Wall Street’s First Corporate Governance Crisis: The Conspiracy Trials of 1826

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Abstract: In July of 1826, several prominent Wall Street firms abruptly went bankrupt, amid scandalous revelations of fraudulent financial practices by their management. The directors of many of these companies, mostly insurance firms, were indicted by the District Attorney of New York for criminal conspiracy, and their subsequent trials captivated the attention of the city for months. These events represented a watershed in the early development of the corporation laws and investor protections governing Wall Street: in the aftermath of the scandals, New York State enacted an extensive package of legislation designed to protect the interests of investors. This paper analyzes the fraudulent practices of the firms that failed, and the evolution of the law in response. The analysis highlights the critical role played by scandal-driven legislation in developing effective investor protections, and improving the governance institutions of corporations.

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The month of July, 1826 was a traumatic one on Wall Street. After several years of great prosperity, with many innovative new companies listed on the New York Stock & Exchange Board, and rapid increases in stock prices, the market began to contract in late 1825, and in the following July, six (of 67) listed companies failed suddenly, and several prominent banks had to suspend payment on their notes. Eventually, a total of 18 companies would fail or be shut down; these firms collectively defaulted on more than $2 million worth of notes, and had paid-in capital totalling more than $4.4 million.\textsuperscript{1} As rumors of failures spread, the offices of the companies on Wall Street were besieged by “immense crowds” of angry investors, in scenes that were likened to an “eruption of a volcano.”\textsuperscript{2} To the city’s financial community, the failure of so many firms was a problem, but the revelations of the practices that led to the failures were a momentous scandal, and threatened to erode confidence in the markets, and in the governance of all financial corporations. Newspaper editorialists wrote of an “extensive, bold, well-combined, and far reaching system of deception” among many companies, and cried out for criminal investigations to “guard the victims of the frauds from further depredations,” and “clear away the feculence of Wall Street.”\textsuperscript{3} In response, the District Attorney of New York City obtained a series of criminal indictments against the directors of many failed companies, and the subsequent trials captivated the attention of the city for months.

But these prosecutions were mostly unsuccessful, and in general the scandals of 1826 confronted the political leadership of the State of New York with the realization that the laws and institutions in place to protect the stockholders of corporations were no match for the practices developed by some of the more aggressive financial firms. In the early decades of the nineteenth century, New York City developed into the nation’s preeminent financial center. Yet the state had no financial reporting requirements for corporations, and offered relatively few legal safeguards for investors. Many of the fraudulent manipulations at the center of the scandals apparently violated no law, and moreover, established legal doctrines did not permit the District Attorney to use the state’s chancery courts to intervene in the internal affairs of corporations in order to protect investors.\textsuperscript{4} One might term the events of 1826 a “corporate governance crisis,” not unlike the one that occurred 175 years later with the revelations of fraud at Enron and Worldcom. And just as that modern scandal provoked the passage of the Sarbanes-Oxley act, in response to the scandals of 1826 the state of New York implemented an extensive series of changes to its corporation laws designed to safeguard the

\textsuperscript{1}The market capitalization of equity shares traded the stock market at its peak in 1825 was less than $40 million.  
\textsuperscript{2}New York Commercial Advertiser, 18 and 19 July, 1826  
\textsuperscript{3}New-York American, 14 August 1826, and Evening Post, 25 July 1826.  
interests of investors and creditors. In particular, the state adopted a sweeping package of legislation designed to improve the governance of corporations by prohibiting the manipulations brought to light in the scandals, and introducing financial reporting requirements, accounting standards, rules governing the election of directors and the acceptable forms for capital contributions, and new legal responsibilities for directors. In addition, the jurisdiction of the court of chancery was changed by statute so that the District Attorney could file bills in equity against malfeasant directors.

The statutory reforms enacted by New York in the wake of the scandals of 1826 illustrate the process by which corporation law evolved in the early-nineteenth-century United States. In contrast to other areas of the law, the United States did not inherit from England a well-developed set of common-law precedents relating to business corporations.\footnote{Dodd (1954). As many have pointed out, a striking illustration of this is found in an early and important English volume on corporation law, Kyd’s *Treatise on the Law of Corporations*, which is concerned almost exclusively with charitable and municipal corporations (Kyd 1793).} American state governments, who chartered business corporations at rates never before seen, actively regulated the enterprises they created, and rather than deferring to common-law rules, frequently specified the rights of investors and creditors in statutes.\footnote{Kent’s *Commentaries* note that “we are multiplying in this country, to an unparalleled extent, the institution of corporations, and giving them a flexibility and variety of purpose unknown to the Roman or the English law” (Kent 1826: II, 227). Histories of the business corporation in particular states, which include works analyzing those of Massachusetts (Dodd, 1954), Maryland (Blandi, 1934), New Jersey (Cadman, 1949) and New York (Seavoy, 1982), illustrate the active role played by state governments in the evolution of corporation law.} As Angell and Ames noted in 1832, “the statute books of many states will show that an opinion has strongly and extensively prevailed that the common law relative to commercial corporations is not adequate to their proper regulation and government.”\footnote{p. 357. Angell and Ames’s volume was the first American treatise on the law of corporations. Lamoreaux and Rosenthal (2005) also emphasize the important role of statute law for business enterprises within the American legal system.}

As the number of American business corporations expanded and the courts adjudicated disputes over their powers and governance, an indigenous case law did of course develop. But in many important respects, corporation law was statute law, and the scandals of 1826 provoked a major step in its evolution.

This paper tells the story of what became known as the “conspiracy trials” of 1826, and the legal reforms that followed. Drawing from a wide range of manuscript records from New York’s early corporations and from the criminal and civil litigation that ensued, I analyze the fraudulent practices at the center of the scandals, and identify the weaknesses and gray areas in early corporation law that were exploited in some firms. I then present a brief account of the criminal prosecutions of the directors of the firms that failed, and of the statutory reforms implemented by
the state in an attempt to better protect the interests of investors, and strengthen the governance of corporations.

The analysis of the scandals suggests that the directors of some early companies managed their firms’ operations with little regard for the interests of the other stockholders, in part because existing corporation law presented few obstacles to doing so. Most firms were not required to produce financial statements of any kind; there were no rules regulating self-dealing, and directors frequently loaned themselves substantial portions of their firms’ capital stock; and weak standards governing capital contributions and the conduct of elections of directors enabled some directors to insulate themselves from the votes of the other stockholders, without actually owning much of the stock. The governance of some early firms thus suffered from an acute form of a problem familiar in some countries today: the control rights of directors often substantially exceeded their cash-flow rights.\(^8\) Unaccountable to the other stockholders, some directors made extraordinarily risky investments with their firms’ capital in the speculative frenzy that prevailed in New York 1824 and 1825, acquiring large numbers of companies, and borrowing spectacular sums. And when they suffered losses in a market downturn that began in late 1825, they engaged in fraudulent transactions intended to help prop up their firms, which magnified the losses suffered by investors when the firms finally failed. A simple empirical analysis of New York’s publicly-traded corporations shows that the difference between the control rights and cash-flow rights held by directors was often quite large, and was strongly correlated with firm failure.

The contributions of this paper are twofold. First, it presents an analysis of the early evolution of American corporation law, including the case law and statute law. Considerable recent research has focused on the historical legal origins of contemporary investor protections, and in particular, common law systems have been shown to provide stronger protections of creditors and investors (LaPorta, et al., 1998; 2007) and lower degrees of procedural formality and greater degrees of flexibility and adaptability (Djankov, et al., 2003; Beck et al., 2003). But in the very early nineteenth century, complaints that American common-law courts required an onerous degree of procedural formality were quite common (see, for example, Sedgwick, 1822, and Sampson, 1826), and moreover, investors and creditors enjoyed few of the rights they have today. The literature on legal origins has not attempted to address the question of how contemporary common-law systems

\(^8\)See, for example, LaPorta et al (1999). The significance of this problem was first observed by Berle and Means (1932), who called it the “separation of ownership from control.” Hilt (2008) analyzes the provisions in some early charters designed to address these problems.
evolved over their very long history into their present form, with characteristics so salutary for investors. This paper contributes to this literature by analyzing an important moment in the development of investor protections in a common-law jurisdiction, and in particular examines the forces driving changes in the law.

Secondly, this paper presents a detailed portrait of an important early financial crisis. In some respects, the events of 1826 resemble those of many historical financial crises, as cataloged in Kindleberger (1996): a period of low interest rates and abundant credit helped fuel a speculative “mania,” in this case in the shares of new financial companies, which presented opportunities for “swindles.” But what makes this episode unique and important is its lasting impact on the development of investor protections and corporation laws governing Wall Street—the laws of New York. Moreover, although the early history of America’s banks and financial markets is well documented, the events of 1826 have not been the focus of much scholarly research. The documents from the criminal trials and civil litigation analyzed in this paper provide a unique window into the financial transactions undertaken by the companies affected by the scandal, and present a picture of surprising sophistication and complexity, and, in some cases, breathtaking audacity.

The paper begins with an analysis of the state of corporation law in New York prior to the scandals. This is followed in section two with a description of the stock market’s rapid increase and subsequent decline in value in the 1824-26. Section three presents an outline of the history of the new generation of companies that emerged in the 1820s and the financial practices they employed, and section four presents a simple quantitative analysis of the determinants of the failures. Section five describes the efforts of the District Attorney to prosecute the directors of the fraudulent companies, and the criminal trials conducted in 1826-27. Section six presents a discussion of the evolution of the law following the scandal, in the form of new legislation created by the state legislature, and also new legal precedents emerging from the courts.

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9. One important exception is Pistor, et al. (2002), who make a comparative study of the evolution of the rights of investors and creditors across legal systems. Other work, such as Lamoreaux and Rosenthal (2005), has contested the superiority of common-law systems for business, while Musacchio (2008) questions the role of legal systems in determining financial market development. LaPorta et al (2007) survey the literature on legal origins.


11. See, for example, Bodenhorn (2003), Rousseau and Sylla (2005), Werner and Smith (1991), and Wright (2002).
1 New York corporation laws prior to 1826

In the first decades of the nineteenth century, American corporation law was still in its infancy, with relatively little case law relating to matters such as the rights of minority shareholders or the conduct of elections of directors, and little statute law as well. Nonetheless, the American states made heavy use of the corporate form in the first decades of the nineteenth century. By 1830, thousands of businesses been granted corporate charters by the American states, and especially beginning in the 1820s, a small but growing number of these firms had publicly-traded equity shares (Rousseau and Sylla, 2005).\textsuperscript{12}

The growing use of the corporate form was particularly pronounced in New York; during the years from 1790 to 1830, New York chartered more business corporations than any other state. The cumulative total of New York incorporations over this period is illustrated in the left panel of figure 1. The state went from having only one bank, one manufacturing corporation, and no insurance corporations in 1791 to having granted more than 1,000 charters to businesses in 1830, including 150 banks and insurance companies, which were known as “moneyed incorporations.” The right panel of the figure illustrates the annual number of incorporations in banking and insurance over the period, which increased following the expiration of the charter of the Bank of the United States in 1811, and then dropped significantly following the panic of 1819. In spite of efforts to curtail the rate at which corporations were created, including a provision inserted into the state’s constitution requiring a two-thirds majority for the passage of any corporate charter, the 1820s saw a dramatic resurgence in these moneyed incorporations.\textsuperscript{13} In response to a surge in demand for charters with financial powers, New York’s legislature granted an unprecedented 25 in 1825.\textsuperscript{14} Note also the collapse in 1826 and 1827, in response to the scandals.

By modern standards, the rights of stockholders in the early 1820s were quite weak. There were no financial reporting requirements, listing requirements, or statutes regulating issuers of publicly-traded securities, and there were relatively few statutes that regulated the relationships between corporations and their investors.\textsuperscript{15} In general, the state legislature had been reluctant to

\textsuperscript{12}The total number of business incorporations in the United States for any year after 1800 is not known, but the data in Davis (1917), Evans, (1948) and Kessler (1948) indicate that well in excess of two thousand businesses were chartered prior to 1826 in the large but incomplete group of states covered by those volumes.

\textsuperscript{13}Article 7, section 9 of the New York Constitution of 1821 imposes the two-thirds requirement for charters.

\textsuperscript{14}The legislature was then under the control of the “People’s Party,” whose backers included many businessmen hoping for corporate charters. Opponents of the People’s Party claimed that it sent “a body of men unaccustomed to legislation, and filled with crude and speculative schemes” into office after winning the election of 1824 (\textit{New-York Enquirer}, 6 November 1826).

\textsuperscript{15}It should be noted that, like most states, New York actively regulated securities trading and attempted to curb
Figure 1:
Incorporations of Businesses in New York, 1790-1830

Cumulative Number of Incorporations

Banking and Insurance

Annual Incorporations, Banking and Insurance

Source: Author’s calculations from New York Laws, 1790-1830, and New York Comptroller’s records, New York State Archives. New York granted one corporate charter prior to 1790, to the Bank of North America (1782), but the bank never operated under that charter.
intervene in the internal affairs of corporations, and much of the legislation proposed to protect stockholders over the years was rejected on this basis.\textsuperscript{16} In this era of “special charters” granted to corporations, whatever protections were available to shareholders were mostly those specified in the charters themselves.\textsuperscript{17} And very few of these charters required the production of regular financial statements, or imposed any meaningful limitations on the ability of directors to utilize their firms’ resources for their own benefit.\textsuperscript{18}

In general, the legislature regulated corporations only on the most politically sensitive matters, and the enforcement of these regulations proved difficult. For example, in 1804 New York passed the first of a series of “restraining statutes” that prohibited all businesses except the handful of chartered banks in the state from engaging in banking or issuing banknotes or other note-like instruments such as post-notes or bonds.\textsuperscript{19} There were no administrative agencies charged with monitoring compliance with these laws; instead the Banking Committee of the New York Senate from time to time investigated reports of violations, and referred them to the Attorney General. But the Attorney General’s attempts to enforce the statute by filing a bill in equity against violators were rejected by the Chancellor, who held that courts of equity had no visitatorial jurisdiction over business corporations—that is, the chancery court had no right to intervene in the internal affairs of business corporations on behalf of the state.\textsuperscript{20} Finally, the Attorney General did successfully enforce the law by bringing a quo warranto proceeding against the violator in the supreme court.\textsuperscript{21} Stockholders seeking to protect their interests through litigation faced similar problems. In particular, the question of whether shareholders could sue directors for breach of their fiduciary duties was unresolved at the time; no court of equity prior to 1830 applied the

\begin{itemize}
  \item \textsuperscript{16}For example, a proposal in early 1826 to grant investors holding at least 1% of a corporation’s shares the right to fully inspect all the books and property of that business, and to make hypothecated stock ineligible to vote, was rejected in the Assembly, 60 to 26, as one legislator remarked that “it was as well to let the Wall-street folks shave in their own way, without legislative interference.” New York Commercial Advertiser, 15 February 1826.
  \item \textsuperscript{17}Hilt (2008) presents a detailed examination of the contents of New York’s charters.
  \item \textsuperscript{18}Hilt (2008) documents that only 15% of New York’s corporations chartered prior to 1826 were required to produce annual financial statements.
  \item \textsuperscript{19}New York Laws, 1804, ch. 117. The act was clarified and strengthened in 1813, and then again in 1818, in response to violations.
  \item \textsuperscript{20}Attorney General v. Utica Insurance Co., 2 Johns. Ch. Rep. 371 (N.Y. 1817). The advantage of filing a bill in equity was that the chancellor could issue an injunction against the violators; law courts do not have the power to issue injunctions. For a historical discussion of the issue of visitatorial powers over business corporations, see Bloch and Lamoreaux (2006).
  \item \textsuperscript{21}People ex rel Attorney General v. Utica Insurance, 15 Johns. 358 (NY Sup Ct. 1818). Quo warranto means ‘by what warrant’ and is a prerogative writ that challenges the authority of, in this case, a corporation to perform an action it has taken.
\end{itemize}
principles of fiduciary law to the directors of business corporations (Dodd, 1954)\textsuperscript{22}.

2 The speculative mania of 1824-25

The boom in American securities markets in the mid-1820s was at least partially stimulated by events in Britain, where the years 1824 and 1825 witnessed feverish speculation in the shares of new companies. With low interest rates and abundant credit, British investors sought higher returns first in the sovereign debt securities of the newly-independent nations of South America, then in the shares of mining companies in those countries, and eventually in the shares of new British companies. Following the spectacular appreciation of the shares of the newly-listed “Alliance British & Foreign Life & Fire Insurance Company” in March 1824\textsuperscript{23}, British promoters launched hundreds of new companies, often of dubious prospects—“bubble schemes came out in shoals like herring from the Polar Seas.”\textsuperscript{24} In total, some 624 new companies were launched in 1824 and 1825.\textsuperscript{25}

During these years, conditions in the United States, and in particular in New York, resembled those prevailing in Britain. After experiencing a traumatic banking crisis in 1819, the early 1820s saw interest rates fall to historically low levels in the United States\textsuperscript{26}, and a rage for shares in new companies, particularly those with financial powers, swept over Wall Street. The early months of 1825 saw the peak of the mania, as the subscription books for the “New York Water Works,” a firm with no prospects for profits other than a plan to lobby the legislature to obtain banking powers in the future, received orders totalling more than nine million dollars, when the capital stock of the firm was limited to one and a half million.\textsuperscript{27} The demand for new issues was so intense that riots broke out in front of subscription offices, as investors scrambled to add their names.\textsuperscript{28}

Noting the credulous attitudes of investors toward the new companies, \textit{Niles’ Register} observed:

\begin{itemize}
  \item It is strange that no sort of madness can break out in England, without affecting us in the United States. At one time we have the mania, in the shape of mite societies or
\end{itemize}

\textsuperscript{22}It should be noted, however, that the Chancellor’s 1817 decision in the Utica Insurance case seemed to state that fiduciary law did indeed apply to business corporations.

\textsuperscript{23}Hunt (1936: p. 32).

\textsuperscript{24}Letter to \textit{The Times}, 20 April 1826, quoted in Hunt (1936: p. 30). The British speculative mania of 1825 is mentioned by Kindleberger (1996), and analyzed in great detail by Hunt (1936).

\textsuperscript{25}Tabulations of the companies created in England during these years are presented in English (1827).

\textsuperscript{26}On the panic of 1819, see Rothbard (1956). Homer and Sylla (1996) document that yields on federal government debt fell from 5.9\% in 1819 to 4.25\% in 1824.

\textsuperscript{27}\textit{Niles’ Register}, 22 April 1825. Niles also reports that the New York Dry Dock company received subscriptions for more than 2 million dollars, when their capital was limited to $700,000 (4 June 1825), and the Commercial Bank of Albany received subscriptions of $1,500,000 for its $300,000 in shares (11 June 1825).

\textsuperscript{28}\textit{Niles’ Register}, 7 May 1825.
tread mills ... Now we have it in stock companies. *There will be a smash*—equal to that caused by the blowing up of the banks some time ago. We are grossly abusing the prosperity we have.  

The predicted “smash” did indeed arrive, first in England. In November 1825, some of their newly-formed companies collapsed as large numbers of their investors were unable to pay the calls required of their subscriptions, and in December, several private banks failed, triggering a general collapse in English share prices, and ultimately a deep financial crisis.  

With many American merchants and banks, especially those in New York, maintaining close financial ties to their counterparts in Britain, the panic there created tighter monetary conditions here in late 1825 and early 1826.

A further mechanism through which the financial crisis was transmitted to New York was through cotton prices. In the first two decades of the nineteenth century, New York merchants attained a central role in the cotton export business, providing large advances to planters (via their factors in cotton ports), shipping cotton bales to New York, and selling the product, America’s largest export, to merchants in Britain. In late 1824, the stock of cotton held in Liverpool was much lower than usual, causing prices to rise quickly, and several British merchants sought to purchase enormous quantities in American ports, causing prices to rise still further, and resulting in an “orgy in cotton speculation” in New York and Liverpool. In April of 1825, the price of cotton in Liverpool began to fall, and the large quantities of cotton arriving there from American ports and from Brazil pushed it down further. By the end of the summer, cotton prices fell to their 1824 levels, and they continued to decline in 1826. The scale of this boom and subsequent bust is perhaps best seen in the volume of exports of domestic goods from New York port, which rose from $13 million in 1824 to $20 million in 1825, and then fell again to $11 million in 1826. In late 1825, merchants on both sides of the Atlantic who had provided advances or purchased cotton at the peak of the market were ruined, and as one of the directors of the New York branch of the Bank of the United States noted, “many who have not had any thing to do with Cotton, are brought to the verge of ruin by the purchase of bills drawn by Cotton shippers.”

There was no generalized banking or financial panic in the United States, however, at least in part because the Bank of the United States worked assiduously with its New York branch to

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29 May, 1825. Italics in original.
30 On the consequences of the panic and the reforms implemented in the English financial system, see Neal (1998).
31 See Albion (1939), and Chandler (1977, ch. 1).
32 Albion (1939: p. 114).
33 Albion (1939). These figures exclude re-exports of foreign goods, which total about $10 million per year during each of those years.
34 Robert Lenox to Nicholas Biddle, 9 November 1825 (Nicholas Biddle Papers.)
Figure 2: Total Market Capitalization
Publicly-Traded New York Corporations, 1817-1830

Note: Quarterly data for the total market value (number of paid-in shares times market price per share) for all New York corporations traded on the New York Stock & Exchange Board. The figure therefore excludes public debt issues and the occasional out-of-state corporation that traded on the Board. Moreover, only the 67 corporations where transactions were recorded in at least two quarters were included in the figure. As many shares traded somewhat infrequently, the average value over each quarter is used (rather than end-of-quarter data, which would be frequently missing for many companies.) The number of paid-in shares is taken from the Records of the New York Comptroller, New York State Archives, Albany NY. The par value of the shares is from the corporate charters, in New York’s Laws, 1790-1830. Finally, the market prices, expressed as a percentage of par value, are from Sylla, Wilson and Wright (2005).

provide credit to the banking community there.\textsuperscript{35} Although some small country banks in upstate New York, New Jersey, and Connecticut either failed or suspended payment on their notes in late 1825,\textsuperscript{36} in general New York’s banking system withstood the pressures of that year reasonably well. The tighter financial conditions in New York did, however, end the period of “wild and exaggerated speculation”\textsuperscript{37} in New York’s financial markets, which had further repercussions.

Figure 2 illustrates the value of equity shares traded on the New York Stock & Exchange Board

\textsuperscript{35}The correspondence between Nicholas Biddle and Robert Lenox throughout 1825 reveals that Biddle monitored financial conditions in New York quite carefully, and in response to the pressure from Britain shifted resources to the New York branch, and increased the bank’s loans in that city. See, for example, correspondence with Lenox on 7 December, 8 December, and 23 December, 1825 (Nicholas Biddle Papers.) Biddle maintained later that his actions saved the nation from serious losses; see Catterall (1903). The \textit{New York American} commended the Bank of the U.S. for its conduct during the crisis (27 October 1826).

\textsuperscript{36}\textit{Niles’ Register} mentions the failure of the Eagle Bank of New Haven in October, 1825, the Lombard and Derby banks of New Jersey in November, and the Banks of Niagara and Plattsburg in December.

\textsuperscript{37}This is the characterization of Nicholas Biddle. Biddle to Isaac Lawrence, 12 May 1825 (Nicholas Biddle Papers).
(NYS&EB) from 1817-1830. In the figure, the value of the shares increases dramatically from early 1824 through mid-1825, rising 60% over this period. This increase in share values was driven almost entirely by the addition of new companies to the market (and the rising value of those new companies’ shares), rather than through appreciations of the values of existing companies; as the dashed line in the figure makes clear, the collective value of companies chartered prior to 1823 rose very little over the period (about 8%). The figure then shows a consistent fall in market values after its mid-1825 peak that continues through 1829; in the four year period beginning with the third quarter of 1825, the market fell a total of 30% relative to its peak value. As the fall in the dashed line makes clear, all companies, including the more conservative firms chartered well before 1823, lost value between 1825-29; a “bear market” for stocks seems to have emerged. In the years 1826-29, the stocks of a total of 18 firms disappeared from the market, usually because of financial difficulties.

What went wrong with these new firms? Many of them were created by a new generation of entrepreneurs, who Hammond (1957) refers to “Jacksonian business men,” who had little patience for the conservative practices of the old Wall Street banks and insurance companies, and, imbued with a passion to get rich quickly, pursued their ventures with boldness, creativity, and strategies that often crossed the line into fraud. Their “new-fashioned” enterprises were quite different from their predecessors’, especially in the aggressiveness of their financing arrangements. The next section describes some of the most important strategies employed by these men.

3 The frauds and the failures

The Jacksonian entrepreneurs who managed many of the companies that eventually failed exploited the weak legal environment of the time to obtain control over new enterprizes with relatively little capital, and then use the firms’ resources for their own benefit, “against the actual wishes and interest of the honest stockholders.” In some cases, a controlling stake in a firm was obtained at its founding, by subscribing for a large block of shares, and borrowing (using securities as collateral) to pay for that block. Alternatively, groups of investors, known at the time as “associations” or

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38It should be noted that the specific circumstances behind the halt in the trading of a few of these 18 companies can not be determined. Most of them went bankrupt, but in a few cases detailed information about the fate of the firms could not be obtained, and it is at least possible that the stockholders may have voted to shut down their firms due to poor performance, a circumstance somewhat different from a bankruptcy.

39Niles' Register, 7 July 1826.

40Comments in the New York Assembly in support of legislation curtailing the ability of speculators to control companies in this way, as reported in the Commercial Advertiser, 15 February 1826.
“confederacies” would use the resources of the firms they controlled to gain control of additional companies, by using the capital in their firms to acquire controlling stakes in additional firms. In either case, once control was attained, the investors could use their power over the firm’s resources to loan themselves the cost of the acquisition, and thereby repay any loans used to finance the acquisition initially. Thus, the controlling shareholders would end up deeply indebted to their own firms, but because they held control they could dictate the terms of these loans, and avoid repaying them. In some cases, these loans were ultimately repaid by returning substantial portions of the shares to the company, effectively making them treasury shares. But given the lax standards by which director elections were conducted, the directors often continued to vote these shares, and so maintained their control over the firm.\footnote{Voting such shares was later held to be illegal (Ex parte \textit{Holmes} 5 Cow 426 (NY Sup. Ct. 1826)), but this practice seems to have been common nonetheless.}

Once they attained control of a firm with at least a tenuous legal claim to financial powers, these investors would often issue bank-note-like securities, as a means of granting high-interest loans. These securities, referred to at the time as “bonds,” are more accurately described as post-notes, and were designed to circulate like bank notes. In the process, and extremely high degree of leverage was obtained, and the firms were rendered quite vulnerable.

### 3.1 Acquiring control, and issuing post notes

The brief existences of the Hudson Insurance Company and the United States Lombard Association illustrates these patterns. The U.S. Lombard Association was incorporated in 1825. Its charter authorized the firm to make loans on goods or other personal property as collateral, and its $300,000 capital stock was quickly oversubscribed when it was offered in May, 1825. The act incorporating the Hudson Insurance Company had been passed by the legislature back in 1811, but the firm had never been brought into operation.\footnote{New York \textit{Laws}, 1811, ch. 154.} However, the charter contained a little-noticed but extremely valuable clause granting the firm financial powers normally reserved for banks or loan companies, and a group of entrepreneurs purchased the charter from the original incorporators and opened subscriptions for the firm’s $200,000 capital stock in April of 1825, which were immediately filled. The two firms had many founders and directors in common, and their finances were intimately connected.\footnote{The stockholder list of the Hudson Insurance Company shows that four of its 13 directors were also directors of U.S. Lombard, and in particular George Brown, president of U.S. Lombard, held 30\% of the shares. (Manuscript stockholder list, New York State Archives, Albany NY).}
The way that the founders of the firms acquired control over their operations was quite typical. The founders subscribed for controlling blocks of the stock of each company, intending to borrow from the companies the amount due for their subscriptions once control was attained, using the shares as collateral. But in April of 1825, in response to reports of financial abuses, New York passed a statute prohibiting the practice of accepting I.O.U.’s for payments for stock subscriptions.\textsuperscript{44} So instead, the founders of Hudson and Lombard simply used the shares they subscribed for in one company as collateral for a loan \textit{from the other}, taking advantage of their control over the finances of both institutions. After completing these transactions, large blocks of shares in both companies stood in their names, and in the extremely lax rules governing elections of directors at the time, they could vote those shares. With controlling blocks in both enterprises, the founders were then able to vote themselves in as directors, and operate the companies.

Although its charter authorized the Hudson to write insurance policies on lives and property, the directors never apparently bothered with the insurance business, and upon commencing operations immediately began to issue post notes. In total, the Hudson issued about \$300,000 in such notes; U.S. Lombard, about \$500,000. Unlike a bank note, which would be payable on demand, a post note was payable only at some future date. The transaction in which a note was issued would be conducted in the following manner: the borrower offered to the company his note (I.O.U.), payable in six months, for, say \$1,000, and received in exchange the company’s post note, which obligated the company to pay a sum equal to that promised in the note, minus a discount, in this case \$35, also in six months.\textsuperscript{45} The borrower then sold the post note in the money market, and effectively obtained a loan of whatever amount he received for the note. Then after six months, the borrower’s I.O.U. came due, and he was obligated to pay the issuing company \$1,000.

In issuing post notes in this manner, the company would effectively bear the credit risk of the borrower, and the holder of the post note would bear the credit risk of the issuer. The post note would come due on the same date as the borrower’s I.O.U.; if the borrower repaid the I.O.U., then the company simply used this sum to pay the amount due on the post note. But if the borrower defaulted on his I.O.U., the company would have to use its own funds. The price obtained for the note reflected the credit risk of the issuing firm, as well as the discount applied when the note was issued.

\textsuperscript{44}New York \textit{Laws}, 1825, ch. 325.
\textsuperscript{45}The details of the transactions in which post notes were issued differed somewhat across companies, depending on the financial powers stated in their charters. In some cases, prospective borrowers obtained insurance on their lives or on an I.O.U., and the insurance company would then advance the policy holder the amount of the policy, minus a discount, in post notes. Such complexities were evidently designed to conform to the limits on lending powers normally imposed in insurance company charters (\textit{New York National Advocate}, 25 January 1825).
issued to the borrower, and as a result the borrower received a loan at an extremely high rate of interest. In mid-1826, the notes of the Hudson and Lombard Association were priced to yield as much as 5% per *month*.\(^46\) Given that creditworthy borrowers could obtain loans from reputable banks at far lower rates of interest, only high-risk borrowers would seek credit on these terms. Perhaps not surprisingly, many of the I.O.U.’s and securities held by the companies as collateral for the post notes they had issued ultimately proved worthless, especially once the financial market turmoil of late 1825 and early 1826 set in. Eventually the firms became desperate for funds to meet their obligations, and began to sell post notes directly in the market to raise cash. When market conditions worsened and they became unable to raise funds in this way, the companies failed: the Lombard stopped payment on its notes on July 14, 1826, and the Hudson failed a few days later.

The consequences of these failures were immense. On the day after the U.S. Lombard failed, the *Evening Post* printed the following letter expressing the outrage of the holders of “notes, bonds, &c of the numerous new Banks, Lombards, Insurance Companies, &c.:

> Formerly the directors of a bank knew no other duty than to facilitate the business transactions of the city, when they could do so with perfect safety. They were stockholders and the servants of stockholders, and they were responsible to them. Now a-days, it would seem the object in getting up a bank, is to swindle the public. The first object of the directors is to get possession and control of all the funds (if any are actually paid in). The next is to manufacture an immense amount of notes, bonds, &c. duly engraved and handsomely filled up. And with these they and their retinue of Brokers will come into the market, and buy up no matter what...After emitting some hundreds of thousands in this way & some begin to fall due and they shin it for a few days, down comes the gilt sign—can’t shin it in dog days—and when the poor hard working mechanic applies for the cash for one of their notes or bonds with which he has tried, in vain, to buy a breakfast for his hungry children, he is answered forsooth, “we are incorporated!!”\(^47\)

The author’s rhetorical flourish of mentioning “hungry children” seems a bit exaggerated—most of the notes issued by U.S. Lombard, Hudson Insurance, and other companies managed in the same way were in relatively large denominations, and purchased by investors hoping to earn the extremely high rates of return they paid.\(^48\) Nonetheless, the losses experienced by the holders of the notes were undoubtedly quite large.

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\(^{46}\)Yields on such notes were rarely reported in the press, but some reports stated that 2% per month was typical (*New York National Advocate*, 25 January 1825), and during the turmoil of mid-1826, yields reached as much 4½% per month or more (*New York Enquirer*, 10 July 1826).

\(^{47}\)15 July, 1826. The letter was signed “MANY MECHANICS.”

\(^{48}\)The *Evening Post* wrote that “most if not all the bonds are held by speculators, and by those who have made loans to them at enormous rates of interest” (25 July 1826).
During the 15 months in which these two “money-manufacturing establishments”\textsuperscript{49} existed, neither ever produced a financial statement for its stockholders. The resources and borrowing capacities of the two companies were used to support each other, and artificially inflate the value of the firms’ securities. For example, much of the funds raised from the installments paid on U.S. Lombard’s stock were loaned to Hudson Insurance (with no security given), and U.S. Lombard frequently made loans on Hudson Insurance post notes. When the holders of the notes questioned management about their value, the directors of Hudson Insurance could, for example, show that the firm was holding large quantities of “unquestionable good securities”—U.S. Lombard stock, whose price remained near par on the NYS&EB throughout 1825.

3.2 Control over large numbers of firms

The financial manipulations made possible by the control of multiple corporations, coupled with the issuance of large amounts of bonds or notes, were used to much greater effect by groups of investors, who took control of larger numbers of companies. One such group, led by Ferris Pell, William Israel, and Thomas L. Smith, gained control or at least substantial influence within several large corporations: Greenwich Fire Insurance, Sun Fire Insurance, Niagara Insurance, New York Lafayette Fire Insurance the New York Coal Company, and the Jersey Bank.\textsuperscript{50} With the exception of the Jersey Bank, all of these companies were chartered in 1824 and 1825, and the group was among the founding shareholders of each. The group opened an office of discount for the Jersey Bank inside New York City (in violation of New York’s restraining statute) and used the power of the bank to issue notes to help finance its acquisitions. Table 1 lists all publicly traded corporations in 1826, with the year of their charter and the amount reported as paid-in capital, for a comparative perspective.

Once they held control of these companies, however, they used their financial resources to achieve even greater ends. For example, although the New York Coal Company’s charter gave it authority only to mine and sell coal, the group used the funds of the company mainly to purchase securities in other corporations, and in early 1825 much of the remaining capital stock of the New York Coal company was used to purchase a controlling stake in City Bank, whose market value was at the time about $1.25 million. In this rather audacious transaction, they used $80,000 of N.Y. Coal’s

\textsuperscript{49}Niles’ Register, 29 July 1826.

\textsuperscript{50}Pell and his associates held directorships in all of those companies, and controlled significant blocks of votes in each (Manuscript stockholder lists, New York State Archives, Albany NY.) As it is a New Jersey corporation, no stockholder list has been found for the Jersey bank, but contemporary sources indicate they held control of the bank.
## Table 1:
Firms Traded on the NYS&EB, 1826

<table>
<thead>
<tr>
<th>Firm</th>
<th>Year of Incorporation</th>
<th>Paid-In Capital ($)</th>
<th>Failed or Shut Down (‘26-29)?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aetna Insurance</td>
<td>1824</td>
<td>200,000</td>
<td></td>
</tr>
<tr>
<td>American Insurance</td>
<td>1812</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Atlantic Insurance</td>
<td>1824</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Brooklyn Fire Insurance</td>
<td>1824</td>
<td>156,000</td>
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</tr>
<tr>
<td>Chatham Fire Insurance</td>
<td>1822</td>
<td>400,000</td>
<td></td>
</tr>
<tr>
<td>Dutchess County Insurance</td>
<td>1814</td>
<td>200,000</td>
<td>yes</td>
</tr>
<tr>
<td>Eagle Fire Insurance</td>
<td>1806</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Equitable Insurance</td>
<td>1823</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>Farmers Fire Insurance &amp; Loan</td>
<td>1822</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Franklin Fire Insurance</td>
<td>1818</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Fulton Fire Insurance</td>
<td>1819</td>
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</tr>
<tr>
<td>Greenwich Fire Insurance</td>
<td>1824</td>
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<tr>
<td>Globe Insurance</td>
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</tr>
<tr>
<td>Hope Insurance</td>
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</tr>
<tr>
<td>Howard Insurance</td>
<td>1825</td>
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<td></td>
</tr>
<tr>
<td>Hudson Insurance</td>
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</tr>
<tr>
<td>Jefferson Insurance</td>
<td>1824</td>
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<td></td>
</tr>
<tr>
<td>Lafayette Insurance</td>
<td>1825</td>
<td>–</td>
<td></td>
</tr>
<tr>
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<td>1822</td>
<td>600,000</td>
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</tr>
<tr>
<td>Manhattan Fire Insurance</td>
<td>1821</td>
<td>250,000</td>
<td></td>
</tr>
<tr>
<td>Mechanics Fire Insurance</td>
<td>1819</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Mercantile Insurance</td>
<td>1818</td>
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<td></td>
</tr>
<tr>
<td>Merchants Fire Insurance</td>
<td>1819</td>
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<td></td>
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<tr>
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<td></td>
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<td>New York Contributionship Insurance</td>
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<td></td>
</tr>
<tr>
<td>New York Insurance</td>
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<tr>
<td>New York La Fayette Fire Insurance</td>
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<tr>
<td>Niagara Insurance</td>
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<tr>
<td>North River Insurance</td>
<td>1822</td>
<td>350,000</td>
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</tr>
<tr>
<td>Ocean Insurance</td>
<td>1810</td>
<td>350,000</td>
<td></td>
</tr>
<tr>
<td>Orange Fire Insurance</td>
<td>1819</td>
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</tr>
<tr>
<td>Pacific Insurance</td>
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<td>400,000</td>
<td></td>
</tr>
<tr>
<td>Phoenix Fire Insurance</td>
<td>1823</td>
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<td></td>
</tr>
<tr>
<td>Protection Fire Insurance</td>
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<tr>
<td>Sun Fire Insurance</td>
<td>1824</td>
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</tr>
<tr>
<td>Traders Insurance</td>
<td>1825</td>
<td>250,000</td>
<td></td>
</tr>
<tr>
<td>Tradesmere Insurance</td>
<td>1825</td>
<td>200,000</td>
<td></td>
</tr>
<tr>
<td>Union Insurance</td>
<td>1818</td>
<td>400,000</td>
<td></td>
</tr>
<tr>
<td>United States Fire Insurance</td>
<td>1824</td>
<td>263,000</td>
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</tr>
<tr>
<td>Washington Insurance</td>
<td>1814</td>
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</tr>
<tr>
<td>Western Insurance</td>
<td>1817</td>
<td>230,836</td>
<td>yes</td>
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</table>

<table>
<thead>
<tr>
<th>Firm</th>
<th>Year of Incorporation</th>
<th>Paid-In Capital ($)</th>
<th>Failed or Shut Down (‘26-29)?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks, and Firms with Banking Powers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank of America</td>
<td>1812</td>
<td>2,049,000</td>
<td></td>
</tr>
<tr>
<td>Bank of New York</td>
<td>1791</td>
<td>1,000,000</td>
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</tr>
<tr>
<td>Chemical Bank</td>
<td>1824</td>
<td>414,000</td>
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<tr>
<td>City Bank</td>
<td>1812</td>
<td>1,496,250</td>
<td></td>
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<tr>
<td>Delaware &amp; Hudson Canal</td>
<td>1823</td>
<td>491,000</td>
<td></td>
</tr>
<tr>
<td>Fulton Bank</td>
<td>1824</td>
<td>554,062</td>
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</tr>
<tr>
<td>Franklin Bank</td>
<td>1818</td>
<td>500,000</td>
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</tr>
<tr>
<td>Manhattan Bank</td>
<td>1799</td>
<td>2,000,000</td>
<td></td>
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<tr>
<td>Mechanics Bank</td>
<td>1810</td>
<td>2,000,000</td>
<td></td>
</tr>
<tr>
<td>Merchants Bank</td>
<td>1805</td>
<td>1,490,000</td>
<td></td>
</tr>
<tr>
<td>New York Dry Dock</td>
<td>1825</td>
<td>700,000</td>
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</tr>
<tr>
<td>New York Loan</td>
<td>1825</td>
<td>200,000</td>
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<tr>
<td>New York Lombard</td>
<td>1824</td>
<td>200,000</td>
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<tr>
<td>New York Mount Hope Loan</td>
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<tr>
<td>North River Bank</td>
<td>1821</td>
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<td></td>
</tr>
<tr>
<td>Phoenix Bank</td>
<td>1812</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Tradesmere Bank</td>
<td>1823</td>
<td>600,000</td>
<td></td>
</tr>
<tr>
<td>Union Bank</td>
<td>1811</td>
<td>1,000,000</td>
<td></td>
</tr>
<tr>
<td>U.S. Lombard</td>
<td>1825</td>
<td>300,000</td>
<td>yes</td>
</tr>
</tbody>
</table>

| Companies in Other Industries              |                       |                    |                               |
| New York & Schuylkill Coal                | 1823                  | 314,300            |                               |
| New York Coal                             | 1824                  | 200,000            | yes                           |
| New York Gas Light                        | 1823                  | 495,000            |                               |
| New York Water Works                      | 1825                  | –                  | yes                           |

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16
capital stock, which amounted to 10% of the of the $800,000 it cost to purchase 16,000 (64%) of City Bank’s shares, and borrowed the remaining amount, using the City Bank shares as collateral. While they held this controlling stake in the firm, they voted themselves into directorships at City Bank. However, the firm’s stock rapidly lost value after they took control and they quickly had to sell their stake. The stockholders of the New York Coal Company lost $50,000 on the transaction.\textsuperscript{51}

The group led by Pell and Israel was not alone in its extensive network of acquisitions; other such groups, who were at least somewhat independent, acquired equally large numbers of firms. (The extent to which these groups acted in coordination with one another, or perhaps even represented one large group, is somewhat unclear; journalists and observers at the time described a single group of investors, but stock ownership lists and director lists seem to indicate that there were at least partially distinct groups.\textsuperscript{52}) The largest of these “combinations possessing themselves of the various banks & insurance companies,”\textsuperscript{53} led by Henry Eckford, a prominent figure in Republican politics\textsuperscript{54}, along with Thomas Vermilyea and Samuel Leggett, gained control of the Life & Fire Insurance Company, the Western Insurance Company, the Dutchess County Insurance Company, the Mercantile Insurance Company, the Morris Canal & Banking Company of New Jersey, the Franklin Bank and briefly acquired control of the Tradesmen’s Bank and the Fulton Bank. The breathtaking scale of the holdings of this group were a source of some concern on Wall Street, although the true extent of their holdings was not generally known, and the subject of many rumors. Even Nicholas Biddle, president of the Bank of the United States, began to inquire with his confidants in New York whether the stories of combinations of companies he had heard could possibly be accurate. In response to his inquiries, one of his correspondents, Campbell P. White, wrote:

\begin{quote}
there is no manner of doubt of the existence of such an association which has an accession controlling the Franklin Bank, Franklin Fire Insurance Company, City Bank, New
\end{quote}

\textsuperscript{51}Manuscript bill of complaint, 5 August 1826, Robinson v. Smith, New York County Clerk’s Office, R911. The directors’ minutes of City Bank record the presence of Smith, Pell and Israel on City Bank’s board in mid-1825 (Citigroup Archives, New York NY).
\textsuperscript{52}Mordecai M Noah, editor of the \textit{New York National Advocate} and \textit{New York Enquirer}, and outspoken critic of the financial practices they employed, referred to all of these investors collectively as the “Screw Party,” because they would “put the screws” on companies and acquire control (\textit{New York Enquirer}, 7 July 1826).
\textsuperscript{53}Nicholas Biddle to Walter Bowne, 12 July 1826 (Nicholas Biddle Papers.)
\textsuperscript{54}Eckford was a wealthy shipbuilder and a “grand sachem” in the Society of St. Tammany, the organization commonly known by the building in which it met, Tammany Hall (Myers, 1817). Eckford also published a newspaper, the \textit{New York Advocate}, which served as a mouthpiece for his political views. His political opponents in other Republican factions, notably M.M. Noah, accused him of plotting to get Adams elected in the 1824 presidential election, and thinking of Adams as “a bauble, with which he may play games” (\textit{New York National Advocate}, 14 February 1825).
York Coal Company, Life & Fire Company, Dutchess County Insurance Co., Mercantile Insurance Co., Hudson Insurance Co., Fulton Bank, Morris Canal Bank, and lastly the Tradesmen’s Bank. Changing the Presidents, Cashiers or Directors or molding them to their will: as if by the work of a magician their success which has been remarkable in accomplishing their purposes has at once increased their confidence in their power and their resources for future action, and threatens the peace and harmony of all the respectable institutions. They have certainly acquired an influence to which their wealth, talents and respectability do not entitle them. They now boast their next object is to control the Bank of the United States...  

White ascribes control of this long list of companies to a single “association” of investors, when in fact many of them were held by different groups. The possibility that the group might attempt to take over the Second Bank of the United States was repeated by several of Biddle’s confidants, although Biddle dismissed these rumors as unrealistic.  

At the center of Eckford and Vermilyea’s group’s holdings was the Life & Fire Insurance Company, which commenced operations in April, 1823, and from that time up until its failure in July 1826, the company issued $1,300,000 worth of post notes, which the group used, in part, to gain control of some of the other companies. In late 1825 or early 1826, the group aligned itself with the somewhat notorious character of Jacob Barker, also a prominent figure in Republican politics, who used his influence in several other companies to try to keep Life & Fire Insurance afloat. Life & Fire never produced any financial statements of any kind, and in fact the books of the company were never made up after the August, 1824 entries in the general ledger and journal end in that month. The clerk of the company, one Mr. Blossom, was “given to intoxication” and “unwell,” and unable to keep up the books. Nonetheless, the firm paid regular dividends of 8% per year, to avoid scrutiny by the other shareholders.

Eckford and his confederates’ control of the Life & Fire company was nearly absolute, in that all of the other directors were close associates. But their control over several of the other companies was somewhat more tenuous—in the Morris Canal and Banking Company, for example, they held three of the directorships, and control of the finance committee. But most of the other directors,  

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\(^{55}\)Campbell P. White was a prominent New York merchant who later served in the U.S. Congress. Letter to Nicholas Biddle, 13 July 1826, in Nicholas Biddle Papers.  
^{56}\)In letters to Biddle, Robert Lenox (10 July 1826) and John Potter (25 July 1826) also mention the possibility that Barker’s group might attempt to take over the Bank of the United States. To these concerns, Biddle replied “I do not think that the Bank has anything to apprehend” (14 July 1826 Nicholas Biddle Papers.)  
^{57}\)Manuscript bill of complaint, 4 August 1826, Barclay v. Eckford, New York County Clerk’s Office, BM 282-B.  
^{58}\)Barker was also a “grand sachem” of Tammany (Myers, 1917). The extent of his political influence is illustrated by the fact that he opened a private, note-issuing bank, called the Exchange Bank, in direct violation of the state’s restraining statutes, and was later granted an exception to the restraining statute. In his biography, he claims to have been instrumental in the political efforts to prevent the charter of the first Bank of the United States from being renewed (Barker, 1855).  
^{59}\)Testimony reported in Barker (1827, p. 130).
who included such prominent New Yorkers as Henry Astor (brother of John Jacob Astor) did not participate actively in the management of the firm. Their control was thus contingent on the willingness of the other directors to delegate the management of the firm to them; and they made efforts to drive away vigilant or scrupulous directors, and replace them with more passive “men of straw.”

The Eckford and Vermilyea group used the large network of companies they created to conduct numerous complex exchanges of securities, enabling them to profit personally, and also shifting resources or financial assets among the firms, as necessary. For example, Vermilyea and Barker sold large quantities of Life & Fire post notes to other insurance companies they controlled, earning substantial commissions on the sales, and shoring up the Life & Fire’s finances in the process. At the time of the failure of the Life & Fire, Franklin Insurance held $60,000 of the notes, Mercantile Insurance held $85,000, Western Insurance held $15,000, and Dutchess County Insurance held $50,000. At different times the Tradesmen’s bank held Life & Fire post notes worth $262,000, and the Morris Canal & Banking Company held $250,000 of them. The transaction by which the Morris Canal came into possession of those $250,000 in post notes was particularly complex, and became the focus of one of the later criminal trials. It illustrates the nature of the group’s control of their companies quite vividly, and is worth examining in detail.

The transaction occurred in May of 1826, when the outstanding post notes of Life & Fire that were issued in exchange for notes that proved worthless were coming due in amounts averaging about $1,000 per day. In the previous year, two close associates of Vermilyea and Eckford, Mark Spencer and George W. Brown, had subscribed for 2,000 shares of stock in the Fulton Bank (20% of the total), using notes from Spencer and Brown, with the shares of stock as collateral on the loans. Spencer and Brown were directors of the Fulton Bank, and they convinced the other board members to accept stock in the Morris Canal as payment for their shares, which could then be used by Eckford for other purposes. Figure 3 illustrates the sequence of exchanges within the transaction.

First, the Morris Canal shares had to be acquired. So Eckford ordered Life & Fire to issue a $250,000 post note—this is step (1). At the time, Life & Fire notes were close to worthless. But Vermilyea and his associates controlled the finance committee of the Morris Canal, and had

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60The testimony in the subsequent criminal trials contains accounts of directors who were “never consulted” regarding operations of the companies, “knew nothing of the books” of the companies, and simply attended brief meetings once per year (Barker 1827a, pgs. 53, 54, 86).
persuaded the president of the company to sign a series of blank stock certificates, so that shares could be issued as necessary. So Vermilyea ordered the cashier to fill out certificates for 2,500 Morris Canal shares, the value of which was $250,000, certified them as being fully paid-in, and exchanged them for the Life & Fire note. This was step (2). Vermilyea then presented the Morris Canal shares to Spencer and Brown of Fulton Bank. When the president of the Fulton Bank, Robert Cheesebrough, became aware of the form of payment made, he objected, as he knew that the stockholders of the Morris Canal had not yet paid up all of their installments. But Vermilyea later assured him that the shares had been paid in in cash. With that assurance, Cheesebrough relented, and with the 2,000 Fulton shares now accepted as paid-in, Spencer and Brown transferred them to Eckford, who in turn transferred them to Barker, who in turn transferred them to William R. Thurston, president of Mercantile Insurance. Many of these shares were then sold, and the proceeds were used to pay the creditors of Life & Fire.

Vermilyea’s group conducted a number of similarly complex transactions among the companies they controlled, one of which was used to acquire a majority stake in the Tradesmen’s bank. The funds of this bank were used to support Life & Fire Insurance, and the bank reportedly lost more than $100,000 in the process. But on July 17, 1826, a New York chancery court granted an
Table 2:
Events of July 1826

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 July</td>
<td>Jersey City Bank stops payment on its notes.</td>
</tr>
<tr>
<td>7 July</td>
<td><em>New York Enquirer</em> publishes account of fraudulent transactions be-</td>
</tr>
<tr>
<td></td>
<td>tween Fulton Bank, Morris Canal Bank, and Hudson Insurance.</td>
</tr>
<tr>
<td>8 July</td>
<td>Run on Fulton Bank.</td>
</tr>
<tr>
<td>11 July</td>
<td><em>New York Enquirer</em> publishes list of firms believed to be under con-</td>
</tr>
<tr>
<td></td>
<td>trol of groups of speculators.</td>
</tr>
<tr>
<td>14 July</td>
<td>U.S. Lombard and Franklin Manufacturing Company stop payment on</td>
</tr>
<tr>
<td></td>
<td>their post notes.</td>
</tr>
<tr>
<td>15 July</td>
<td>Hudson Insurance Company stops payment on its post notes. Several</td>
</tr>
<tr>
<td></td>
<td>Wall Street brokers fail.</td>
</tr>
<tr>
<td>17 July</td>
<td>Injunction granted against Tradesmen’s Bank; panic ensues among</td>
</tr>
<tr>
<td></td>
<td>holders of its notes.</td>
</tr>
<tr>
<td>18 July</td>
<td>Life &amp; Fire Insurance Company fails.</td>
</tr>
<tr>
<td>19 July</td>
<td>Several more brokers fail.</td>
</tr>
<tr>
<td>31 July</td>
<td>New York Mount Hope Loan Company fails</td>
</tr>
<tr>
<td>1 August</td>
<td>First suits filed against directors of many failed companies by stock-</td>
</tr>
<tr>
<td></td>
<td>holders and note holders</td>
</tr>
<tr>
<td>12 August</td>
<td>New York District Attorney obtains the first of a series of indictments</td>
</tr>
<tr>
<td></td>
<td>against the directors of the failed companies.</td>
</tr>
</tbody>
</table>

injunction against the Tradesmen’s bank sought by some of its stockholders, forcing it to cease all transactions. With its final means of support cut off, on July, 18, Life & Fire failed.

The month of July of 1826 saw a number of companies controlled by investor groups suddenly fail; most of these were firms that had issued large amounts of post notes. Table 2 presents a simple chronology of the major events of that month. The first major firm to collapse was the Jersey Bank, the bank at the center of the Pell group’s acquisitions. The next day, the *New York Enquirer*, whose publisher was a political enemy of Henry Eckford and some of the other members of the investor groups, published a detailed (but only partially complete) account of the complicated transaction between Morris Canal Bank and Fulton Bank, and that article may have precipitated the run on the bank that began the following day. Then in the following week, the *Enquirer* published a long list of all of the firms the editor believed were under the control of investor groups. It is not clear whether the article contributed meaningfully to the events that followed, but in the subsequent
days all of the other companies that had issued post notes failed. Many other firms that were
controlled by these groups remained in operation for some time, but eventually succumbed in the
months and years that followed.

4 Quantitative analysis of the failures

In total, 18 publicly-traded firms failed or were shut down in the years 1826-29, and many more
suffered heavy losses. This section presents a simple statistical analysis of the determinants of the
failures. Lists of the stockholders of 38 of the 67 New York firms whose shares were traded on
the NYS&EB were found in the New York State Archives, and these were matched to directors
lists from contemporary newspapers and directors’ minute books, which were found for 60 of the
67 firms. These data were then matched to stock price data from Sylla, Wilson and Wright
(2005). In principle, these data can be used to estimate the determinants of firm failures, or the
determinants of the price behavior of firms’ equity shares.

But early stock market data presents some challenges to the researcher attempting to use them
in this way. Figure 4 displays monthly share price data for three insurance companies known to be
connected to the investor groups, and one that was generally known not to be (New York Insurance,
chartered 1798.) The share prices of the three firms controlled by the investor groups (Life & Fire,
Western, and Protection) all decline in the second half of 1825, and in the first half of 1826. But
in April 1826, when crisis-like conditions began to prevail in the market, the shares of Western
Insurance stopped trading completely, and in July of 1826 Life & Fire’s shares stopped trading as
well. Both of these companies ultimately went bankrupt and their shares never traded again on the
exchange, but the market for their shares was so illiquid that they did not decline in value—they
simply halted trading. In contrast, shares of Protection Insurance, which was under the influence
of the Pell group, actually continued to trade. Thus, in any empirical analysis of the firms’ share
prices, some assumption about the the value of shares that halt trading needs to be used. As most
of the firms that failed resulted in near total losses for their stockholders, I will assume that the

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61 Lists of stockholders were submitted by all New York corporations to the state comptroller pursuant to its
capital tax of the 1820s. These were found in various record groups in the New York State Archives associated with
the comptroller’s office, including A0833, A0829, and A0847. The lists of directors were found by searching New
York City newspapers from the year 1826 including the *New York Evening Post*, *New York Enquirer*, *New York
American*, *Journal of Commerce*, and the *Commercial Advertiser*. These were supplemented with lists of directors
found in the minute books of corporations held a the following institutions: Citigroup Archives, New York NY; Oneida
County Historical Society, Utica NY; SUNY Albany Library, Albany NY; the New York State Historical Association,
Cooperstown NY; and the New-York Historical Society, New York NY.
market price of these shares fell to zero.\textsuperscript{62}

We can begin the analysis of these events by asking: which firms failed? In particular, was the influence or control by one of the notorious investor groups systematically related to the survival, or stock price performance, of publicly-traded firms? Although stockholder lawsuits and the subsequent criminal investigations provide very clear indications of the companies in which the investor groups engaged in the most fraudulent practices, they probably held some influence, if not control, within many other firms. So first we can ask: were the firms that contemporary journalists claimed were under the control of investor groups more likely to fail or decline in price? And, since these journalists were probably imperfectly informed about the ownership of these firms, we can use the director lists of the firms to ask whether firms with one of the notorious investor groups’ members on its board were more likely to fail or decline in price.\textsuperscript{63} The \textit{New York Enquirer}’s list mentioned 12 of the 67 publicly-traded firms, and the investor groups’s member were on the boards of 21 firms; the correlation coefficient between these two measures is 0.65.

\textsuperscript{62}The results of the regressions that follow are generally robust to the exclusion of all firms where this assumption is used. The size of the estimated effects falls, but statistical significance generally remains.

\textsuperscript{63}This variable was coded equal to one if any of the following people were listed as directors in 1826: Henry Eckford, Samuel Leggett, Thomas Vermilyea, Jacob Barker, Ferris Pell, William Israel, Thomas H. Smith, or George O. Brown.
The dependent variable in columns (1) through (4) is a binary variable equal to 1 if a firm’s shares stopped trading during the years 1826-29. The dependent variable in columns (5) through (8) is the percentage change in a firm’s share price during the year of 1826. Firms whose shares stopped trading are assigned a value of -100%. Robust standard errors in parentheses; ***, **, and * denote significance at 1%, 5%, and 10%, respectively. A constant term (not reported) is also included.

The results of regressions with these measures of the influence of investor groups are reported in table 3. The dependent variable in the first four columns is a binary variable equal to one if a firm failed or was shut down in the years 1826-29, and in columns (5)-(8), it is a continuous variable measuring the percentage change in a firm’s price over the year 1826. Both measures of the influence of investor groups are highly correlated with firm failures, and with larger price declines over the year. Overall 27% of firms that were publicly traded in 1826 eventually failed, but firms that appeared on the Enquirer’s list failed at rates nearly 70% higher than those that were not, and firms that had a notorious investor on their boards failed at rates nearly 60% higher than those without such board members. Equally large effects are found in the regressions with stock market performance as the dependent variable; the mean price change over the year of 1826 was -24%, but firms on the Enquirer’s list had price declines that were more than 60% lower than those that were not on the list. Including the logs of firm age and paid-in capital, along with industry fixed effects as covariates has little impact on the result. These results provide a clear confirmation of the effect of these investor groups on firm survival and performance.

But they do not indicate why these firms failed, nor do they explain why some of the firms in which these investors had at least some influence performed much worse than others. One possible
Table 4:
Stakes held by directors, 1826

<table>
<thead>
<tr>
<th>Company</th>
<th>Stake owned directly (%)</th>
<th>Stake held in trusts (%)</th>
<th>Stake held by other firms (%)</th>
<th>Total indirect stake (%)</th>
<th>Total stake held (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dutchess Insurance</td>
<td>10.7</td>
<td>0.0</td>
<td>40.2</td>
<td>40.2</td>
<td>50.1</td>
</tr>
<tr>
<td>Mercantile Insurance</td>
<td>21.2</td>
<td>1.2</td>
<td>15.2</td>
<td>15.2</td>
<td>37.7</td>
</tr>
<tr>
<td>Mechanics Fire Insurance</td>
<td>7.0</td>
<td>6.7</td>
<td>0.0</td>
<td>6.7</td>
<td>13.7</td>
</tr>
<tr>
<td>Tradesmen’s Insurance</td>
<td>12.8</td>
<td>39.6</td>
<td>0.0</td>
<td>39.6</td>
<td>52.3</td>
</tr>
<tr>
<td>United States Fire Insurance</td>
<td>27.7</td>
<td>19.7</td>
<td>0.0</td>
<td>19.7</td>
<td>51.9</td>
</tr>
<tr>
<td>Western Insurance</td>
<td>3.1</td>
<td>74.0</td>
<td>0.0</td>
<td>74.0</td>
<td>77.1</td>
</tr>
<tr>
<td><strong>All publicly-traded firms (N=38)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Contemporary accounts indicate both groups controlled several other firms, but no stockholder lists could be found for those companies. The data in the table are calculated from lists of directors obtained from contemporary newspapers, and lists of stockholders held in the records of New York’s comptroller’s office, New York State Archives.

Table 4 presents the ownership stakes of the directors in several firms associated with the investor groups, and compares them to the average for all firms. The data in the table indicate that for most of the companies, these directors held majority stakes (making them unaccountable to the other stockholders), but a substantial portion of those stakes was held indirectly, through trusts and other companies they controlled. On average, the directors of publicly-traded companies held about 17% of the stock of their firms indirectly, but with many of the firms in the table, the
### Table 5: Failing vs. Surviving Companies

<table>
<thead>
<tr>
<th></th>
<th>Firm failed, 1826-29 (Mean 0.27)</th>
<th>% change in share price, 1826 (Mean -0.24; SD .37)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Total indirect stake of board</td>
<td>1.552*** (0.264)</td>
<td>-1.059*** (0.336)</td>
</tr>
<tr>
<td>Indirect stake: trusts</td>
<td>1.767*** (0.372)</td>
<td>-0.535 (0.534)</td>
</tr>
<tr>
<td>Indirect stake: held via other firms</td>
<td>1.229*** (0.512)</td>
<td>-1.553*** (0.337)</td>
</tr>
<tr>
<td>log(firm age)</td>
<td>0.041 (0.090)</td>
<td>-0.112 (0.078)</td>
</tr>
<tr>
<td></td>
<td>0.029 (0.089)</td>
<td>-0.062 (0.082)</td>
</tr>
<tr>
<td></td>
<td>0.100 (0.103)</td>
<td>-0.087 (0.073)</td>
</tr>
<tr>
<td>log(paid-in capital)</td>
<td>-0.024 (0.180)</td>
<td>0.149 (0.172)</td>
</tr>
<tr>
<td></td>
<td>-0.356* (0.190)</td>
<td>0.343** (0.166)</td>
</tr>
<tr>
<td></td>
<td>0.226 (0.231)</td>
<td>-0.015 (0.163)</td>
</tr>
<tr>
<td>Industry effects</td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td>Observations</td>
<td>38</td>
<td>38</td>
</tr>
<tr>
<td></td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td></td>
<td>37</td>
<td>42</td>
</tr>
<tr>
<td></td>
<td>Y</td>
<td>37</td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.42</td>
<td>0.28</td>
</tr>
<tr>
<td></td>
<td>0.19</td>
<td>0.39</td>
</tr>
<tr>
<td></td>
<td>0.14</td>
<td>0.14</td>
</tr>
</tbody>
</table>

The dependent variable in columns (1) through (4) is a binary variable equal to 1 if a firm’s shares stopped trading during the years 1826-29. The dependent variable in columns (5) through (8) is the percentage change in a firm’s share price during the year of 1826. Firms whose shares stopped trading are assigned a value of -100%. Robust standard errors in parentheses; ***, **, and * denote significance at 1%, 5%, and 10%, respectively. A constant term (not reported) is also included.

The stake held indirectly was as high as 60% or more, effectively guaranteeing the directors total control, while providing them with little incentive to utilize the firms in a way that was beneficial to the shareholders. Note also that there is quite a bit of variation in the extent to which that was true across these firms; with Mechanics Fire Insurance, for example, where Henry Eckford and Thomas Vermilyea were directors, only 6.7% of the stock was held indirectly, and the total stake held by all directors was only 13.7%. Because of its potential effect on the incentives of the directors, this variation in the different types of director ownership stakes might therefore be a determinant of the firms’ performance.

The results of regressions that use the directors’s ownership stakes to predict firm performance are presented in table 5. The first column in the table regresses the firm failure variable on the ownership stake of the directors held indirectly (in either trusts or via other firms), along with the log age and paid-in capital, and industry effects. The results indicate that a one-standard-deviation increase in the indirect stake held by the directors (.17) resulted in a 26% increase in the probability of failure, an effect approximately equal to the mean failure rate. The next columns regress firm failure on only the stake held in trusts, and the stake held via other companies, and the results are similarly dramatic. In columns (4)-(6), roughly similar results are obtained for regressions with the
percentage change in the stock price as the dependent variable, with the one exception that the
treasury shares has a much smaller effect, which is also statistically indistinguishable from zero.
Overall, however, the indirect stakes held by directors were strongly negatively correlated with the
change in the firms’ share prices.

This is strongly consistent with the notion that when the directors of firms controlled through
some means other than a large direct ownership stake—that is, when their control rights exceeded
their ownership rights, due to the mechanism by which they attained control—they had little
incentive to manage their firms prudently and for the interest of the stockholders. This is, of
course, not the only interpretation of these data: it may have been the case that the process by
which these stakes were attained, often borrowing to purchase shares and then effectively returning
the shares to the firm, so damaged the financial health of the firms that they were made vulnerable
to any shock, and irreparably harmed. But these results clearly lend support to the reasoning
behind the legislative changes introduced by the state, discussed below.

The remaining sections of the paper discuss the legal response to the scandals: the criminal
trials, the legislative reforms, and the civil suits initiated by stockholders. Each had an important
impact on the subsequent development of corporation law in New York.

5 The criminal trials

With so many failures, and rumors of financial fraud and deceptive manipulations, in July of 1826
there were calls for a criminal investigation into the affairs of the bankrupt companies. Almost
immediately, Hugh Maxwell, the District Attorney of New York City, began to examine the papers
of the failed companies, and in August and September of 1826, he obtained bills of indictment
against a number of their directors. Trials were held beginning in September.

Many of the New York papers sent reporters to court to hear the testimony before the Grand
Jury, and applauded the indictments when they were obtained. The views of the editors of the
*New York American* were typical:

The crisis at which we have arrived is most momentous; and it must be steadily looked

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65The editors of the *Evening Post*, for example, wrote that the conduct of the “men connected with the monied
institutions that have recently failed...ought to be made the subject of investigation by the next Grand Jury of our
criminal court.” (17 July, 1826).

66Testimony in the subsequent criminal trials indicated that Maxwell examined the papers of the Life & Fire in
their office in July, 1826, the month the firm failed.
at. The comfort, and property of our citizens—the honor and character of our city, are concerned in the issue of the investigations now going, and still to go, on.\textsuperscript{67}

The subsequent trials, held in what was known as the court of Oyer and Terminer (which functioned as a criminal court with Supreme Court justices presiding), were followed by all of the major New York papers, whose reporters produced detailed accounts of each day’s testimony.

The primitive state of the law at the time presented enormous challenges for the District Attorney—what charges could he bring? The investor groups operated their companies with near-total contempt for the interests of their firms’ creditors and stockholders, but given the state of the law at the time, much of what they did was not illegal, and moreover, many of the laws they seemed to break carried no criminal penalty. For example, several of the firms that issued post notes did so in violation of New York’s restraining statute, which forbid any company other than a chartered bank from issuing circulating notes—but the penalty for this violation would simply be to forfeit their charter, which would harm the interests of their already-suffering creditors and stockholders. Similarly, in some of their transactions it seems apparent that no clear distinction was maintained between the finances of the controlling investors, and the finances of their firms: they often withdrew securities owned by the companies, and sold them for their own benefit, or for the benefit of other companies or their creditors. This could constitute embezzlement, but there were no clear examples of securities withdrawn with nothing given in return; they were always taken in exchange for a guarantee or security of some kind. That and the disorganized state of the books of the companies would have made an embezzlement case difficult to prosecute.

A better possibility was fraud, a criminal act at common law. If the investor groups had knowingly sold worthless post notes to investors, or exchanged them for valuable securities from other companies, this would certainly have constituted fraud. But perhaps because of the complexities of some of the transactions undertaken, which involved several successive exchanges made by different people and with different companies, some of which were more clearly fraudulent than others, and with the roles of the different individuals difficult to establish in each step of the transactions, the District Attorney opted instead to seek indictments for conspiracy, also a common law offence.

The indictments charged that the members of the confederacies “did conspire, confederate, and

\textsuperscript{67}14 August 1826. Most of the New York papers applauded the grand jury investigations, but the \textit{Enquirer}, whose editor seems to have been politically aligned with Jacob Barker, opposed them, writing “Grand Juries erect themselves into inquisitorial bodies for the purpose of prying into the private trading business concerns of individuals, and bring them into Courts of Justice for imaginary offences” (25 July.) A lively debate between the \textit{Enquirer} and the \textit{Evening Post} ensued over the following days.
agree...by wrongful and indirect means, to cheat and defraud” their companies. The common-law concept of conspiracy is extremely vague and expansive, and was often used in England to suppress political dissent. This made conspiracy charges a particularly powerful instrument for prosecutors, but they also risked at least the appearance of unfairness to the defendant in the eyes of some judges.  

Table 6 lists the indictments obtained by the District Attorney, and summarizes the outcome of the trials. The list of those indicted contains many prominent New Yorkers, including some of the very wealthiest. Henry Eckford and Alfred Pell, for example, were taxed for more than $100,000 in wealth in 1828, making them among the 50 richest New Yorkers. Ferris Pell and Samuel Gouvernor were both taxed at $50,000, making them among the hundred wealthiest (Pessen, 1973). However, some of the others indicted had already achieved a certain measure of prominence for other reasons. Jacob Barker’s previous involvement in other failed ventures made him a “notorious character” in the view of some on Wall Street, for example, and many of the others indicted were regarded as “men of doubtful characters, and still more doubtful means.”

The District Attorney began with the most spectacular case, that of Vermilyea, Eckford, Barker, and five other defendants, who were charged with conspiring to defraud five different corporations. This trial commenced in September 1826, and continued through October. All of the New York City newspapers that covered financial news—the *Evening Post*, *American*, *Commercial Advertiser*, *National Advocate* and *Enquirer*—sent reporters to the courtroom, and although the judge admonished them not to print transcripts of the proceedings, their daily reports included very detailed summaries of all of the arguments made and testimony given. The prosecution called dozens of witnesses—directors, clerks, securities dealers, and note holders—and the twelve attorneys representing the defense (with Barker and one other defendant representing themselves) cross-examined them at length. Council for the defense included some of the most eminent legislators and attorneys in New York, and one commentator from another city who observed the proceedings concluded from the sophisticated and eloquent arguments presented on all sides that “the New York bar is a strong one” (*Evening Post*, 2 December 1826).

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68 Hurst (1956) discusses what he call the “uneasiness” of nineteenth-century American judges with the crime of conspiracy.
69 The September 15 indictment of Henry Eckford and his confederates superseded four earlier indictments, of August 12 and 15, in which fewer companies were named.
70 Letter from John Potter to Nicholas Biddle, 25 July 1826 (Nicholas Biddle papers). Barker’s autobiography presents his own less-than-objective perspective on his many failed ventures (Barker, 1855).
71 *New York American*, 14 August 1826
<table>
<thead>
<tr>
<th>Corporation(s) Allegedly Defrauded</th>
<th>Trial Date</th>
<th>Individuals Named in Indictment</th>
<th>Outcome of Trial</th>
<th>Key Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hudson Insurance, U.S. Lombard Association</td>
<td>December 1826</td>
<td>Thomas Hyatt, Prosper M. Wetmore, S.D. Jackson, Mark Spencer, George W. Brown</td>
<td>Only Hyatt and Jackson tried, Dec. 1826. Hyatt found guilty, Jackson, not guilty. Hyatt sentenced to 2 years in prison, and “absconded.” In February 1827 he was found in Vermont, and brought to New York to serve his sentence.</td>
<td>Hudson issued $300,000 in post notes, U.S. Lombard, $600,000</td>
</tr>
<tr>
<td>Sun Fire Insurance</td>
<td>December 1826</td>
<td>John J. Lambert, Samuel F. Lambert, Henry B. Lambert, Charles Mowatt, Benjamin A. Waldron</td>
<td>John J. and Samuel F. Lambert pled guilty, along with Benjamin Waldron. Charles Mowatt and Henry B. Lambert were tried in Dec. 1826, and found guilty. Mowatt was sentenced to two years, Henry B. and Samuel F. Lambert to one year.</td>
<td>$260,000 of Sun’s capital stock (which totalled $300,000) lost on transactions with directors.</td>
</tr>
<tr>
<td>New York Mount Hope Loan, Franklin Manufacturing Company</td>
<td>—</td>
<td>Isaac Lucas, Edward Macomber</td>
<td>Defendants obtained delays until December 1827, when trials were halted.</td>
<td>Post notes totalling “several hundred thousand dollars” issued by the companies.</td>
</tr>
<tr>
<td>Greenwich Fire Insurance</td>
<td>—</td>
<td>Ferris Pell, Alfred L. Pell</td>
<td>Defendants obtained delays until December 1827, when trials were halted.</td>
<td>$230,000 of Greenwich’s capital stock (which totalled $250,000) lost on transactions with directors.</td>
</tr>
<tr>
<td>Tradesmen’s Bank</td>
<td>—</td>
<td>Matthew Reed, Samuel Cox, Samuel L. Gouvernor, Matthew L. Davis</td>
<td>District Attorney delayed trial until December 1827, when the trials were halted.</td>
<td>Tradesmen’s bank suffered losses of more than $100,000.</td>
</tr>
</tbody>
</table>

*Sources:* Indictments obtained from manuscript indictment files, New York Municipal Archives. Outcome of trials complied from the *New York Evening Post*, various issues, 1826-27, and Barker (1827a).
The accounts of the affairs of the companies that were presented included many breathtaking revelations, of absentee directors who had never bothered to inquire about the affairs of their firms, of companies being kept afloat through the issuance of post notes that were almost certainly worthless, and of extraordinarily complex exchanges of securities among companies that were difficult to comprehend. In the end, the trial ended in a hung jury. This was followed by a second trial, in which the defendants were found guilty, but the verdict was overturned on appeal, on the basis that some of the jurors were prejudiced against the defendants by the first trial. Finally, a third trial was held, beginning in June of 1827, in which Barker was tried separately and found guilty.

Two other bills of indictment were brought to trial in December of 1826. Each of these cases involved fewer defendants and fewer companies, and their trials proceeded much more quickly, with some lasting only a few days. Each resulted in convictions for at least some of the defendants. But one of those defendants, Henry B. Lambert, who was convicted of conspiring to defraud the Sun Fire Insurance Company, appealed his conviction, on the basis that the indictment did not precisely specify the means by which the conspiracy was alleged to have occurred. As the this case had implications for all of the defendants, the District Attorney suspended any further trials pending the outcome of the appeal.

In his argument before the Supreme Court, Lambert’s attorney claimed that his indictment stated only that Lambert “conspired to defraud” Sun Fire Insurance of its property, but did not specify which property, or the specific acts by which the conspiracy was to have been carried out, or precisely what constituted the conspiracy. Lambert’s attorney pointed out that this permitted the prosecutors in the trial to present evidence on a variety of transactions, and it was never clear which ones corresponded to those for which the defendant was indicted. The New York Supreme Court upheld his conviction in May of 1827, stating that the indictment “was sufficient in form.” But Lambert then appealed this decision to the state’s highest court, the Court for the Trial of Impeachments and Correction of Errors. The members of this court include the Supreme Court justices, the Chancellor, and the members of the Senate—and since many of the attorneys representing the defendants in the conspiracy trials were sitting members of the Senate, they were able to vote on the case. The case was heard twice by the court, and in the end, there were an equal number of votes were cast to affirm and to overturn the indictment. The President of the

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72 People v. Vermilyea and Barker, 7 Cowen 369 (N.Y. Sup. Ct. 1827).
73 Lambert v. The People, 7 Cowen 166 (N.Y. Sup. Ct. 1827).
74 The role of this court as an appeals court has no parallel at the federal level. But as a court for the trial of impeachments its role is similar to that of the United States Senate.
Senate (the Lieutenant Governor) then cast the deciding vote, to overturn the indictment.\textsuperscript{75}

The majority decision was written by John C. Spencer, a Senator who had represented Jacob Barker in his later trials, and a vocal opponent of the conspiracy indictments. In March of 1827, Spencer had proposed a bill “To regulate proceedings on indictments for conspiracy”\textsuperscript{76} requiring much stricter standards for conspiracy indictments, and the Senate Judiciary Committee, chaired by Cadwallader D. Colden, also an attorney for defendants in the conspiracy trials, produced a report on the bill stating that conspiracy indictments “have recently become frequent...chiefly for the purpose of reaching offences not well defined, or difficult of proof.”\textsuperscript{77} The bill eventually became law. In his decision, Spencer agreed with Lambert’s counsel that because the indictment did not specify “the means by which it was intended to accomplish the conspiracy,” it violated the principal that “every man is entitled to a specification of the charge against him.”

A dissenting opinion, written by Charles Stebbins, offers an impassioned and detailed (and nearly 50-page) argument that the indictment was sufficient according to the standards of the common law, and in his conclusion, he stated “The common law of England is the law of this land...whatever may be our opinions as to what the law should be, ours is a single duty to administer it...” (p. 82). In its decision, the court took the extraordinary step of rejecting common-law precedent, and effectively overturned not only Lambert’s conviction, but those of Barker and the others as well. Barker, a former member of the Assembly and an important figure in Republican politics at the time, spent the next several years attempting to clear his name and blaming the convictions on his political enemies; Eckford and some of the other merchants involved in the scandals did the same.\textsuperscript{78}

In essence, the New York Senate had decided that the approach taken by the District Attorney to prosecute the confederacies—which was almost certainly the best one available given the state of the law at the time—was unacceptable, and in particular unfair to the defendants. Given the political prominence of some of the defendants, it is of course possible that party loyalties may have figured into this decision. Nevertheless, the state legislature passed a series of reforms to the states


\textsuperscript{76}Senate Documents, 1827, No. 161 (March 20, 1827).

\textsuperscript{77}Senate Documents, 1827, No. 160 (March 20, 1827).

\textsuperscript{78}Barker attempted to get the Assembly to conduct an inquiry into the conduct of the judge who presided over the trials (Assembly Journal, 18 March 1828); published numerous books and pamphlets that reprinted his speeches from the trials, and outlining his theories about the conspiracies against him (Barker 1826, 1827b, 1827c) and ran for the New York Senate on a platform of “making it a Felony in a ‘Minister of Justice’ to take money from ‘indicted, but untried and unacquitted individuals’ ” (New York Enquirer, 26 February 1828). Henry Eckford, a wealthy shipbuilder and merchant, presented the Assembly with petitions and affidavits arguing for his innocence (Assembly Journal, 1828, Appendix C.). See also Leggett (1831).
laws governing the internal affairs of corporations, access to the courts, and other matters essential to corporate governance. Overturning the conspiracy convictions was the most minor development in a series of legal changes that modified longstanding common-law practice.

6 Legal Reforms

The scandals of 1826 had a profound impact on New York’s politics, and were reported in newspapers throughout the United States. In his annual message to the New York Assembly in January 1827, Governor DeWitt Clinton reflected on the “late alarming commercial convulsions,” and argued that “general regulations are indispensably necessary” for preventing the excessive emissions of bank notes, and “compelling the attendance and increasing the responsibility of directors” in corporations generally. In 1826 and 1827 no bank charters were granted or renewed, although one insurance charter was granted in 1826 (see figure 1.) And efforts were made to begin to strengthen the legal protections of investors.

The process of reforming the law actually began somewhat before the scandals of 1826, as legislators learned about some of the financial practices of companies on Wall Street that ultimately led to the scandals. In mid-1825, legislation was passed “to prevent fraudulent bankruptcies” by prohibiting payments for stock subscriptions in the form of notes, and making it “the duty” of the supreme court to act quickly when presented with a complaint about unfair practices in corporate elections. This law probably did have some effect on the behavior of corporate directors, but it represented only a first step.

In 1827, the legislature approved a new revision of the laws, the Revised Statutes of 1828, which contained major changes to many areas of the law, and in particular added significant new legislation relative to corporate governance. The Revised Statutes represented the outcome of an effort to organize and partially codify the state’s laws, which had begun a few years earlier. But the contents of the final product, which was the first-ever such partial codification in any common-law jurisdiction, and was enormously influential in other states, and contained several provisions that

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79 For example, in October, 1826, articles describing the conspiracy trials were printed in such papers as the Baltimore Patriot, Boston Commercial Gazette, Macon Telegraph, Louisiana Advertiser, the Richmond Constitutional Way, New Hampshire Sentinel, and Vermont Gazette, among many others.

80 Assembly Documents, No. 2 (January 2, 1827), p. 9.

81 The act also limited corporations’ indebtedness to three times their capital stock, and prohibited dividends from being paid except out of firms’ profits (New York Laws, 1825, ch. 325). However, these latter provisions were usually already included in the charters of most financial companies.
were written in response to the events of 1826.\textsuperscript{82}

6.1 Investor Protections

The Revised Statutes contain a number of provisions designed to protect the interests of the stockholders and creditors of “moneyed corporations,” defined as banks, insurance companies, or other firms authorized to make loans, and introduced some of the strongest protections of the investors and creditors of corporations ever known.\textsuperscript{83} Many of the new laws contained in the Revised Statutes specifically prohibited the manipulations and exchanges utilized by the investor groups, and eliminated the gray areas and weaknesses in prior law that had been exploited.

For example, the first nine sections of the title on moneyed corporations prohibit: exchanges of capital or post notes between corporations; payments of installments on stocksubscriptions in the form of securities; purchases of a corporation’s own stock, except when using profits from operations; acceptance of a corporation’s own stock as payment for debts; loans to stockholders enabling them to withdraw money paid in; or loans to directors equivalent to more than one third of the capital stock. They also mandated that any transfer or assignment of a corporation’s property of $1,000 or more could only be made according to a resolution of the entire board. The next sections provide for powerful enforcement mechanisms for these provisions: they stipulate criminal penalties for any violation, and making the directors personally liable from any losses that result from violations.

Later sections held that every corporate insolvency was to be assumed to be fraudulent, placing the burden of proof on directors and stockholders to defeat the presumption of fraud, and made the directors, and then the other stockholders, personally liable for any losses in fraudulent bankruptcies, with the total amount not to exceed the nominal amount of the shares (thus imposing double liability.) In other sections, the statutes prohibited the holder of hypothecated shares (shares pledged as collateral for a loan) from voting in corporate elections, and prohibited anyone from voting shares belonging to the company or held in trust for the company. The statutes also required all moneyed corporations to transmit annual financial statements to the comptroller, and

\textsuperscript{82}On the process of revising the laws, and the innovations produced in New York’s Revised Statutes, see Cook (1981), Butler (1889), and Discoll (1987).

\textsuperscript{83}What follows is a discussion of Part I, Chapter 18, Title 2, Articles 1-3 of the Revised Statutes. For a lucid summary of the provisions of the Revised Statutes, see Spencer (1830a, 1830b). A rigorous comparison to other common-law jurisdictions is difficult to make because of the differences across legal systems that had already emerged in the early nineteenth century. In England, for example, the law of joint-stock companies was dominated by an adherence to unlimited liability, which was intended as a substitute for complicated statutes such as those adopted in New York (Hunt 1936).
included detailed accounting standards for those statements and for calculations of profits.

The Revised Statutes also introduced an important change in the jurisdiction of courts of equity, which enabled the state to intervene in the internal affairs of corporations when their stockholders or creditors were harmed. That is, the chancellor was given visitatorial powers over corporations, and in particular the statutes provide that these powers "shall be exercised...at the instance of the attorney-general prosecuting in behalf of the people."\textsuperscript{84} These provisions specifically gave the chancellor, in response to a bill filed by the Attorney General, the power to compel directors to account for their actions, to compel payment by them for losses incurred in violation of their duties, to remove directors from office, and to void any transfers of the corporation's property made by its directors.\textsuperscript{85} This effectively overturned longstanding precedents that held that equity courts had no visitatorial jurisdiction over business corporations, and that the state had no visitatorial power over corporations generally.\textsuperscript{86}

Finally, the Revised Statutes began to simplify the process of bringing suits against corporations. For example, they mandated that in actions against corporations, it would no longer be necessary to prove the company's existence, or recite its acts of incorporation.\textsuperscript{87} Until this point, it was the practice in New York's courts of law and equity for plaintiffs to actually transcribe the entire act of incorporation of the company they were suing in their filings in court.

\textbf{6.2 The impact of the law, and rollback of some provisions}

These changes to New York's laws had a lasting impact, both within New York State, and in other states. In New York, stockholders in banks particularly used the provisions of the Revised Statutes governing the behavior of moneyed corporations, and empowering shareholders to seek injunctions against directors.\textsuperscript{88} Although a number of changes were introduced in these areas of the law as the state's administrative agencies became more sophisticated, the provisions of the Revised Statutes governing moneyed corporations—from the limitations of loans to directors, to

\begin{itemize}
  \item \textsuperscript{84}Revised Statutes, Part III, Chapter 8, Title 4, Section 35.
  \item \textsuperscript{85}Revised Statutes, Part III, Chapter 8, Title 4, Section 33.
  \item \textsuperscript{86}This was certainly the belief of Chancellor Kent in New York (Attorney General v. Utica Insurance Co., 2 Johns. Ch. Rep. 371 (N.Y. 1817)); See also the discussion of the supreme court's Dartmouth College decision in Bloch and Lamorraux (2006).
  \item \textsuperscript{87}Revised Statutes, Part III, Chapter 8, Title 4, Sections 3 and 13
  \item \textsuperscript{88}See, for example, Ferry v. Bank of Central New York, 15 How. Pr. 445 (N.Y. Sup. 1858); Gaffney v. Covill, 6 Hill 567 (N.Y. Sup. 1844); and Gillett v. Moody, 3 Comst. 479 (N.Y. 1850). It should be note that the courts often interpreted the rights of stockholders in suits against directors quite conservatively (see, for example, Verplank v. Mercantile Insurance, 1 Edw. Ch. 84.)
\end{itemize}
the visitatorial jurisdiction of courts of equity—remained on the books until the 1880s.\footnote{New York (1909). The entire title regulating moneyed incorporations was repealed in 1882, and replaced with a new banking law (New York \emph{Laws}, 1882, ch. 402.} A few other states emulated New York by introducing somewhat similar legislation; New Jersey passed a significant law “To prevent frauds by incorporated companies”\footnote{Acts of the General Assembly of the State of New Jersey, 1829 (second sitting), p. 58.} in 1829 that was similar to New York’s, and Massachusetts passed a new banking law 1829 which contained some provisions that resembled those of New York.\footnote{Massachusetts’s banking system was quite different than New York’s, and much of the new law was no doubt enacted to reform particular features of its own system. However, the 1829 law does contain provisions regulating capital contributions, limiting loans to stockholders on pledges of their own stock, creating unlimited liability for directors in the case of mismanagement, and imposing criminal penalties for directors using banks’ capital for their own purposes. (Massachusetts \emph{Acts and Resolves}, 1829, Ch. 96, p. 144.)}

However, a few of the new laws enacted in New York, in particular the more punitive enforcement provisions that created the presumption that all bankruptcies were fraudulent, and stipulated that directors would be personally liable (and subject to criminal charges) in the case of fraudulent bankruptcies or violations of other provisions, were quite controversial. As one observer noted, “Responsible parties were indisposed to become directors of moneyed incorporations subject to such a code of laws.”\footnote{Cleaveland (1857, p. xli).}

Once the Revised Statutes took effect, in 1828, any moneyed corporation chartered (or having its charter renewed) after that date was subject to those provisions. But given the legal uncertainties associated with the state’s power to change the terms of existing charters, corporations with existing charters were not made subject to their terms.\footnote{Revised Statutes, Part I, Chapter 18, Title 2, Articles 3, Section 52.} In 1828 and 1829, a number of insurance companies were created or had their charters renewed, making them subject to the Revised Statutes.\footnote{See, for example, the renewal of Albany Insurance’s charter, New York \emph{Laws}, 1828, ch. 220.} However, no bank charters were granted or renewed in 1828, probably due in part to the enforcement measures included in the new laws.

In 1829 a completely new banking law—the safety fund law, which created a coinsurance system among its member banks, and an administrative office to oversee and inspect them—was passed in New York.\footnote{New York \emph{Laws}, 1829, ch. 94. See the discussion in Bodenhorn (2003) and Cleaveland (1857).} The safety fund law provided that any bank chartered according to its provisions would be exempt from the parts of the Revised Statutes that created the presumption that insolvencies were fraudulent, and stipulated personal liability for stockholders in the case of any fraudulent bankruptcy. In 1829 alone, the state chartered or renewed the charters of more than 25 banks, making them all subject to the safety fund law, and to all of the terms of the Revised Statutes.
except for those bankruptcy provisions. Finally, in 1830, the state repealed for all firms (not just those banks created under the safety fund) the personal liability sections of the Revised Statutes, and also the section adding criminal penalties to directors’ violations of the key terms.96

6.3 Shareholder litigation

As might be expected from the failure of so many companies in such complex circumstances, an enormous amount of litigation quickly followed—one judge remarked that “innumerable cases of frauds upon creditors, and many innocent and unsuspecting stockholders of incorporated companies” were brought before the courts.97 Most of the litigation occurred within the chancery courts, which had jurisdiction over bankrupt corporations, and also had the power to grant injunctions, which were sought by the stockholders of some corporations who feared that certain creditors were being given preferential treatment by receivers or by management. The volume of chancery suits became so large in 1826 that the court struggled to keep up.98

Many of these cases took more than a decade to resolve, as the stockholders and creditors attempted to reach settlements on the division of whatever assets that remained in their companies. One factor that contributed to the bitter and protracted nature of the litigation was the contention by the receivers appointed by the Attorney General for some of the corporations that when post notes were issued without legal authority, in violation of the restraining acts, they were void. This meant that the claims of the note holders on the assets of the companies would all be rejected—the note holders would get nothing. In 1842, this question was finally resolved by the Chancellor, who ruled in favor of the receivers, and against the note holders.99

A second issue, with far more important implications, that arose in the litigation was that minority investors in some of the companies asserted the right to sue the directors of their companies in equity for breach of fiduciary trust. As stated above, no court of equity prior to 1830 applied the principles of fiduciary law to the directors of a business corporation (Dodd, 1954). The significance of the investors’ legal strategy is that in the doctrine of fiduciary trust, there is a well-established principle that trustees can be held personally liable for losses due to their negligence or malfeasance.

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96The repeal was not retroactive; the insurance companies chartered between 1828 and mid-1830 continued to be subject to those terms, and the safety fund banks chartered prior to mid-1830 were subject to the criminal penalty provisions. New York Laws, 1830, ch. 71.
97Nathan v. Whitlock, 9 Paige Ch. 152. A cynical journalist remarked that these cases were “a fine time for the lawyers!” (Commercial Advertiser, 19 August 1826.)
98The Commercial Advertiser of 29 August 1826 mentions these delays.
The stockholders of some of the failed companies hoped to hold the directors of their firms personally liable for their losses. The most prominent case in which that claim was made, Robinson v. Smith, was initiated by stockholders in the New York Coal Company, who filed a bill in equity against the directors in August 1826, detailing the losses that arose from the securities transactions conducted by the directors, including their ill-fated purchase of a controlling stake in City Bank. The defendants responded to the bill by arguing that the complainants were owners of only 160 of the company’s 4,000 shares (and principles of equity would require the owners of the other shares to be made parties to the suit), and that only the company itself can file a bill in equity, on behalf of all of the stockholders. If their argument had prevailed, it would have effectively foreclosed opportunities for minority investors to seek relief against directors in equity, if the directors held majority control of the corporation.

Ruling in 1832, the Chancellor conceded that an action against directors for breach of trust should be initiated by the company itself, but also recognized that if the corporation were “under the control of those who must be made the defendants in the suit, the stockholders, who are the real parties of interest, would be permitted to file a bill in their own names.”\footnote{Robinson v. Smith, 3 Paige 222 (N.Y. 1832).} This decision became a highly influential precedent, and established the principle that minority investors could seek relief in equity, as long as no remedy existed within the corporations.

The rule in Robinson v. Smith became a general principle of equity jurisprudence, and is often cited as a landmark in the development of minority shareholders’ rights. However, it is important to note that within the state of New York, the legislature provided a means for minority investors to hold directors accountable for malfeasance well before Robinson v. Smith was decided in 1832, by granting courts of equity visitatorial jurisdiction over business corporations. In his decision in the case, the Chancellor made frequent references to this change enacted in the Revised Statutes, although he noted that since the complainants’ original bill was filed in 1826, prior their passage, the new rules did not apply. In subsequent cases that arose from the scandals of 1826, the rule did apply.

7 Conclusion

The events of 1826 bear a striking resemblance to those of 2001-02, and comparisons are irresistible: accounting scandals and high-profile corporate failures, in businesses managed by politically influ-
ential figures, were followed by criminal prosecutions, and the government ultimately passed a significant package of legislation to prevent future frauds and protect investors, which was criticized as excessively punitive. In 2001-02, the failure of Enron, Worldcom and other prominent and respected companies was followed by the passage of the Sarbanes-Oxley “Public Company Accounting Reform and Investor Protection Act of 2002.” In 1826, the failure of the Life & Fire Insurance Company, the New York Coal Company, and other firms led to the passage, in the state’s innovative statutory revision in 1827, of sweeping changes to its corporation laws, which were designed to improve the mechanisms of corporate governance and protect investors and creditors.

Thus even in 1826, the New York state legislature asserted the role that would later be filled by the federal government in the era of national securities markets. In response to scandals, and the perception that existing law did not suit the needs of businesses or investors very well, New York aggressively and creatively modified its laws. The events in both 1826 and 2002 seem to suggest that major changes in corporation laws have developed in response to scandals, and this scandal-driven process occurs mostly (although of course not entirely) outside of the courts, in legislative bodies.

One tentative conclusion that can be drawn from the analysis presented here is that the merits of our common-law legal system arose at least in part due to the efforts of legislative bodies to shape the law, as the needs of the economy changed. This is not to discount the role of common-law courts in adjudicating those laws, which is undoubtedly a critical benefit of a common-law system. But innovations in statute law have played a critical role in the development of our legal system and its protections of investors, that has been somewhat overlooked in the literature.
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