
2) Globalization: Imperial Expansion, Immigration, Capital flows and Companies
3) Company Law Goes Global: Imperial Policy
4) Company Law Goes Global: Implementation in the Colonies
5) Trade Companies – Intergenerational Transfer
6) Managing Agencies, Tea Plantations and Company Law
7) Railway Companies – Expropriation Risk and Investor Protection
8) Submarine Telegraph Companies – Technological Risks and Asset Partitioning
9) Colonial Companies – The Tension between Territorial Governance and Profit Maximization
10) Law for the Informal Empire – The case of Hong Kong, Shanghai, and China

11) Which law? Which court? The Foundation of Private International Company Law

12) The city of London as a hub: Company Promoters, Solicitors, Brokers, Bankers, Accountants

Conclusion