

# The Role of Lawyers in Corporate Promotion and Management: A Canadian Case Study and Theoretical Speculations

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## C.H. Cahan and H.A. Lovett: Corporate Entrepreneurs and Lawyers

Charles Cahan and Almon Lovett were among the most active promoters, financiers, and managers of new industrial enterprises during the first Canadian merger wave of 1909-1912. They were also corporate lawyers, part of an emerging group of specialists who were actively involved in the rise of big business. As documented elsewhere, the members of the Toronto law firm of Blake, Lash & Cassels performed a similar role during the Canadian investment boom in Latin American and Caribbean utility operations before the First World War [3, 22]. Other lawyers, such as J.N. Greenshields of Montreal and the members of the Thomson, Tilley & Johnston firm of Toronto, also were engaged in the creation of big business in Canada and foreign utility operations after the turn of the century [5, 24].

This accords with fragmentary evidence available concerning the changing role of American lawyers during industrialization, in particular their activities during the consolidation waves at the end of the nineteenth century. Lawyers such as John Dos Passos (the Sugar Trust), W.N. Cromwell (the Cotton Oil Trust), James Dill (architect of the New Jersey Holding Company Act), S.C.T. Dodd (chief counsel to Standard Oil of New Jersey and creator of the "trust" form of corporate control), and Elbert H. Gary (financier, merger promoter, and the first president of the United States Steel Corporation) attest to the creative role lawyers played in the rise of big business in America [16].

With his four-year arts degree, as well as a law degree from the Dalhousie Law School in Halifax, Charles Cahan was one of the few formally educated practitioners in late nineteenth century Canada. This gave Cahan flexibility and, rather than immediately pursuing a legal career, he worked first as a newspaper editor and then became a politician. Only when he was electorally defeated in 1896 did he turn to the practice of law.

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Robert E. Harris already had done much to turn his Halifax firm into the major corporate law firm of the Atlantic region when Cahan joined him to form Harris, Henry & Cahan. The lawyers brought into the partnership after Cahan were also "corporate men," the most notable of whom, Almon Lovett, became a partner in 1905 [5, 6, 10].

By this time, Cahan was spending the majority of his time outside Canada. He had traveled to Latin America and the Caribbean in 1899, representing a group of Montreal and Halifax capitalists eager to invest in new utility ventures that combined electric power generation with urban lighting and tramway services. Initially, Cahan set up the Demerara Electric Company in Georgetown, British Guiana; he then moved on to Port-of-Prince to organize the Trinidad Electric Company in 1900. Two years later, he helped establish a much larger foreign venture--the Mexican Light and Power Company--for his clients and himself. By this time, he had become a substantial shareholder in his own right [5, 6, 10].

Mexican Light and Power combined a large hydroelectric development 100 miles from Mexico City with electrical distribution in the city and its suburbs. Cahan was appointed its managing director and from 1902 until 1909 was, in effect, the company's chief executive officer and its chief legal adviser. Residing at the company's operational headquarters in Mexico City, Cahan handled the contracts and right-of-ways necessary for the ambitious hydroelectric dam project in the Necaxa Valley, as well as the administrative and legal difficulties that arose during its construction. He negotiated the purchase of the Mexican Electric Works, the major electrical distributor in Mexico City, from its German owners, Siemens and Halske, thereby internalizing one of Mexican Power's major customers. Cahan then busied himself with consolidating existing franchises and obtaining new concessions. By 1905, Mexican Light and Power's original concession for Mexico City had been extended to cover the entire Federal District, and the company now was allowed to provide services in the states of Puebla, Hidalgo, and Michoacan. In 1906 Cahan successfully negotiated agreements giving the company exclusive control of various rivers including the headwaters of the Necaxa and Tenango [2, 10].

Through sheer necessity, Cahan became a specialist on Mexican corporate law and knowledgeable about civil law systems in general. He also made ample use of his political skills in negotiating deals, obtaining monopoly concessions from various levels of government, and protecting such concessions afterwards in both a legal and an extra-legal sense. The latter meant becoming a "close friend" of Mexican president and dictator Porfirio Diaz. This relationship politically safeguarded Mexican Light and Power's property (including its contractual and monopoly rights) until Diaz was deposed during the Mexican Revolution [10]. The company acknowledged the importance of such "diplomatic relations" in the Directors Report of 1907 by expressing its thanks for the "courtesy and consideration which this Company and its officials have continued to receive from the Federal, State and municipal authorities in Mexico" [2].

Both Cahan and Robert E. Harris, the senior partner of Harris, Henry & Cahan, were instrumental in the creation of the Royal Securities Corporation in 1903. The new company acted as the central selling agency

of the stocks and bonds that were issued to finance industrial investments in Canada and utility ventures abroad. A wholesale bond house as opposed to a brokerage firm, it was the second of its type in Canada. Within six years, it would become the most dynamic investment bank in the country. Royal Securities cut its teeth by financially reorganizing the Demerara Electric Company and through new security issuances for Maritime industrial companies. It then promoted newer and significantly larger utility companies in Cuba and Puerto Rico [21]. Because Cahan was preoccupied with Mexican Light and Power at this time, Royal Securities used the services of Harris, Henry & Cahan's newest partner, Almon Lovett, who was sent to Cuba and Puerto Rico to negotiate the purchase of existing franchises, older tramway and lighting companies, the concessionary rights to exploit new hydroelectric power sources, and the monopoly contracts for the provision of electrical services. The new enterprises--the Camaguey Company and the Porto Rico Railways Company--were successful, and Royal Securities began to look beyond utility investments to the possibility of large industrial flotations [5, 21].

In 1907, having outgrown its original base of operations, Royal Securities moved its head office from Halifax to Montreal, the financial and industrial center of Canada. The operations of Royal Securities had become more important to Cahan and Lovett than their Halifax law firm; that year, both retired from the partnership. Lovett immediately set up a new law firm in Montreal with the Royal Securities Corporation as his most important client. Resigning from Mexican Light and Power, Cahan moved to Montreal in 1909 to become more active in Royal Securities. His timing was perfect. The first Canadian merger movement was just beginning and Cahan, along with Lovett, would find numerous opportunities to apply his legal, financial, promotional, and managerial skills [5, 6].

This consolidation movement, as much as the establishment of American branch plants before and after World War I, set the corporate landscape in Canada for the twentieth century. Some accused (at times quite accurately) these mergers of being monopolies because of the degree of horizontal integration they represented. What was less apparent was that the new owners often rationalized the plants they took over, and expanded existing operations to achieve a significant degree of forward and backward integration. Companies also transformed their managerial structure to deal more effectively with larger operations carried out through the firm rather than the marketplace. Within a couple of years, these Canadian firms built organizational and managerial structures that were comparable to the most progressive business enterprises in the world. This, in turn, funneled investment into the most technically advanced capital processes available. The success of Canada as an industrial nation in the twentieth century is directly connected to such changes [21]. Lawyers such as Cahan and Lovett ventured beyond their role as corporate facilitators and directly participated in the promotion, finance, and management of the new industrial consolidations.

Max Aitken, later to be known as Lord Beaverbrook, was the most brilliant and the most notorious merger promoter of the day. Aitken put together the three largest and most successful industrial consolidations of

the first Canadian merger wave: Canada Cement, Canadian Car and Foundry, and the Steel Company of Canada. Cahan was Aitken's main legal adviser and closest associate in each case. Cahan also was a member of two of the promotional syndicates in his own right, having paid the necessary syndicate fee and agreed to take up a portion of the underwriting. Lovett's role during these mergers was restricted to the more traditional functions of the corporate lawyer. As corporate counsel to Royal Securities during the Canada Cement merger, for example, he provided legal advice concerning the interpretation of syndicate agreements, options to purchase, bondholder agreements, and securities requirements. When Canada Cement began functioning, Lovett was put on retainer as its corporate counsel, likely through the influence of Cahan and Aitken. Lovett then played the role of facilitator for Canada Cement, reviewing its contracts with suppliers to ensure timely delivery, representing it in negotiations with competitors and the government, and conducting commissions of inquiry on behalf of the company [5, 6, 7, 8, 11]. In the cement merger, Cahan and Aitken negotiated the option agreements of the eleven firms that eventually comprised Canada Cement. Various disputes over the contractual terms, in particular over the valuation of the individual cement plants and the amount the syndicate was willing to pay, complicated the negotiations, however, and the agreements had to be continually redrafted and rechecked by Cahan. Canada Cement's first organizational meetings were held in Cahan's law office, and Cahan was appointed the first president of the company on the understanding that he could retire the following year to attend to his new corporate law practice in Montreal [11]. When the merger came under intense fire because of overcapitalization and Aitken was assailed in the press and in the House of Commons as a fraudulent profiteer, Cahan used his political acumen, journalistic skills, and numerous contacts to wage a propaganda war against the allegations [5, 6].

Cahan handled the negotiations as well as the legal aspects of the Canadian Car and Foundry merger, which melded the three largest rolling stock manufacturers in the country [5]. Cahan's connection with the company continued after amalgamation, when he was retained as counsel for the company and elected chairman of the board of one of its subsidiaries [13]. During World War I he headed the company's New York agency, which had been created to establish a large munitions manufacturing operation in the United States.

In 1909-1910 Aitken tried to consolidate all the primary and secondary steel producers in Canada into one giant firm along the lines of the United States Steel Corporation. Aitken was able to negotiate with every major firm except Nova Scotia Steel and Coal. Its president, Robert E. Harris, had never forgiven Aitken for enticing Cahan and Lovett out of his law firm by moving Royal Securities to Montreal. Aitken's response was to surreptitiously purchase a majority stake in Nova Scotia Steel and have Harris removed from the board at the next annual shareholders' meeting. As Cahan was preoccupied with mop-up work on Canada Cement and the numerous disputes following the merger, Lovett was brought in to advise Aitken on how best to conduct the hostile takeover. The battle lasted five months and, in the end, Lovett and Aitken were defeated in large

part by Harris' brilliant legal and financial maneuvering in the weeks preceding the general shareholders' meeting. Convinced that a consolidation of primary and secondary producers made inherent economic sense, however, Aitken continued dealing with the remaining companies, and Cahan was called in to help in the negotiations leading up to the Steel Company of Canada merger [5, 17].

In almost all of the utility and merger promotions conducted on behalf of Royal Securities, Cahan and Lovett were prominent members of the underwriting syndicates. Here, the question of their legal skills was of much less importance: the underwriting contracts issued by Royal Securities and entered into by the syndicate members were standard forms that needed no specialized legal advice. Moreover, the strict terms of the contracts were rarely if ever enforced because of the potentially negative impact on future promotions. Instead, the general manager of Royal Securities (the syndicate leader) relied on exhortation and financial pressure to collect from underwriters when issues were not fully subscribed by brokers and investors [5].

Cahan, Lovett, and other corporate lawyers were valued members of such syndicates because of their own substantial capital, their willingness to risk that capital, and their numerous business and political contacts. Their corporate work and its considerable remuneration were cumulative and interactive; by giving legal advice on promoting, financing, and corporate matters generally, these lawyers came into contact with promoters, financiers, directors, and officers. The substantial fees they collected in the process permitted corporate lawyers to take part directly in the promotion of new enterprises, and this participation was valued because of their social position, political experience, and knowledge of other financiers and industrialists. As their experience, capital, and connections increased, their opportunities for greater direct participation in corporate promotion multiplied.

With time, Cahan and Lovett became more creative and direct participants in corporation promotion, finance, and management. Much could be accomplished through the Royal Securities Corporation and by being closely connected to Max Aitken. Cahan, for example, had become the first president not only of Canada Cement but of the Western Canada Power Company--one of the largest utility companies in the country, which he had promoted with the assistance of Aitken [25]. Nevertheless, both Cahan and Lovett were ultimately limited by Aitken's firm control over Royal Securities and the various promotional syndicates he set up to finance existing companies and new mergers [5, 6]. As Cahan and Lovett became more ambitious, it was only natural that they would seek other means of becoming even more directly involved in financing and directing corporate activity. Creating their own "investment bank," Cahan and Lovett became principals as opposed to mere agents.

In late 1910 Cahan and Lovett established the Corporation Agencies, Limited. Using its founders' experience in utility promotions, Corporation Agencies began raising money in France in 1911 for a small Canadian railway company. This was followed by the underwriting of \$5.5 million worth of securities for a new hydroelectric company [23]. Cahan and Lovett

then promoted a new canning company, of which Cahan became president. In 1913 Corporation Agencies handled the financial reorganization of the Robb Engineering Company, the first major electrical engineering manufacturer in Canada, and turned it into the International Engineering Works. Cahan became president of the new company, which was sold a year later to the Dominion Bridge Company of Montreal.

Through their contacts with J.N. Greenshields, another Montreal corporate lawyer heavily involved in investment banking, Cahan and Lovett promoted new mergers in the coal, brick manufacturing, and pulp and paper industries. Lovett became the president of the Canadian Coal and Coke Company (a consolidation of four major producers) and, along with Cahan and Greenshields, was named a director in the National Brick Company. Lovett then traveled to Europe with Greenshields to have the common stock of their new pulp and paper holding company listed on the Paris and Brussels stock exchanges, the home of many of the subsidiary companies' shareholders. Cahan and Lovett then formed the Montreal-London Securities Corporation, which was intended to perform exactly the same role as the Royal Securities Corporation in promoting mergers and making new issues of securities, particularly those aimed at the British capital market. The largest merger issue handled by the Montreal-London Securities Corporation was the 1911 flotation of the Sherwin-Williams Company of Canada, a chemical and paint company capitalized at \$12 million [18, 24].

### **The Rise of Big Business and the Role of Lawyers: Some Theoretical Speculations**

Traditionally, lawyers have dealt with, and profited from, the transaction costs of the marketplace. The costs of negotiating contracts and the elaborate precautions taken to ensure compliance with their terms had become an increasing part of the services provided by lawyers during the eighteenth and nineteenth centuries. In reducing contractual terms to writing that required clear title to the property being transferred, the proper quantity and quality of goods, timely delivery, and the adequate performance of services, as well as obtaining judicial remedies for their non-performance, lawyers supplied a facilitating role for business. Nevertheless, lawyers rarely specialized in this type of law; expediting business was only a small part of a matrix of services with a social component as large, if not larger, than the purely economic. With the rise of big business during the second industrial revolution, the function of most lawyers changed little; in contrast, the role of the few lawyers who chose either to specialize in facilitating the promoters and financiers or who concentrated on servicing newly incorporated enterprises, changed dramatically.

The establishment of a limited company, as opposed to a family business or partnership, required from its inception the services of a lawyer who could prepare the necessary documents to meet the legal requirements of the jurisdiction in question. In North America, each state and province had different incorporation legislation varying in liberality, reporting requirements, and registration fees. Canadian enterprises were faced with the additional choice of incorporation under federal or provincial laws.

Further, modern industrial enterprises did not restrict their operations to national boundaries. This meant that corporate lawyers were now required to master foreign systems of law and corporate practice. Because each political jurisdiction had a different legal and regulatory environment, lawyers also had advantages in formulating corporate strategies which involved multiple jurisdictions. As a result, corporate lawyers often went beyond providing "technical" legal advice to become part of the management and sometimes the chief executive officers of such enterprises. Cahan's management of Mexican Light and Power is instructive in this respect [10].

With the rise of the modern enterprise came an increased reliance on long-term planning. Through extensive horizontal integration, some enterprises were able to obtain sufficient market share and power to control price and output to a degree previously unknown. Vertical integration replaced some intermediate markets in goods and services with a bureaucratic allocation of resources, often with the objective of permitting the firm greater flexibility and control. Although it eliminated some of the transaction costs that lawyers had previously facilitated, corporate planning put greater emphasis on remaining contractual relations with other firms that supplied inputs and handled outputs. The performance of such obligations had to be precise and timely for planning to be effective. As corporate counsel for Canada Cement, Lovett spent much time designing contracts to secure inputs, as well as negotiating with industry competitors to give the company greater control over the quantity of production and price. This in turn permitted more detailed and accurate planning [11, 12].

Corporate planning involved control over the labor force as well as physical inputs. Lawyers were enlisted to draft employment contracts that precisely defined the responsibilities of both the corporation's salaried managerial hierarchy and the wage-labor force. Where workers were represented by unions, lawyers often took on the task of negotiating collective agreements. The many-tiered bureaucracies and the multiple job descriptions within the new governance structures required more formalized relations between the employees and the corporation. As a consequence, labor services were provided on a more predictable basis and, through variously worded contracts, labor-managerial services could be molded and shaped to fit new production processes and organizational structures. After the Canada Cement formation, Cahan and Lovett negotiated the terms and drafted the contracts for the company's new management hierarchy, which in the more complex instance of the new general manager took a large amount of time and skill [7].

The above propositions constitute some of the transaction costs reasons for the increasingly prominent role of lawyers during the second industrial revolution. The fact remains, however, that American and Canadian lawyers were more *directly* involved in the rise of big business, particularly in corporate promotion and finance but perhaps also in management, than their European counterparts. Any explanation of this difference must rely on social or cultural reasons. English solicitors remained more the agents of business during this period, although some lawyers in the earliest stage of industrialization were directly involved in channeling funds to business--a function that the country banks would

eventually take on. By the nineteenth century, though, English lawyers had for the most part dropped this "financing" function, and there is little evidence that they were a significant factor in the management of the enterprises they began to incorporate in the second half of the nineteenth century [1]. By virtue of a different educational system, which viewed law as a more generalized training, lawyers on the continent played a slightly more active role in the rise of the modern industrial enterprise, primarily as managers and directors. This was often a byproduct, however, of their "stranglehold" in staffing the professional civil service, an important source of white-collar employees for private industry [20].

There is some evidence of the pragmatism of the North American lawyers relative to their European counterparts in the nineteenth century. When opportunity knocked, they seemed more than willing to put aside traditional notions concerning the limits of professional practice or the ideology of objective service it encompassed and embrace new profit-making opportunities [15, 16]. This was, no doubt, a reflection of a frontier society in which rapid change and social mobility were accepted norms. Lawyers had immense opportunities to use their positions as a springboard to great wealth and social position, but the lack of societal and professional structure also meant that many, perhaps a majority, of lawyers had to struggle to make a living in the United States and Canada. Consequently, nineteenth-century North American lawyers were accustomed to going beyond the traditional functions of the solicitor and the courtroom barrister simply to make ends meet. Lawyers eagerly took up the new business opportunities offered by industrialization, particularly those offered by the rise of big business [4, 14, 19]. In this way an important minority of lawyers chose to become the handmaidens of big business. Receiving generous compensation for their services, these specialists quickly became the elite of the profession in a society that held material gain to be the single most important determinant of social status.

The nature of North American finance in the second industrial revolution also demands examination. In Britain, there continued to be greater dependence on traditional forms of capital accumulation: retained earnings, personal savings, and bank advances, in part because of slower domestic growth. Relative to North American business, British industry had more modest capital requirements by the late nineteenth century. In the continental countries that did have rapidly expanding economies, such as Germany, security financing was much more regulated and was handled through the great mixed banks. In contrast, security financing was largely unregulated in Canada and the United States until the 1930s. This meant that creative possibilities were greater, but that abuses were also more prevalent. In this punishing but potentially very profitable world of *caveat emptor*, experienced corporate lawyers were capable navigators with skills that could be sold in an agency-type arrangement or employed more directly, as Cahan's and Lovett's were in the formation of their own investment bank.

More so than in Europe, industrial capital formation in North America concentrated on a steady diet of new corporation promotions.



Unlike the mixed banks of the continent, the personalized North American investment banks tended to be more oriented to the short-term:

Their success required staying ahead of the piper. Like Eliza leaping from ice floe to ice floe before each sinks, the main concern and main success of these institutions lay in luring the investment public ever forward to new transactions, either burying the old ones or shoring them up through continuing efforts as extending oligopolization and the profitability inherent therein, as well as through ever more Byzantine financial instruments and structures. This attitude probably led to a behavior pattern vis-a-vis internal management characterized less by credit extenders' let alone managerial concerns than by more speculative or promotional financial concerns [9, pp. 246-47].

Indeed, Cahan and Lovett had little long-term "commitment" to the companies they directly serviced. Although they set very broad corporate policy through their leadership on the executive committees of the board of directors, the details of management were left to the officers of the respective companies, in particular, the general manager. Cahan and Lovett generally remained identified with the companies for a couple of years after their formation or reorganization after which they retired and moved on to new companies and new boards of directors. They were always prepared to sell their ownership interests after a flotation or reorganization; some companies such as International Engineering were sold within a year of their financial reorganization by Corporation Agencies. The management function performed by Cahan and Lovett was typical of the age of financial capitalism, which was succeeded by a more stable regime of managerial capitalism a few years after the first Canadian merger wave. Nevertheless, it is significant that corporate lawyers such as Cahan and Lovett went beyond the promotional aspect of their work and took on such a transitional managerial function. They formed, in fact, a bridge between the small business owner-operators prevalent before the rise of the modern industrial enterprise and the new hierarchy of professional managers that was just beginning to form.

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