Chapter 7

Railway Companies:
Expropriation Risk and Investor Protection

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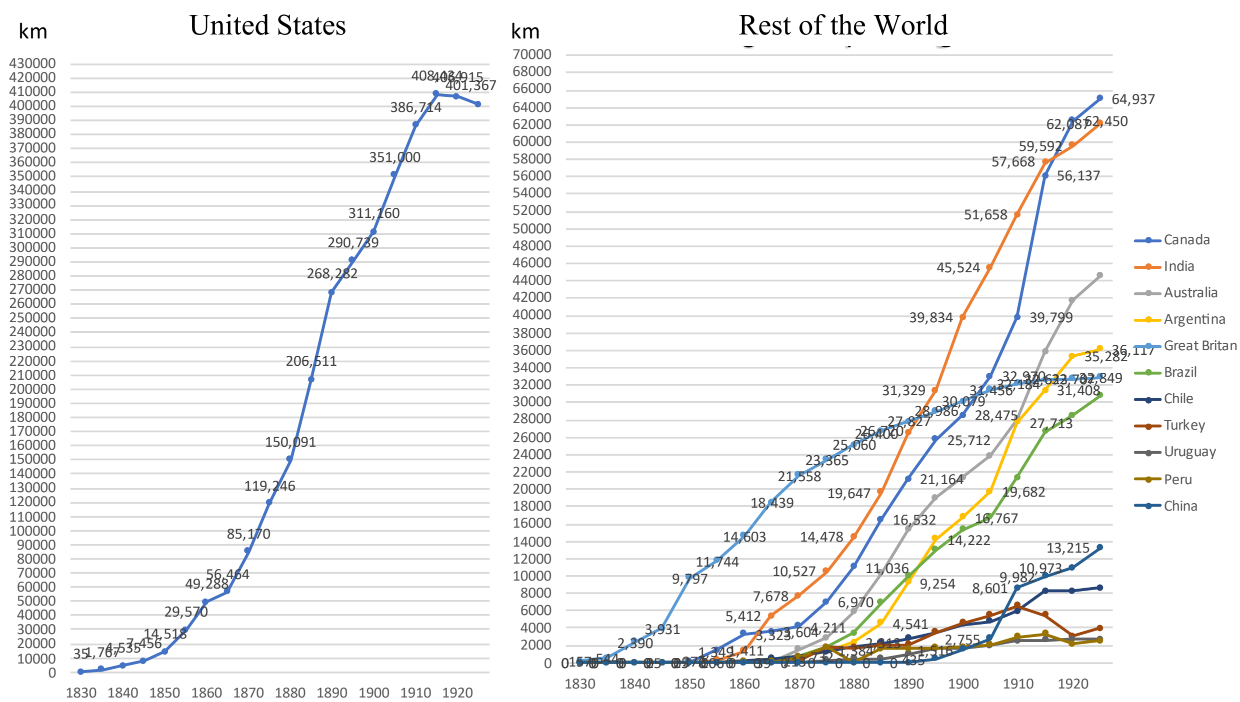
Of the British capital investments overseas, in and outside the Empire, the largest investment beyond government bonds (36.3%) was in railway companies (31.7%). Railways amounted to nearly half of the investment in private companies. The investment in the second largest sector, raw materials, was barely a third of the investment in railways. Investment in railways composed 61.6% of the total British investments in the US and 57.5% of the investment in Argentina. Within the Empire, over 40% of the investments in India and Canada were in railway companies.[1]

Railway construction was a central outcome of the Industrial Revolution, a combination of iron, coal, and the steam engine. The first wave in Britain began in the 1820s, reaching the 281 KM mark in 1839, the 437 KM mark in 1847, and 16,093 KM of railway lines in

[1] Irving Stone, *The Gobal Export of Capital from Great Britain, 1865-1914: A Statistical Survey* (Basingstoke: Macmillan Press, 1999), 412.

1858.[2] British technology, expertise, and capital carried railways with a two to three-decade lag to the Empire and the rest of the globe. The most significant deployment of railways in the world took place in the US where between 1830 and 1920 approximately 400,000 KM of tracks were laid, roughly 6 times more than of Canada and India, and 12 times more than Britain.

Figure 1.1 – Length of operating railways in the US and the rest of the world between 1830-1920



Source: (Mitchell, 1993); (Pérez, 2017); (Lavallée, 1982); (Mitchell, 1998, p. 496-507); (Schram, 1997, p. 65); (Mitchell, 1978, p. 581-588); (Stover, 1997, p. 205)
United States (Mitchell, 1993), (Stover, 1997, p. 205); **Canada** (Mitchell, 1993) (Lavallée, 1982); **India** (Mitchell, 1998, p. 496-507) **Australia** (Mitchell, 1993), (Stover, 1997, p. 205); **Argentina** (Mitchell, 1993), (Pérez, 2017) **Great Britain:** (Schram, 1997, p. 65), (Mitchell, 1978, p. 581-588); **Brazil** (Mitchell, 1993); **Chile** (Mitchell, 1993);

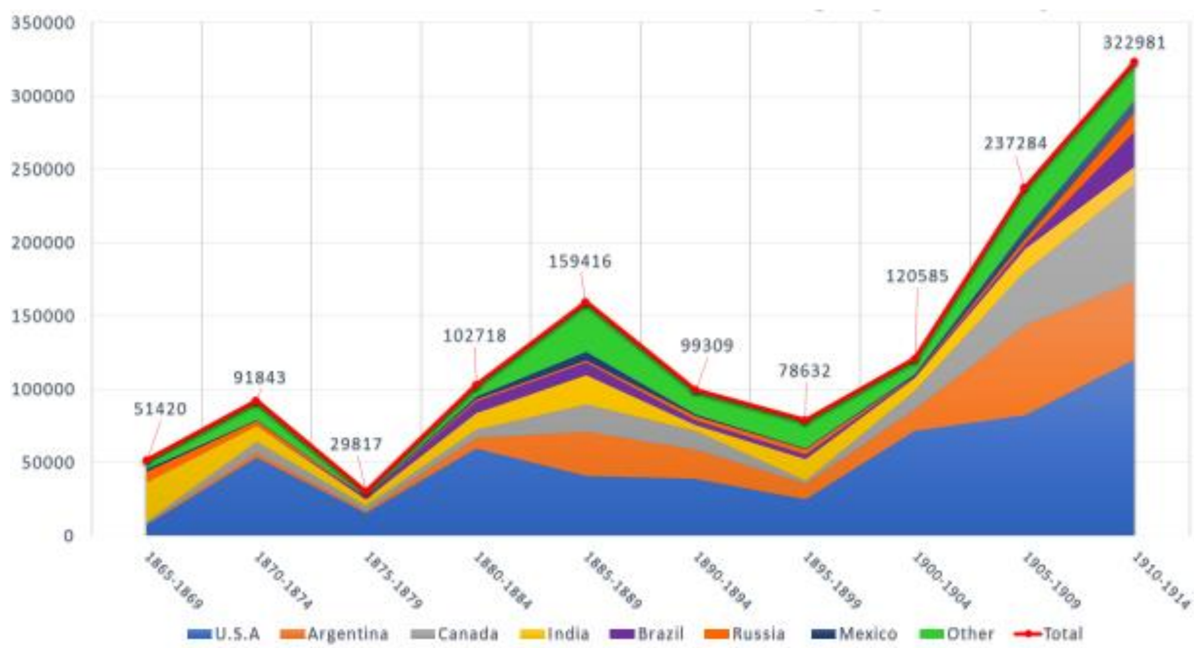
[2] B. R. Mitchell, *European Historical Statistics 1750-1970*, Abridged ed. (London: Macmillan London, 1978), 581-88.

Turkey (Mitchell, 1998, p. 496-507); **Uruguay** (Mitchell. 1993); **Peru**: (Mitchell, 1993); **China** (Mitchell, 1998, p. 496-507)

Some view the British investment in overseas railways as one of the utmost expressions of colonialism and exploitation. Some view this investment as bringing about global markets integration and economic modern growth beyond Europe. This chapter does not deal with the economic impact of railways.

Of all sectors analyzed in this book railways needed the State the most and feared the most from the State. This sector challenges the overarching argument of the book that in this period the business corporation escaped the control of states. Railways needed the state for licenses that allowed foreigners to construct lines within their jurisdiction, for permission to use state lend or eminent domain powers to take private land, and for the right to charge fares from the public. Railways required a large investment per project. The promoters often underestimated the costs, either because of their familiarity with the topography and terrain of the remote region in which the line was constructed or because they preferred to manipulatively lower costs at the IPO stage in order to lure uninformed investors. The investment was in a lump sum upfront. The payoff began only when the two destinations (say two major cities, or a mine and a port) were connected. Revenues reached full level only when a railway network was completed, either by a single company or several companies with interconnecting lines using the same gauge. The full return of the initial investment could take decades. Given all these characteristics it was often unfeasible for private enterprises to raise capital from passive investors without some level of sharing of the investments or the risks by the host states.

Figure 1.2 – British investment in railways (in 000's) between 1865-1914



Source: (Stone, 1999, p. 386)

Railway is also the sector in which the protection of British investments was most challenging. The Investment was mainly in immovable – land, rails, and stations – that could not be pulled out of the country of investment if things turned to the worse. Furthermore, rolling stock was often brought from Britain, which only increased the capital that was subjected to expropriation. Once the British investment was done in full and the railway line was completed, troubles only began. The profitability of the line was subject to network effect. A single line depended on other lines that would connect it to major urban centers, ports, mining districts, and agricultural hinterlands. The effect of the network depended on gauge standardization. Furthermore, the business plan and the expected profitability relied not only on passenger and freight traffic volumes but also on prices and rates. A future regulatory decrease in rates is in a sense an expropriation. A line's traffic could be damaged by a future concession granted by the host government to a competing line. The host government could also increase the income taxation of the railway company. The expropriation risk of the company's property (say lines or stations) and even nationalization of the company itself is the ultimate risk. Investors had to protect themselves from this ultimate risk as well as from lesser risks before making the lump sum investment.

The literature on credible commitments and the literature on sovereign debt teaches us that governments cannot easily make credible commitments not to expropriate or commitments to repay the money they borrow.[3] The main problem is the absence of third-party enforcement. Domestic commitments between private individuals can be enforced by the state, but the state is not likely to enforce its own commitments to its detriment. Those who consider lending money to the state or investing in assets within its jurisdiction know this and would refrain from doing this unless the state can credibly commit to repay or not to expropriate. Commitments can be done using various formal and informal tools, starting with constitutions that protect property rights and independent judiciary, through international treaties, laws, and arbitration, to guaranties, the threat of boycotts and sanctions by creditors' associations, and ending with the gunboat policy. A state that can offer a weak level of commitment will be able to attract less investment at higher costs (say interest) than a state that can offer a high level of commitment not to expropriate and to

[3] Douglass North and Barry Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England," *The Journal of Economic History* 49, no. 4 (1989); "Questioning Credible Commitment," in *Questioning Credible Commitment: Perspectives on the Rise of Financial Capitalism*, ed. D'Maris Coffman, Adrian Leonard, and Larry Neal, Macroeconomic Policy Making (Cambridge: Cambridge University Press, 2013).

repay. As we shall see the flow of capital out of London that constructed railway networks in the Americas and Asia (and to a lesser extent Eastern Europe, Africa, and Australia) faced problems that should be understood in terms of both **investor protection** and **sovereign debt problems**. In this chapter, when dealing with and contracting with the host governments, the companies simultaneously define the content of these contracts and enhance the ability to enforce them given the above challenges. I will investigate how these agreements with host states, and the problems of enforcing them, shaped the organization, governance, and finance of railway companies. I will do so by examining variations between the organizational details of railway companies that were active in the Empire, in the informal empire, and outside the empire. I will also look at changes over time in the organization of railway companies in the same country in the period 1850-1914. Lastly, I will explain later in the book, organizational differences between railway companies and companies in other sectors that rely heavily on land use, such as mining, oil production, plantations, and telegraph.

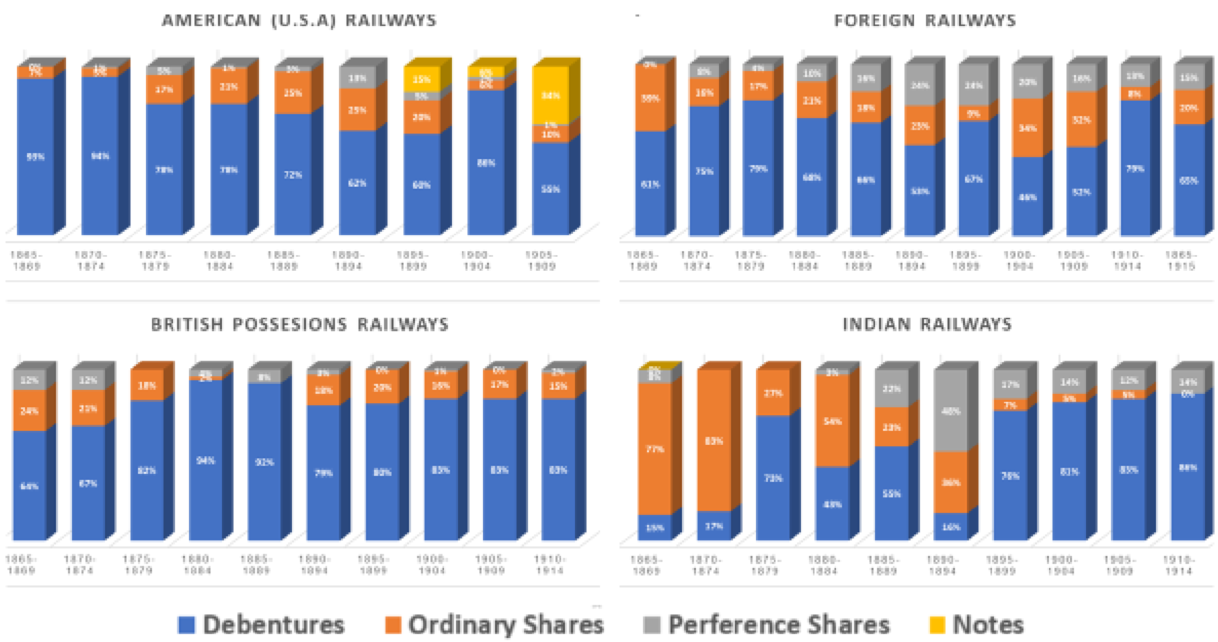
The basic organizational structure of overseas railway companies seems, at first sight, to be trivial and non-revealing. They were considered by Mira Wilkins as stand-alone companies, that is companies that invested in only one location and were not part of corporate groups. They raised their initial capital in Britain and were listed on the London Stock Exchange and invested it overseas, meaning that these companies were the channel for capital exportation from Britain to the rest of the globe. They were mostly registered in England and thus subject to British company law.

In Britain itself, an environment in which the constitutional tradition went back to the Magna Carta, land law to the Doomsday Book and the writs of Henry the II, the independence of the judiciary was enhanced by the Bill of Rights, the government could credibly commit that it will not expropriate investors in railway companies. The main concern of investors was that projects would fail before completion. The major tools for easing this concern were by the mix of some level of acquaintance between the incorporators and the local investors, investment by installments according to the progress of the construction and a combination of equity and debt finance secured on the land and rail. There was some concern over ex-post parliamentary regulation that would undermine the profitability of a railway company. With this, each company could struggle with normal parliamentary lobbying tools. Outside of Britain, the credibility of the host governments was questionable. Investor protection was mostly found in the financial structure of the railway companies and to an extent in governance details.

The best way to expose these organizational details is by looking at variations in the organization of railway companies between different jurisdictions in which the expropriation threat to investments varied. Investments in railway companies in the Empire were better protected than investments in the informal empire and in foreign countries. Within the Empire, self-ruled settler colonies could pose different expropriation threats than the government of India or a crown colony. The legal systems of Imperial China and the Ottoman Empire treated foreigners and their investments in different ways. The ability of the British to protect their investments in Argentina was different from that in the United States.

When examining the financial structure of railway companies in which the British invested overseas, the characteristic that was common to railway companies in different jurisdictions was the widespread use of debt finance. This was in contrast to other sectors, in which equity investment in ordinary shares was the main mode of investment.

Figure 1.3 – Security composition of British capital exports – railways



Source: (Stone, 1999, p. 396)

India

The two first companies established for the construction of railways in India were the East Indian Railway Companyand the Great Indian Peninsula Railway Company (Great Indian Peninsula). They were by far the largest Indian railway companies in the 19th century. The first connected Calcutta and Delhi along the Gangetic Plain. The second connected Bombay with the Gangetic Vally. The two railways eventually connected at Jabalpur.

Map 1.1 – Illustration of the routes of the East Indian Railway Company and the Great Indian Peninsula Railway Company

The formation of the two companies took place simultaneously. I will thus discuss them jointly. The first question that comes to mind with respect to colonial railways is, were they in fact state railways or private railways? The answer is not in black or white.

Rowland Macdonald Stephenson (1808-1895) was the first to introduce the idea of a railway system in India.[4] Already in the year 1841, Stephenson started trying to convince the East India Company to allow and subsidize railway construction in India.[5] Subsequently, Stephenson formed a group of investors in Britain known as the East Indian Railway.[6] Stephenson promoted the idea as offering both military and commercial benefits, and outlined a scheme for major railroad lines linking Calcutta, Delhi, Bombay, Madras, and Calicut. The East India Company shared with Stephenson and the other East Indian Railway initiators the view that the line would be of a great importance, but also its inability to construct the railway based on the Indian Government's budget.[7] Support for the railway came also from interest groups, mainly the cotton industry manufactures from Lancashire and Glasgow, the London East India houses, the P&O line, the city bankers, and the Midlands cutlery and hardware manufactures, who believed that the railway would make overland transportation faster at lower costs and facilitate India's trade with Britain and the rest of the globe. All of those put pressure on the court of directors of the East India Company to reach an agreement with the railway promoters.[8]

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[4] George Huddleston, *History of the East Indian Railway* (Thacker, Spink and Company, 1906), 2.
[5] D. R. Headrick, *The Tentacles of Progress: Technology Transfer in the Age of Imperialism, 1850-1940* (Oxford University Press, 1988), 58.
[6] J. Hurd and I. J. Kerr, *India's Railway History: A Research Handbook*, Handbook of Oriental Studies (Brill, 2012), 7.
[7] Huddleston, *History of the East Indian Railway*, 3.
[8] Headrick, *The Tentacles of Progress: Technology Transfer in the Age of Imperialism, 1850-1940*, 60.

The common story with respect to the Great Indian Peninsula is quite different. According to one version, the idea for the Great Indian Peninsula was of George Clark, a railway engineer who arrived in India in 1843 and became the Chief Engineer of the Government of Bombay. His plan was examined by a special Committee headed by the Chief Secretary of Bombay, Henry Conybeare, and approved by the meeting of the citizens of Bombay in April 1845.[9] According to another version, the formation of the Great Indian Peninsula as a company was largely thanks to the work of the engineer and promoter John Chapman in London at the service of abolitionist George Thompson with the goal of advancement of the life of Indians.[10] Both versions are public interest versions, unlike the East Indian Railway private benefit version.

The legal formation of the two companies was similar. They were formed in a company law transition period. The General Incorporation Act was passed in 1844, shortly after the initiation of the two projects. At the time India was ran by the East India Company, itself incorporated under Royal Charter. The authority of the Company to incorporate other entities was not yet settled. The first Indian General Incorporation Act was passed only six years later, in 1850. The Assam Company, the first Indian company we encountered in a previous chapter, was formed by deed of settlement in 1840 (it was incorporated by the Private Act of the Government of India in 1845). The two railway companies, like the Assam Company, began as unincorporated enterprises, and concluded in a deed of settlement made in London, serving as an interim platform, for seeking incorporation and

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[9] Rita P. Bhambi, "Great Indian Peninsula Railway Company and Its Contractors (1853-1871)," *Proceedings of the Indian History Congress* 73 (2012): 880.

[10] Ralf Roth and Günter Dinhobl, *Across the Borders: Financing the World's Railways in the Nineteenth and Twentieth Centuries* (Ashgate Publishing, Ltd., 2008), 229-31.; Bhambi, "Great Indian Peninsula Railway Company and Its Contractors (1853-1871)," 880.

rail concession. They were provisionally registered in 1845 based on the 1844 Companies Act. The Initial round of subscriptions was made within the group of promoters of each of the companies. In the following years, offers were made to the public in prospectuses advertised in the London press, in the Economists, the Times, etc.[11] Subscribers were expected to make only small payments early on, and to commit to additional payments upon future calls to be made with the progress of the projects. The initiators of the two companies eventually reached in 1849, the first of a series of agreements with the Government of India. Capital for building the railways was to come from the shareholders. In return, the East India Company guaranteed them an annual dividend of 5 % for a duration of 25 years. The state granted the railways free land in a 99-year lease. The state reserved the right to appoint a director, to supervise the construction and to control the railways' fares and their operation.[12] The railway companies had the option to sell their property to the Government after the end of the first 25 years for reimbursement of the construction costs. The Government had the option to buy it during the same time window and for the same remuneration. If none of them would not exercise that option, the state would acquire the property for free after 99 years. An in-depth analysis of the investment conditions shows that in order to deal with the profitability risk, the arrangement was designed in a way that stripped almost all the risk from investment in shares to such an extent that investing in shares was more similar to investment in government-guaranteed bonds on the down side, while maintaining the upside of share ownership in the form of capturing profit and dividend, and the control aspect of shares by holding voting rights.

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[11] Roth and Dinhobl, *Across the Borders: Financing the World's Railways in the Nineteenth and Twentieth Centuries*, 231.; "The East Indian Railway Company," *The Economist*, Nov. 8, 1845, 29.
[12] Headrick, *The Tentacles of Progress: Technology Transfer in the Age of Imperialism, 1850-1940*, 60-61.

The two Indian Railway Companies, like domestic railway companies in Britain itself, sought Parliamentary incorporations. They were reincorporated by Local Acts of the British Parliament on the same day, August 1st, 1849.[13] The Act of Incorporation by Parliament embedded and enforced the agreement between the incorporators and the East India Company. It also served as a means for overcoming any restrictions on the power to incorporate or any powers the East India Company faced being a corporation and signaled to it the expectations of London.

The members of the Board of Directors of the two companies included senior military officers and civil officials in India and promoters, merchants, and bankers in Britain.[14]

After the completion of the legal stage the construction moved forward, relying on contractors, many of them Indian, each constructing sections of the longer line. The first sections were opened in 1853, more calls were made on shares in London, and by the end of the 1850s, most of the original railway plan was in operation.

By 1859 there were six private railway companies in India besides the East Indian Railway Company and the Great Indian Peninsula. Those companies were: the Madras; the Bombay, Baroda, and Central India; the Sind, Punjab, and Delhi Railway; the Eastern Bengal; the Great Southern of India; and the Calcutta and South-Eastern.[15]

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[13] East Indian Railway Company Act 1849 (12 & 13 Vict. c. xciii).; Great Indian Peninsula Railway Company Act 1849 (12 & 13 Vict. c. lxxxiii)

[14] Roth and Dinhobl, *Across the Borders: Financing the World's Railways in the Nineteenth and Twentieth Centuries*, 231.

[15] Headrick, *The Tentacles of Progress: Technology Transfer in the Age of Imperialism, 1850-1940*, 63-64.

Table 1.1 – Growth of the private guaranteed railways between 1853–1871

Private guaranteed companies	First operational year	Mile/kms opened in first year	Miles/kms opened be end of 1877
1) Great Indian Peninsula	1853	21/34	1273/2050
2) East Indian	1854	38/61	1503/2420
3) Madras	1856	65/105	830/1336
4) Bombay, Baroda and Central India	1860	35/56	341/549
5) Sind, Punjab and Delhi	1861	110/177	554/892
6) South Indian	1861	49/79	186/299
7) Eastern Bengal	1862	110/177	157/253
8) Oudh and Rohilkhand	1867	42/68	42/68

Source : (Hurd and Kerr, 2012, p. 9)

In 1870 the government faced criticism of two types, one that the cost of dividend guarantees was placed on Indian taxpayers and the other that it created a deficit for the Government of India (now Imperial rather than Corporate) and therefore it began financing railways itself. These projects were much cheaper than the guaranteed lines, though in less profitable frontier and rural regions. These projects were financed by issuing debentures.[16] In the 1880s' the Government shifted back to a guaranty system. In the new system, the guaranteed rate was lowered from 5% to 4% or below.[17] Old contract railway companies (with high guaranteed rate) were gradually bought by the government beginning in 1880 and were operated by the government or by contractors.[18] By the turn of the 20th century, five basic types of railway lines could be found:

[16] Ibid., 72.
[17] Ibid., 74.
[18] Ibid., 77.

1. Early lines, 1850-1970 owned and operated by private companies guaranteed under old 5% contracts; 25 years extended to 50 years.

2. 1870-79 state-owned lines constructed and operated by the state; (mostly frontier, famine areas, and branch lines). Lines with prospects of profit were funded by government debentures issued in London while the strategic lines with lower revenue prospects were funded out of the Government's budget.

3. From 1880 lines owned and worked by private companies guaranteed from 1880 under new 4% or less contracts.

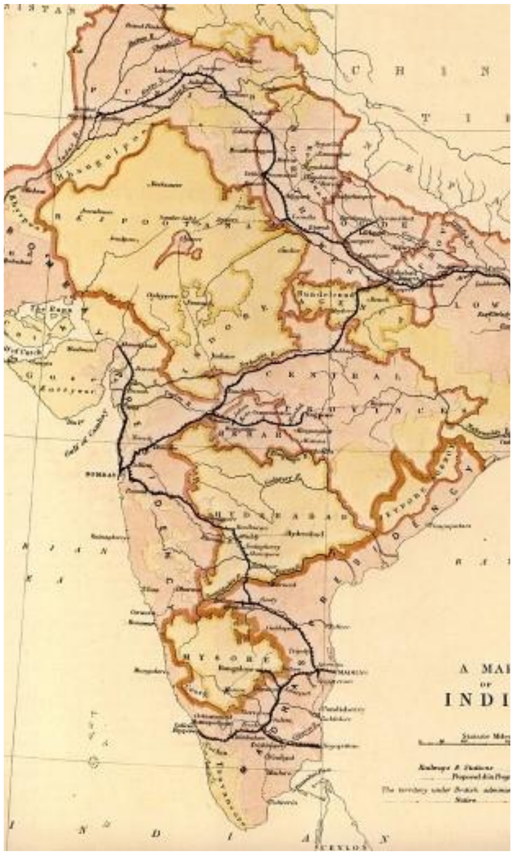
4. 1880-1900 State nationalized lines of old guaranteed companies and employed private companies only for operation.

The construction of the railway was a major colonial project in the Indian subcontinent. From a starting point of no railways at all in 1849, the length of completed lines reached 15,764 KM in 1880 and 59,585 KM in 1915. Railways were by far the largest infrastructure project constructed in India with British capital. Of the £271,000,000 British capital exported to India before 1911 around £200,000,000 were invested in railways.[19] The Indian Subcontinent was covered with a railway network of a blend of private and public lines.

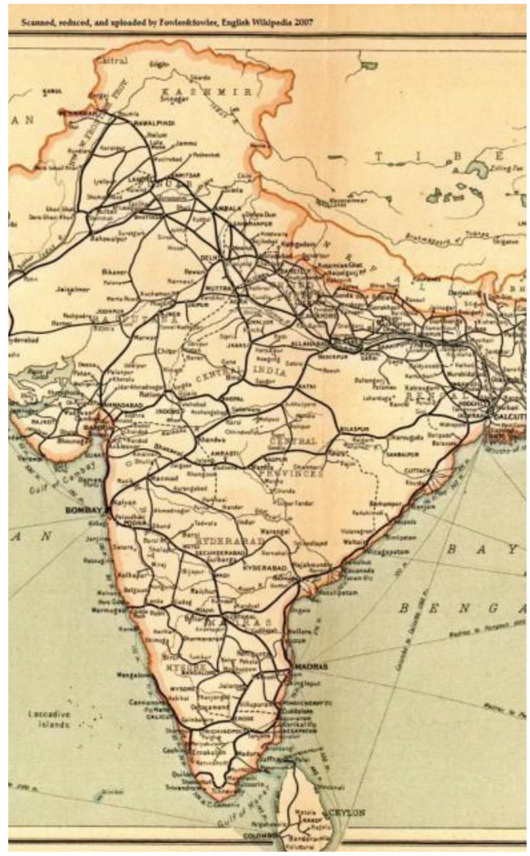
[19] Ian J. Kerr, *Building the Railways of the Raj, 1850-1900* (Oxford University Press, USA, 1995), 4.; Headrick, *The Tentacles of Progress: Technology Transfer in the Age of Imperialism, 1850-1940*, 49-96.

Map 1.2 - Development of Indian railway lines, 1871 to 1909

1871



1909



The project of constructing a railway network was on the border-zone between the private and the public. The British investors in Indian railway companies dealt directly with the British Government and Parliament in London. The East India Company and the Government of India followed the London policy and dealt only with the details. The swing shifted between private initiation and investment accompanied by state guarantees, government initiative and investment accompanied by private loans, and again private initiative and funding accompanied by government guarantees. Investor protection issues in the case of Indian railways, being based on understandings with the Government and

Acts of Parliament, were not that different from those in Britain itself. Therefore, the capital structure was designed to ensure the profitability of the investment and the governmental financial backing and other assistance, and not a protection against expropriation.

Argentina

Argentina's government advanced railway construction with a policy of subsidizing private companies, mainly British, in the form of interest guarantees for investors. Unlike in the US or Canada, a direct money grant or land gifts were rarely used. The national government pursued no fixed policy regarding the inducement offered to foreign capitalists, guaranteeing what it found necessary to secure capital and management services. Of the 20 largest British investments in railway companies overseas (beyond the US and Canada) 10 were made in Argentinian railways. We will expand here on the two largest, which were also the first two to be established.

Table 1.2 – Largest British overseas railways (outside the US and Canada) by capitalization, 1916

Railway company	Location	Capitalization (£)	KM
Central Argentine	Argentina	60,042,000	2067
Buenos Ayres Great Southern	Argentina	56,512,000	2331
Bombay, Baroda and Central India	India	44,643,000	2271
Buenos Ayres Western	Argentina	31,273,000	1113
Buenos Ayres and Pacific	Argentina	29,412,000	2191
East Indian	India	27,311,000	1698
Cordoba Central	Argentina	20,336,000	741
URH&RW	Cuba	17,857,000	426
Leopoldina	Brazil	15,966,000	1095
Bengal Nagpur	India	12,316,000	1671

Argentine Great Western	Argentina	11,807,000	611
Madras and Southern Mahratta	India	11,576,000	1958
Argentine	Argentina	11,029,000	n/a
Bahia, Blanco and North Western	Argentina	10,504,000	451
Antofagasta (Chili) and Bolivia	Chile and Bolivia	10,084,000	512
Entre Rios	Argentina	8,377,000	456
Mexican	Mexico	7,710,000	264
Interoceanic	Mexico	7,563,000	654
Argentine North Eastern	Argentina	6,758,000	417
Bengal and North Western	India	6,345,000	1896

Sources: (US Federal Trade Commission, 1916, p. 541-542); (Railway Year Book for 1915, p. 292-308)

In the first railway, *F.C. Central Argentino* (Central Argentine), whose first 10 km section was built in 1857, the government contributed 39% of the paid-up capital and renounced its right to dividends until the other investors reached a 9% return. The government also donated the lands for the railway line and exempted the company from taxation for 40 years. No other enterprise received such substantial government aid.[20] The Argentinian Republic was unified in 1862. Bartolomé Mitre (1821-1906) became the first president, and he was strongly supportive of foreign investment in Argentina, and particularly supported the development of railway lines connecting the country, which he considered both infrastructurally critical for the growth of the country as well as symbols of that growth.[21]

As land grants were not attractive enough given the high costs of construction compared with the expected value of these lands after line construction, in 1862 the government

[20] Julian S. Duncan, "British Railways in Argentina," *Political Science Quarterly* 52, no. 4 (1937): 562.
[21] John Murray, "Britain and Argentina in the Nineteenth Century," *Studies: An Irish Quarterly Review* 49, no. 196 (1960).

agreed to guarantee investors a return of 7% annually. The guarantee was a promise that the state would ensure a reasonable return to shareholders upon their investments. The guarantee was offered upon a fixed sum calculated, quite like in India, at a specified cost of construction per mile (the recognized capital) according to the company's concession. The guaranteed return was 2% higher than the Indian standard which was at the time 5%, reflecting the higher risk to investors in railways outside the Empire. Obviously, an interest of 2% cannot offset an imminent fear of full expropriation, but it reduces the risk of business failure given the less certain market and regulation environment. The guarantee was devised as a means of attracting and safeguarding investment until an enterprise achieved its profit-earning potential. The state also established a limit on the maximum guarantee allowed and provided for the repayment by the company of previous advances when earnings achieved a mutually agreed level. Subsequently, a guaranteed return upon investment became a common feature of all successfully floated Argentine railway companies.[22]

The Central Argentine Railway had its beginning in a concession given by the Argentine Government to William Wheelwright (1798-1873), an American businessman for the construction of a railway from Rosario to Cordoba. The decree of April 2, 1855, authorizing this railroad, was the first national document relating to railway concession. The concession gave the railway not only the right of way but also land on each side of the track.[23] The Argentine Government had also guaranteed the company an annual interest of

[22]Colin M. Lewis, *British Railways in Argentina 1857-1914: A Case Study of Foreign Investment* (London: Bloomsbury Academic, 1983), 10-11.

[23] George S. Brady and Bureau of Domestic and Foreign Commerce U.S. Department of Commerce, *Part I: Argentina*, Railway of South America (Washington D.C.: Government Printing Office, 1926), 38.

7% per year on the investment to the sum of £6,400 per mile (1.6 KM) for a full 40 years. This meant that if the profit fell below 7%, the Government would make up any shortfall. If, after 40 years, profits exceeded 7%, Central Argentine Railway would repay any excess previously paid by the Government. Mail would be carried free of charge and military personnel and their baggage at half price.[24] Following a power struggle between Wheelwright and his British competitors, on 10th March 1864, the Central Argentine Railway Company was officially registered in London. The capital required was no less than £1,600,000, and two months later 50,000 shares were floated on the London Stock Exchange at £20 each.[25]. In the following years calls were made on the shares and the line was constructed. by 1879, £1,300,000 of the authorized capital had been subscribed and was paying a 7% dividend (guaranteed). By 1887, the total capital issued in both shares and bonds reached £2,325,000; By 1896 the capital issued was £7,835,000.[26]

In the next stage, additional lines were integrated into the Central Argentine Railway as subsidiaries, either under original concessions from the government or lines acquired from provincial governments that were unable to complete them as publicly financed lines. The Central Argentine Land Company Limited was originally set up as a subsidiary of the Central Argentine Railway to administer its land grant. The grant was exceptional in

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[24] Steve J. Plummer, The Wheelwright Family Story, (Lulu.com, 2010). 325.
[25] Ibid.
[26] Duncan, "British Railways in Argentina," 562;. Colin M. Lewis, "'Anglo-Criollo' Rather Than British: Early Investments in Argentinian Railways and Utilities " in *Estudios Sobre La Historia De Los Ferrocarriles Argentinos (1857-1940)*, ed. Teresita Gómez and Jorge Schvarzer (Buenos Aires: Facultad de Ciencias Económicas, Universidad de Buenos Aires, 2007), 258; Royal J. Schmidt, "British Capital and Argentine Railroad Enterprises, 1860-1945 (England, Argentina)" (ProQuest Dissertations Publishing, 1947).

Argentine railway history: it was virtually the only company to obtain a land grant on the US model. The Central Argentine Railway ended up being a parent company.

Chart 1.1 - The Central Argentine Railways Company, Limited

The Buenos Aires Great Southern Railway was the second big British-owned company that built and operated railway networks in Argentina. In August 1861, Edward Lumb (1901-1987), a British entrepreneur, requested the concession of a railway line that would run from Constitución to the city of Chascomús (120 KM from Buenos Aires). Lumb's initiative was debated in the Chamber of Deputies, where it was concluded that the railroad was necessary for the development of the Argentinian nation. Wheelwright, the initiator of Central Argentine Railway tried to bid for the same concession but Lumb was able to fend him off by securing the support of the London financiers. Finally, on 27 May 1862, the Buenos Aires Legislature promulgated the Law that authorized the President of Argentina, Mitre, to enter into a contract with Lumb (grant a concession to him). The Government committed to ensure an annual return of 7% on the costs of construction over 40 years. By the terms of the concession, the property of the railway was to remain exempt from all taxation; the government reserved the right to intervene in the fixing of rates; the company has conceded the right to construct branches and extensions beyond Dolores (the final point of the original concession), but no interest guarantee would be given on such new lines. Finally, the government retained the right to expropriate the railway at any time, by paying the cost plus 20%.[27]

Lumb tried to raise money in Buenos Aires to finance the construction of the railroad but his attempts were not successful, and he had to turn to the London capital market. Once it became clear that the project had to turn to British investments a company, Buenos Aires Great Southern Railway Limited (Buenos Aires Great Southern), was registered in Britain in 1863. Later, with the support of London shareholders **Thomas Duguid**, the **Fair** family, British consul **Frank Parish** (later the chairman of Buenos Aires Great Southern), and the bankers **Baring** and **David Robertson**, Buenos Aires Great Southern. was floated as a British company and Listed in the London Stock Exchange.

The company requested Samuel Petro & E. Ladd to take over the construction of the whole railroad, including lands, stations, and workshops. The first segment of the line from Buenos Aires to Chascomús (112 KM long) was completed in 1865. The provincial government was never called upon to pay a guarantee above the original estimate of £49,000. Buenos Aires Great Southern main line was one of the most profitable Argentine railway companies. Thus, Buenos Aires Great Southern became the first South American railway company to pay a minimum guaranteed dividend upon its capital without recourse

[27] Brady and U.S. Department of Commerce, *Railways of South America: Argentina*, 57.

to the state. In 1881 the government of the province proposed to expropriate the railway (563 KM), which was paying an average dividend of 8% and sometimes a bonus. The chairman of the London Board, Frank Parish, entered a contract with the provincial government by which the latter agreed not to expropriate before 1902. At this time, the authorized capital was increased to £5,000,000.[28] By 1884 Buenos Aires Great Southern was the largest in Argentina, with 1,025 KM of track.[29]

The British investments made in these two companies, and a few other smaller British railway companies in Argentina were protected by the reputation the Argentinian government had to maintain in the City of London, the organization of the investors into an effective interest group that lobbied vis-à-vis the Government of Argentina and the provincial government, and, only in the background, the support of the British government that could exercise diplomatic pressure, trade sanctions and ultimately deploy gunboats. The Bank of London and the River Plate, the London & Westminster Bank, and the Baring Bank were involved with several projects and numerous investors each and served as a platform for organizing British investors in Argentina.[30] This created legitimation and respectability in London and opened political doors in Argentina.[31] Three significant investment groups invested in Argentina's railway networks between 1870 and 1900. The first was headed by Walter Morrison, a British Member of Parliament and director of the

[28] Schmidt, "British Capital and Argentine Railroad Enterprises", 4.
[29]Science Museum Group Collection, "Buenos Aires Great Southern Railway," @sciencemuseum, https://collection.sciencemuseumgroup.org.uk/people/ap26873/buenos-aires-great-southern-railway.
[30] George Bradshaw, *Bradshaw's Railway Manual, Shareholders' Guide and Official Directory*, vol. 23 (Henry Blacklock & Company., 1871), 366-68.
[31] Shima Amini and Steven Toms, "Elite Directors, London Finance, and British Overseas Expansion: Victorian Railway Networks, 1860–1900," *The Economic History Review* 74, no. 2 (2021): 516.

Central Argentine Railway.[32] The second investment group was led by Gabriel Goldney, a director of Capital and Counties Bank, and Edward Norman, a member of the board of directors of the Bahia Blanca & North Western Railway Company Limited, and the Villa Maria and Rufino Railway Company Limited, as well as the Cordoba Central Railway Company Limited and Buenos Aires Extension Railway.[33] Another important group was led by innovator and financier George Wilkinson Drabble and the banking firm Morton Rose, which was established by Levi Parsons Morton and Sir John Rose in 1863. The latter was a colonial administrator, a partner in Morton Rose, and later director in London and Westminster Bank.[34] Drabble was chairman of the Bank of London and the River Plate, the Buenos Aires and Rosario Railway, the Buenos Aires Great Southern Railway, the Buenos Aires Western Railway, and several railways in Uruguay.

These groups often collaborated to promote joint economic interests to the railway companies they led and in having cross directors and interlocking boards. Collaboration also took the form of interdisciplinary collaboration between London's Solicitors firms, banks, and management groups, in channeling investments from Britain to Argentina. Everything, from articles of incorporation to contracts with local governments, was done in a highly legalized manner. The Argentine case shows that members of parliament, often with a legal background, provided experience in negotiations with the political establishment in Argentina and, at the same time, acted in the British Parliament and the London investor community to promote the activities of the railway companies. Therefore,

[32] Charles A. Jones, "Great Capitalists and the Direction of British Overseas Investment in the Late Nineteenth Century: The Case of Argentina," *Business history* 22, no. 2 (1980): 159-60.
[33] Amini and Toms, "Elite Directors, London Finance, and British Overseas Expansion: Victorian Railway Networks, 1860–1900," 517.
[34]" Money-Market and City Intelligence," *The Times*, 27 August 1888.

politicians and financiers provided the legitimacy required to secure the expansion of the British rail network in Argentina.[35] Gunboat diplomacy was the last resort, a threat that had to be employed rarely if at all.[36]

Argentina underwent severe recession in 1890 with its real GDP falling by 11% between 1890 and 1891. In these years investors in Argentine rails were suffering from a fall in profits and an even more disastrous fall in the exchange value of their peso holdings and payments. Net profits fell from £1,484,000 in 1888 to £943,000 in 1891. The Buenos Aires Central and Great Southern, which paid 12% dividends in 1887, paid only 3% and 4% respectively in 1890 and 1891. The Argentinian government had to meet its guarantees and pay the balance.

The guarantee of interest payments to railway companies aggravated the public finance crisis faced by the Government of Argentina. With the economic recession, the government struggled with raising the taxation funds necessary for the payments. The government's guarantee to British investors, including Barings was in Gold Pesos, that is Pesos that could be converted to gold and by this hedged exchange rate exposure. Taxation on the other hand was in paper Pesos. The depreciating exchange rate required an increased income in pesos to meet each guaranteed interest payment. Beyond railway guarantees, Argentina had also heavily borrowed on the international markets through bonds to balance its budget. However, by 1889 the government could not raise enough new loans in London to cover its deficit and it was compelled to declare a moratorium on its foreign obligations.[37]

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[35]" Elite Directors, London Finance, and British Overseas Expansion: Victorian Railway Networks, 1860–1900," 518.
[36] Didac Queralt, *Pawned States: State Building in the Era of International Finance*, vol. 108 (Princeton University Press, 2022).
[37] Duncan, "British Railways in Argentina," 567.

During the 1880s the Baring Brothers bank, under the leadership of Edward Baring became increasingly involved in the financing of Argentinean infrastructure, taking large amounts of railway stocks and government bonds. In the recession of 1890, it was impossible for Barings to sell the large quantities of Argentinean stocks on its books, and by the end of 1890, the firm was in a liquidity crisis. It was forced to turn to the Bank of England for assistance and a loan was arranged. An international consortium assembled by William Lidderdale, governor of the Bank of England, including the Rothschilds and most of the other major London banks.[38] A new company, Baring Brothers & Co Limited was formed to take over Barings' business.[39]

The decline in railway profits and the default of interest payments on public bonds affected severely the export of capital to Argentina. For ten years no new Argentine government securities were issued in London. The increment in the investment in public funds during the decade 1891-1900 was entirely due to the numerous agreements between bondholders and the Argentine authorities to accept bonds in lieu of defaulted interest. The increase in British capital invested in Argentine rails during the years 1891-1900 can be explained almost entirely by the issue of £50,000,000 of gold bonds in lieu of payments of railway profits guaranteed by the government or for the extinction of guaranteed contracts.[40]

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[38] Kris James Mitchener and Marc D. Weidenmier, "The Baring Crisis and the Great Latin American Meltdown of the 1890s," *The Journal of Economic History* 68, no. 2 (2008).
[39] The Baring Archive, "Edward Baring, 1st Lord Revelstoke," https://www.baringarchive.org.uk/history/biographies/edward_baring_1st_lord_revelstoke.
[40] Henry S. Ferns, "Investment and Trade between Britain and Argentina in the Nineteenth Century," *The Economic History Review* 3, no. 2 (1950).

The 1890s demonstrate the close connection between public finance and private finance in the construction of railways in Argentina. The government borrowed in London and taxed its citizens in order to meet its guarantee to private British investors in railways.

In order to restore the confidence of investors in the Argentinian government, a law of 1899 fixed the ratio of the paper peso to the gold peso and created a fund for the conversion of gold, assuring free convertibility. The stability of the peso in an international exchange enabled the country to renew investors' willingness to invest in railways.[41] By the early 20th century the government lowered its commitment to guarantee railway companies' profits. About 50% of them had no guarantee of interest. As for the remainder, the trend was to lower the interest guarantee from 7% to 5% interest. This followed the Indian benchmark and may reflect the lowering of uncertainties as the railway network became more interconnected and construction costs easier to estimate accurately.

The Mitre Law, or ***Ley 5315*** passed in 1907 as a commitment by parliament to respect and enforce the concessions granted to British railway companies. It did not alter the terms of the concessions but turned their status from being a government contract to being a law. The law had the effect of an increase in foreign investments in railroads notably from British companies.[42] The 1890s were a decade of slowdown in railway construction. Around the turn of the century, with the the fix of exchange rate on gold, the pace of construction grew, and it continued to grow after the Mitre Law. By 1914 the total length of Argentinian railway lines passed the 31,000 KM mark.

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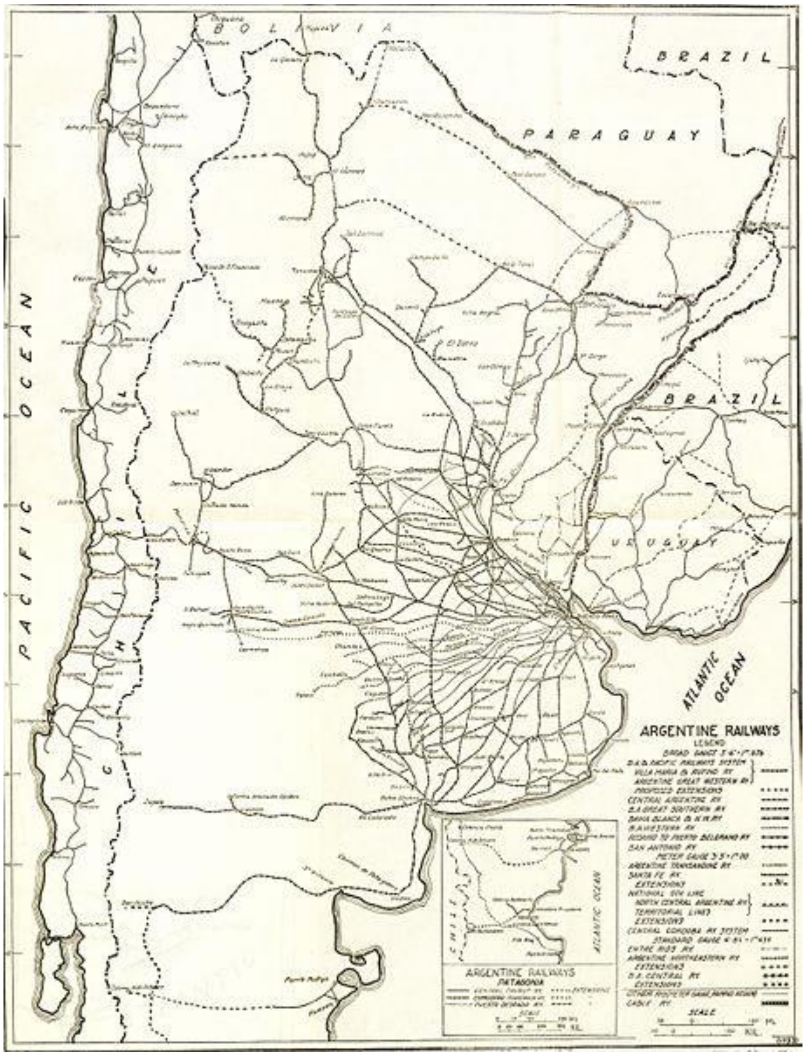
[41] Duncan, "British Railways in Argentina," 563.

[42] Andres M. Regalsky, "Foreign Capital, Local Interests and Railway Development in Argentina: French Investments in Railways, 1900–1914," *Journal of Latin American Studies* 21, no. 3 .(1989)

Map 1.3 – Railway lines in Argentina



Peru

In Peru, unlike in Argentina and India (and Britain), the early railways were constructed by the government as public projects. In order to finance these railways, and being unable to fund such a huge project through the annual budget based on tax payment, the Peruvian government borrowed money in London. Turning to London was not a new move, Peru borrowed money on the London Stock Exchange ever since its independence. In 1870 and

1872 the Peruvian Government issued a large amount of bonds in London (£11,200,000, and £22,000,000 respectively) to serve older debts and to finance the construction of government-owned Railways. The bonds were partly secured by the newly constructed railway lines. Guano and Nitrate, which had high demand at the time as fertilizers were expected to be the main source of income for repaying these debts. In 1876, the Government defaulted on the payment of the interest of the loans, reflecting the country's financial crisis as Guano and Nitrate revenues fell and the railways were far from completion and from yielding revenues. The British bondholders formed a committee that negotiated collectively with the Peruvian Government and approached the Foreign Office in London for support. However, Peru's income could in no way serve as a good enough basis for restructuring the debt. The basis for Peruvian repayment completely collapsed with the War of the Pacific of Bolivia and Peru against Chile in 1879-1883.[43] The war resulted in Chile acquiring Peru's Guano export, which was that served as security for the British bondholders. By 1885 the chairmen of the bondholders committee announced it was pointless to settle their share with Peru because of its hopeless financial situation. However, in the following year negotiation resumed primarily through the activities of the merchant Michael Grace (1842-1920) an Irish businessman active in New York and London. Grace realized that the railways were the only assets with potential revenue that the Peruvian Government could offer. He tried to broker a deal between the bondholders and Peru. After four years of negotiation, a settlement was reached. Grace's contract, as it was known, included the following major terms:

[43] Rory Miller, "British Business in Peru: From the Pacific War to the Great Depression," *Dinero y negocios en la historia de América Latina: veinte ensayos dedicados a Reinhard Liehr/Geld und Geschäft in der Geschichte Lateinamerikas: zwanzig Aufsätze, gewidmet Reinhard Liehr* (2000): 386.

1. The bondholders would get from the government the railways on a 66-year concession lease, complete the construction, operate the railways, and capture the profits.
2. The bondholders were guaranteed an annuity of £80,000 (later renegotiated to £60,000) for 33 years.
3. The bondholders received the right to export a minimum of 2,000,000 tons of guano.
4. In addition, the Corporation received a land grant and Amazon River navigation rights.[44]

Grace himself benefited from the contract by receiving a commission from the bondholders and contracts from the government, and continued to influence the management of the Peruvian Corporation Limited (Peruvian Corporation), to the disgust of Antony Gibbs & Sons, the Corporation's financial advisers.[45]

To manage their newly acquired assets the British bondholders formed a holding company, The Peruvian Corporation. The creditors of Peru converted their government bonds with shares in the newly formed company. For the British investors, the exchange of government bonds for corporate shares meant that they could now manage to railways themselves, and could now capture the upside if the railways would end up profitable. The Peruvian Corporation was registered on March 20, 1890, <u>under the Companies Act in London</u>,

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[44] "The Grace Contract, the Peruvian Corporation, and Peruvian History," *Ibero-amerikanisches Archiv* 9, no. 3/4 (1983): 95.

[45] Ibid., 100.'The Corporation appears to be spending too largely on colonisation, exploration, surveys &c. probably under the Grace-Ollard influence', wrote Herbert Gibbs at the beginning of a campaign by Gibbs to oust the company's management; "Harbert Gibbs to Harry Gibbs," in *Antony Gibbs and Sons Limited* (Guildhall Library, 1893).

having its main office and "headquarters" in London. The Board of Directors had ten members under the Chairmanship of Sir Alfred Dent. G.A. Ollard, of Smiles & Co Solicitors, was Manager in London, and T.E. Webb was Secretary, with Clinton Dawkins as the first representative in Peru.[46] The corporation's solicitors were Smiles & Co from London.

The company was incorporated with an authorized capital of £7,500,000, 4% cumulative preference stock, and £9,000,000 ordinary stock, which, as mentioned, was issued in exchange for the bonds of 1870 and 1872 as follows: The bondholders of the 1870 loan received a cash payment of about 3% from the Chilean cash contribution, 24% in preference shares, and 30% in ordinary shares. The holders of the 1872 bonds received about 21.5% in cash, 20% in preference stock, and 25% in ordinary stock.[47] Most of the stockholders were British, with a minority of French stockholders. The corporation stocks were quoted on the London Stock Exchange, but it is unclear when they were first quoted and at what nominal value.[48]

A clause in the original "Grace Contract" gave the Peruvian Corporation the right to form subsidiary companies for working the various railways. 4 subsidiaries – the Central Railway, the Southern Railway, Pacasmayo and Guadalupe Railway and Trujillo Railway

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[46] "The First Forty Years of the Peruvian Corporation Ltd. 1890-1930," in *Peruvian Corporation Archives* (UCL Special Collections, 1930).; Rory Miller, "British Free-Standing Companies on the West Coast of South America," *The free-standing company in the world economy, 1830–1996* (1998).

[47] United States and Bureau of Foreign and Domestic Commerce, *Railways of South America, Vol 2*, vol. 2 (Washington: U.S. Government Printing Office, 1927), 201.

[48] Frank C. Betts, *Railways and Railway Securities; a Study of All the Railway Companies Whose Securities Are Quoted on the Stock Exchange* (London: Mortimer, Harley & Co., 1922); *Arbitrage Franco-Chilien. MéMoire Pour La PéRuvian Corporation Limited*, (Lausanne: G. Bridel & Cie, 1895); "Agreement for Issue of Fully Paid Shares ", in *Peruvian Corporation Archive* (UCL Special Collections, 1890).

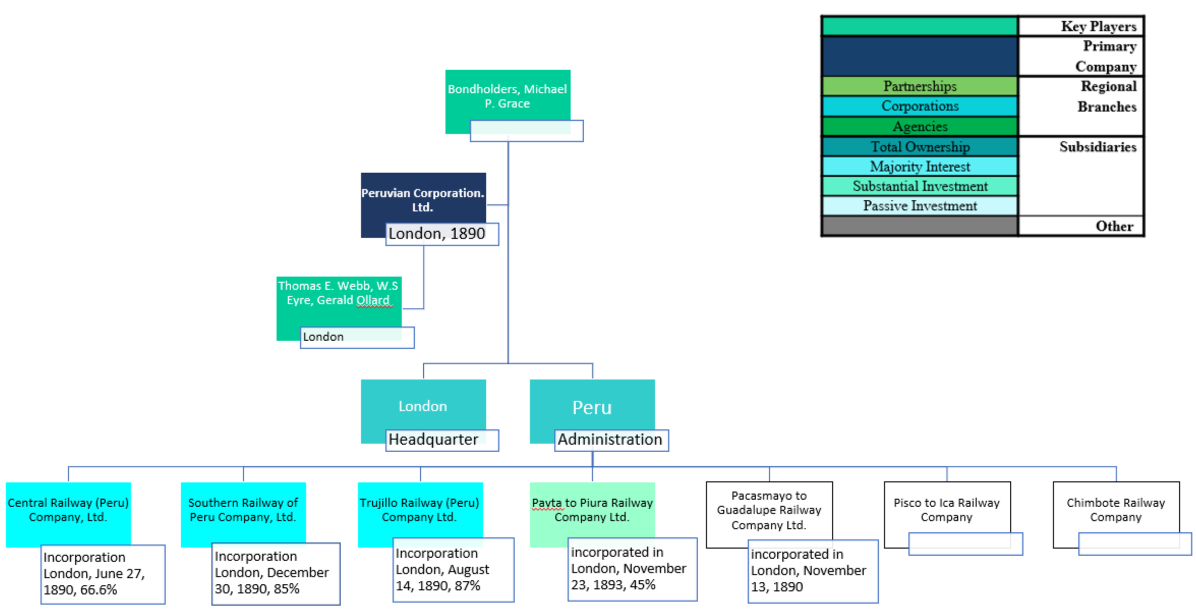
were formed immediately, and three other subsidiaries were formed soon thereafter. The subsidiaries were registered in London. The Peruvian Corporation retained an overwhelming controlling interest in each. Grace was also given substantial interests and was represented on the boards.[49]

Table 1.3 – The stocks and shares in companies, 1905

The Southern Railway of Peru, Limited, Ordinary Stock	2,224,700
The Central Railway of Peru, Limited, Ordinary Stock	1,333,327
The Trujillo Railway (Peru), Limited, Ordinary Stock	439,993
The Pacasmayo and Guadalupe Railway (Peru), Limited, Ordinary Stock	199,693
The Payta to Piura Railway (Peru), Limited, Ordinary Stock	45,000
The Peruvian Cotton Manufacturing Company, Limited, 840 Ordinary Shares allotted on re-construction in respect of 600 Preference Shares, taken inprevious accounts at	600
The New Chosica Land Company (Peru) at cost in Peruvian currency (S/8,100)	810

Source: (Peruvian Corporation Report, 1905, p. 17)

Chart 1.2 – Peruvian Corporation, Limited: 1890-1985



United States and Commerce, *Railways of South America*, Vol 2, 201.

The course of development of British investment in Peru was the reversal of the Argentinian. In Argentina, the government realized early on that it could not finance the construction of a railway network, and therefore it negotiated concessions with British investors groups which formed British companies to hold and execute the concessions. The Peruvian government, on the other hand, financed railway construction by issuing bonds in London and the railways were government-owned.[51] After the War of the Pacific and repeated sovereign debt crises, the government failed to meet the interest payments to the bondholders, and the Grace Contract transferred the main lines to the private hands of the British bondholders which established for this purpose the Peruvian Corporation. The British investors now had to protect themselves against the nationalization of the corporations, a different exercise than the protection of investment of lenders to the government. The Peruvian government hoped that the Grace contract would improve its reputation and creditworthiness and allow it access to the London Stock Exchange sovereign debt market in the future. It appears that the motivation to build up a positive reputation was the a measure for reassuring protection for the British investors against the expropriation risk.

United States

Railways (railroads as they are called in the US) were as central to the expansion and integration of the American nation as they were to its economic transformation. By the 1850s the total length of lines in the US surpassed that of Britain, never to look back. By

[51] Miller, "British Business in Peru: From the Pacific War to the Great Depression," 381.

1910 it was twice as long as the length of railway lines in Canada, India, Argentina, and Australia together. The lines first expanded along the Atlantic seaboard, then to the Midwest and Mississippi Valley, and after the Civil War across the plains, past the Rocky Mountains, and to the Pacific Coast, forming the first transcontinental connections. This section does not pretend to offer a history of American railroads, it deals only with the British investments in American railroad companies.

Map 1.4 – US railroad expansion, 1860 to 1890

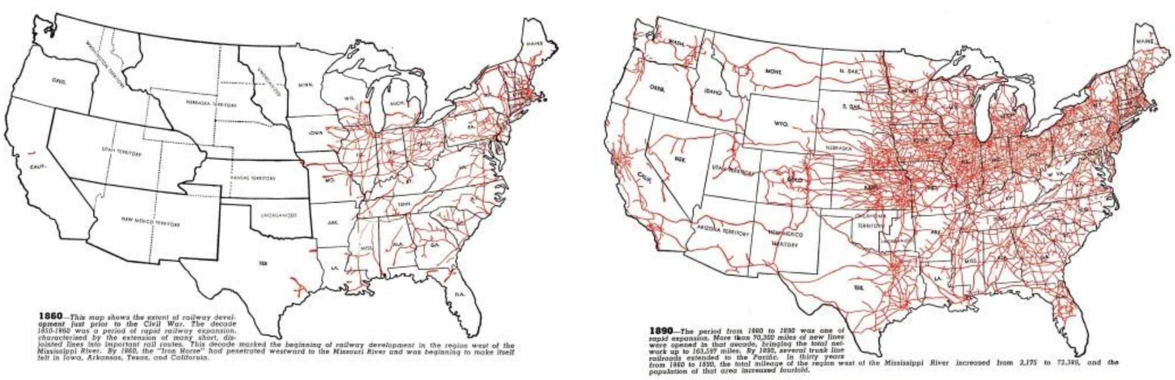
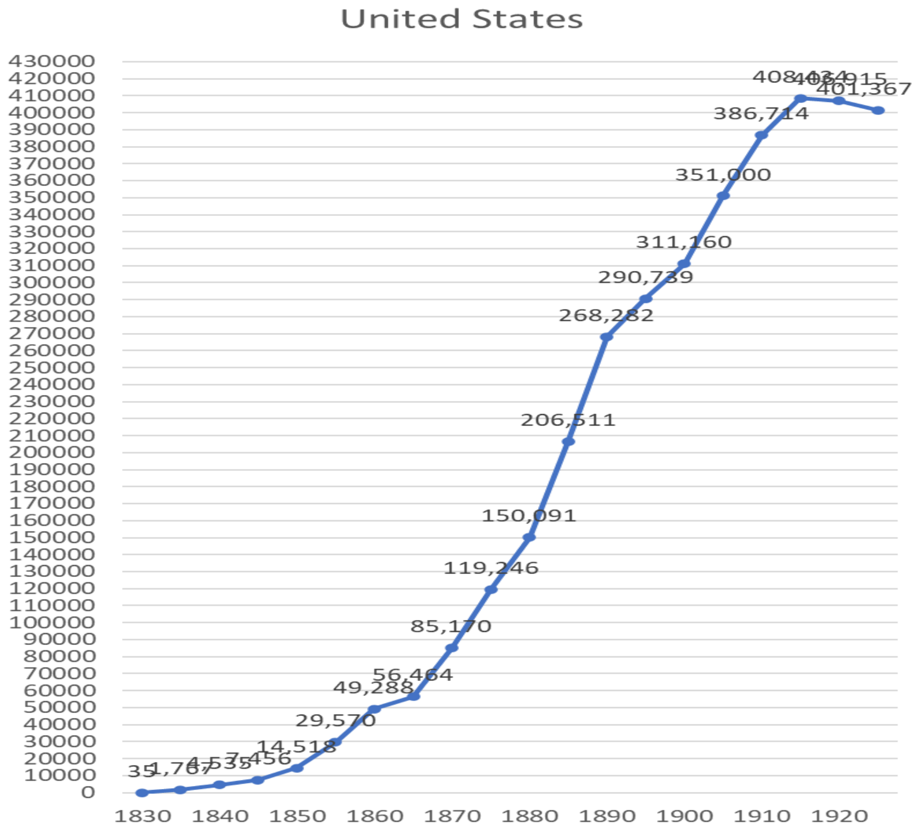


Figure 1.4 – US railroad expansion, 1830 – 1920



Source: (Stover, 1997, p. 205); (B. R. Mitchell,1983)

The US was indeed composed of former colonies of the British Empire, but by our period was positioned well outside the British Empire. The War of 1812 and the Monroe Doctrine (presented in 1823) symbolize the American resilience against any British military or diplomatic or financial interference. These factors made the US case so different from the cases of India on the one hand and Peru and Argentina on the other, in terms of investor protection from expropriation. The US had a constitution that assured an independent judiciary and the protection of property rights against uncompensated taking. ~~century~~ The US had abundant land and was short on capital. The result of these conditions was that as a developing economy, the US was in need of capital all the way to the late 19^{th} century, and that British investment in it could not be protected by the Gun Boat Policy threat. On the other hand, the British investors could rely to an extent on the domestic rule of law.

At the early stages of the railway era in the United States, the railroad lines were mostly local or regional, did not require high investment, and were funded, like canals before them, by local American capital, that of the future users of the line. This was the case especially in New England and in the mid-Atlantic states, where sizable capital accumulated due to international trade. Unlike Latin American countries, the US did not rely after 1835 on British capital to fund its national debt, and private and public finance did not blend. The possibility of British investments was confined to the private sector.

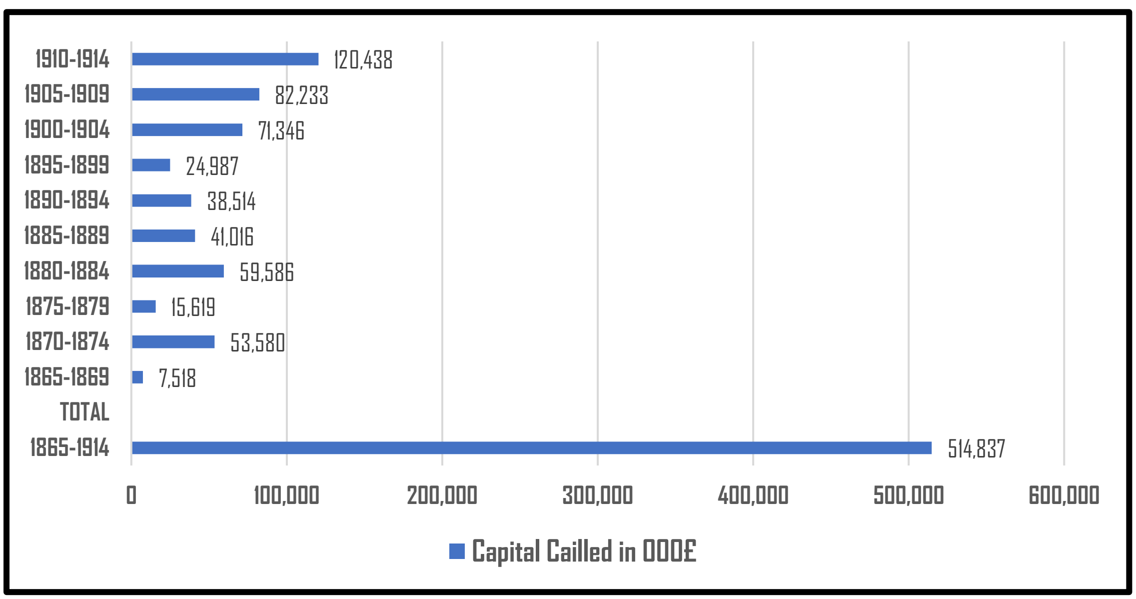
As we shall see in concrete examples below, it was quite common for American private investors to make the initial investment in a railway line in return for controlling shares. Public investment was rare, small scale and without continuation. A few early examples could be found in the mid-Atlantic in the 1830s, and a few in the South, where commercial capital in the hands of investors were less available locally. For example, in South Carolina local government aid helped financing early railway construction.[52]

British investment in American railways began on a small scale in the 1830s, declined after the 1837 crisis, rose again in 1849 along with the discovery of gold in California and decreased during The Civil War (1861-1865) which deterred foreign investors. In the Reconstruction era British investments increased, and since then the general trend, as can be seen in Figure 1.5 was upwards, with periodic declines following the 1873, 1893 and

[52] Augstus J. Veenendaal, "European Investment in American Railways," (2017): 165.

1907 financial crises. British investors were involved in financing American railroads from an early stage. British rail-makers and locomotive producers received part of the pay in railway stock. Early railroad corporate charters included clauses limiting borrowing. The American incorporators raised in a second phase additional capital in London in the form of bond issuing for expansion and upgrade. For this they needed relaxation of the charter limitations. Sometimes British investment in railroad shares was a result of insolvency, reorganization, and swap of shares in return for defaulted bonds. When railways began stretching west to undeveloped territories, in the Midwest, the Great Plains, the Rockies, and the Pacific, the scale of capital investment required increased, and with it the risks. Crudely speaking, Americans were rich in land but poor in cash. The British accumulated capital and looked for investment opportunities. Initially, the British could also offer technological and managerial know-how, but this advantage soon faded.

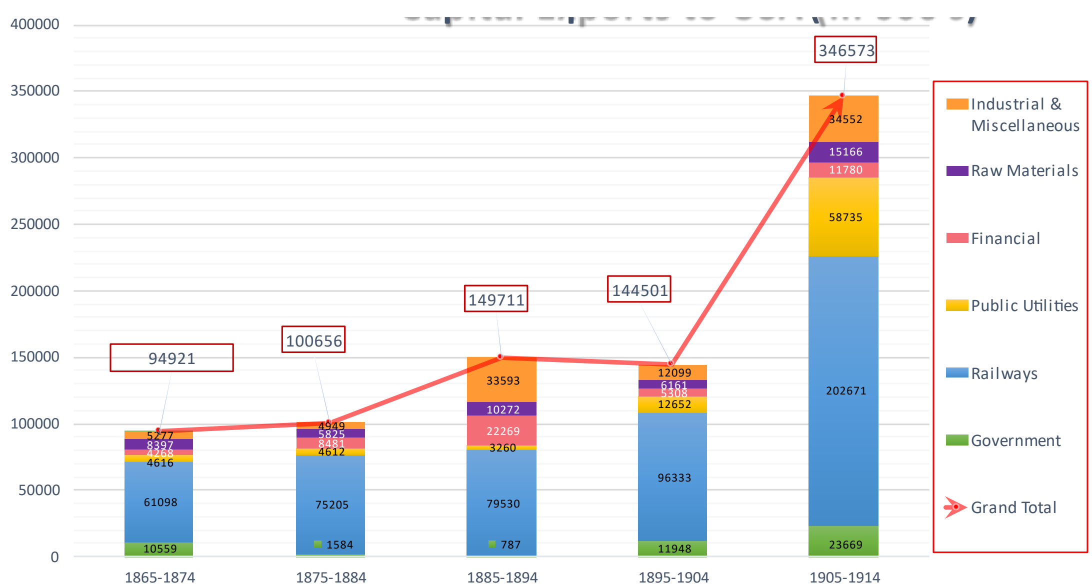
Figure 1.5 – British investments in American railways (000£) between 1865-1914



Source: (Stone, 1999, p. 386)

Almost two-thirds of British investment in the United States was in railroad companies. The only other sector that attracted significant British investment was utilities. Unlike in Latin America, British investments in American public bonds (federal, state, or municipal) was marginal after the 1830s.

Figure 1.6 – Capital exports to USA (in 000's) between 1865-1914



Source: (Stone, 1999, p. 385-93)

The largest foreign investment in the American railway sector was made by British investors, and it was by far the most significant one. On January1899, the major foreign countries of investors in US railway securities were:

Table 1.4 – Major foreign countries of investment in US railways in January 1899

England	2,500,000,000$
Holland	240,000,000$
Germany	200,000,000$
Switzerland	75,000,000$
France	50,000,000$
Rest of Europe	35,000,000$

Source: (Ripley, 1915, 6)

British investments were 6 times as much as all the rest of Europe. In 1914 Britain was still far ahead, comprising 67% of all foreign investments in American railroads. The railway sector was the main destination for British investments in the US, two-thirds of all government and private investments were in railroads:[53]

Table 1.5 – Foreign investment in US railways, July 1914

Nationality	Level (millions of U.S. dollars)	Percentage of nationality`s total investment in America
British	2800	66
German	300	32
Dutch	300	47
French	290	71
Canadian	130	47
Central European	70	47
Mexican	3	-
Other nationalities	277	66
Total	4,170	59

Source: (Lewis, 1938, p. 546, See also p. 532-533, on the way Lewis reached the totals)

This trend was clear throughout the examined period.[54] The estimates are that the total foreign investments comprised from one-fifth to one-third of the total investments in American railroads, the rest being domestic. Unlike elsewhere around the globe, in the Empire and in Latin America, where investment was done through companies registered in Britain itself, in the US, almost all investments were in American registered companies.

[53] Mira Wilkins, *The History of Foreign Investment in the United States to 1914* (Cambridge, Mass. : Harvard University Press, 1989), 194.
[54] For detailed information on foreign investment in American railways in selected years, see: Cleona Lewis and Karl T. Schlotterbeck, *America's Stake in International Investments* (1938), 516-60.Appendix B

Investments in the Empire, in Latin America and around the globe, were made through companies registered in Britain, while in the US, they were mostly in American registered companies. I will refer below to one exception.

Let's go down from aggregate figures and investment banker activity to concrete railroad companies and concrete stock offerings and reorganizations. The following table can direct us to companies worth studying:

Table 1.6 – Percentage of foreign stock in US railroad companies, 1890-96 and 1905

Railroad Company	Per Cent. of Foreign Stock	
	1890-`96	1905
Illinois Central	65	21
Pennsylvania	52	19
Louisville & Nashville	75	7
New York, Ontario & Western	58	12
New York Central & Hudson River	37	9
Reading	52	3
Great Northern	33	2
Baltimore & Ohio	21	17
Chicago, Milwaukee & St. Paul	21	6

Source:(Ripley, p. 5)

In the period 1890-96, the period around the 1893 crisis, the majority of the stockholders of five large American companies were foreigners.

American railway companies were managed, promoted, and operated by Americans with minor involvement by the British investors. With an exception to 1890-1896, British equity holdings in railway companies were small, and with a few exceptions that will be discussed below, did not amount to a controlling stake.[55]

[55] Michael Edelstein, *Overseas Investment in the Age of High Imperialism: The United Kingdom, 1850-1914* (New York: Columbia University Press, 1982), 36.

Pennsylvania Railroad Company

At its peak in the early twentieth century, the Pennsylvania Railroad Company operated over 16,093 KM of track, it employed approximately 250,000 people, and was considered as the largest business corporation in the world. We will focus on one important aspect of its expansion to this magnitude, the raising of capital in London in the form of bonds, which was a prime growth engine of the Pennsylvania Railroad Company.

The London Stock Exchange first entered the US railway building as early as the 1830s and 1840s when bonds were issued for a line connecting Philadelphia with New Jersey, Baltimore, and Western Pennsylvania. Later Bonds for the expansion of the Pennsylvania and New York railroad were floated. The bonds were usually in Sterling yet payable in Philadelphia. Local railway promoters either turned directly to London bankers to serve as their issuing agents or turned to Philadelphia banks such as Nicholas Biddle so that these would be assisted by their London agents and correspondents.[56]

In 1847 several local and regional railway lines going from Philadelphia mostly northward and eastward, some of which were state owned and some private, were merged by a State Charter to form the Pennsylvania Railroad Company. Its initial capital was $3,000,000 (£626,000), and the initial Board numbered 13, all residents of the state.[57] Soon it was authorized to issue $7,500,000 in 150,000 shares of $50 each, with a right to increase the capital to $10,000,000. Its initial charter prohibited debts to half of the capital actually paid

[56] Alfred D. Chandler, "Patterns of American Railroad Finance, 1830-50," *The Business History Review* 28, no. 3 (1954).
[57] Albert John County, *The Pennsylvania Railroad Company*, Making of the Modern World, Part Iii (March, 1906), 1-17.

in.[58] Soon this prohibition was lifted, and bonds became the main means for raising additional capital for the expansion of the company's lines and upgrading its rolling equipment. The very first issuance of bonds in London took place in 1855, with interest and principal payable in Sterling in London.

In 1868, after the end of the Civil War, an advertisement in the *Economist* offered its British readers an "Issue of £800,000 Sterling Six per Cent General Mortgage Bonds; Principal and Interest payable in London".[59] The offer was made by The London Asiatic and American Company Limited (T. Wiggin and Co. as agents of the Pennsylvania Railroad Company.)

In 1873 the capital stock of the company was increased one more time, by 100%, to the unheard-of sum of $151,700,000. A consolidated mortgage of $100,000,000 was created to allow periodic issuance of bonds based on the same mortgage. The first two bond issuing rounds based on the consolidated mortgage were done in London, £2,000,000 were issued in July 1873 and £3,000,000 more in July 1874.[60] London was the place to go to due to the financial crisis that hit the US economy in 1873. The Morgans were well connected both to the management of the Company and to the London (J.S. Morgan), Philadelphia (Drexel) and New York (J.P. Morgan) stock markets. They understood the company's financial structure and business needs, and the preferences of British investors. The Morgan partnerships served as underwriters, offered shares in a private placement, led syndicates

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[58] Howard Ward Schotter, *The Growth and Development of the Pennsylvania Railroad Company* (Philadelphia: Press of Allen, Lane & Scott, 1927), 6-8.
[59] "Pennsylvania Railroad Company," *The Economist*, December 12 1868, 1436.
[60]Schotter, *A Review of the Charter and Annual Reports of the Pennsylvania Railroad Company 1846 to 1926, Inclusive, by H.W. Schotter*, 106-07.

with their own personal investments, and assisted with drafting and circulating prospectuses.[61]

Another example of a Bond issue is a posting in the 1884 *Economist* in which an issue of "Pennsylvania Railroad Company subscription for 3,000,000 Dols. 41/2 per cent. Gold Bonds… Bonds of 1,000 Dols. Each to bearer".[62] The bonds were offered by J.S. Morgan in London, Drexel & Co. in Philadelphia and Drexel, Morgan & Co. in New York. Three related partnerships of the House of Morgan facilitated the transatlantic investment. The issuers accepted subscriptions in dollars ($980) as well as pounds (£203). The fact that these were "Gold Bonds" was a means for hedging Dollar to Pound exchange rate fluctuations. The posted prospectus goes to great lengths to praise the Company, its capital structure as well as the value of the collateral, and shares in subsidiary companies held in trust.

In the Annual Meeting of March 13th, 1888, British investors criticized the Pennsylvania Railroad Company's President over its dividend policy. They argued that the management uses corporate profits in order to expand the network and construct additional lines rather than distributing them to shareholders as dividends. The management held that expansion and upgrading had to be done based on retained earnings, at the expense of higher dividends to shareholders. President Roberts said that without constant investment the company would be disadvantaged vis-à-vis its competitors. The British shareholders were not convinced. They expected the management to raise additional capital from outside investors for each new expansion or upgrade. President Roberts concluded his speech by

[61] Vincent P. Carosso, *The Morgans : Private National Bankers, 1854-1913*, ed. Rose C. Carosso (Cambridge, Mass.: Cambridge, Mass. : Harvard University Press, 1987), 223-25.
[62] "Pennsylvania Railroad Company," *The Economist*, March 23 1884, 251.

saying that the British did not understand the differences between British and American railway business reality.[63] Unsurprisingly, the most open and heated criticism of the management came from British shareholders rather than bondholders. Bondholders prefer that fewer dividends will be distributed in order to keep more capital in the company and guarantee the debts they are owed.

In [April?] 1908, following the recession of 1907 the management of the Pennsylvania Railroad Company decided to convert short-term debts to long-term bonds and to take advantage of having good ties and reputation in London to overcome the shortage of capital supply in the US. The Pennsylvania Railroad Company issued "£8,000,000 or $40,000,000 4% Consolidated Mortgage Bonds, of which £4,000,000 are reserved for London and $20,000,000 for New York". The issuing was led by Baring Brothers & Co. Limited and N.M. Rothschild & Sons.[64] The post added in much smaller scripts that the issue in New York will be made by Kuhn, Loeb & Co.[65] The prospectus included a letter from the President of the Pennsylvania Railroad Company outlining the business prospects of his company and the solidity of the mortgage. The connection with investment bankers for the issue of bonds in previous years, Kuhn, Loeb and Speyer in 1903, and Kuhn Loeb and JP Morgan in 1905, were the basis for the current bankers' backed issuing.

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[63] The American perspective can be grasped fromSchotter, *A Review of the Charter and Annual Reports of the Pennsylvania Railroad Company 1846 to 1926, Inclusive, by H.W. Schotter*, 218-21. Which is based on the corporate record and perspective; The British investors' perspective can be found in "The Pennsylvania Railroad Dividends and Surplus," *The Economist*, March 17 1888, 345.

[64] Interestingly Barings was by this time (after its 1890 crisis) incorporated and Rothschild still a family partnership.

[65] "Great Bank Group Takes the New Bonds," *New York Times (1857-1922)*, April 23 1908.; AlsoSchotter, *A Review of the Charter and Annual Reports of the Pennsylvania Railroad Company 1846 to 1926, Inclusive, by H.W. Schotter*, 309.

Map 1.5 - Railway lines in Pennsylvania in 1893

Source: General Map of the Pennsylvania Railroad and Its Connections," (United States: Allen, Lane & Scott, Pennsylvania Railroad, 1893). https://www.loc.gov/item/98688766/.

Illinois Central Railroad Company

The Illinois Central Railroad Company (Illinois Central) was chartered by the Illinois General Assembly in 1851. It was one of the first railways that received land grants from the federal government.[66] In 1850 the Federal Congress passed an act granting Illinois, Mississippi, and Alabama, land, in a checkboard pattern on both sides of the future line, to

[66] For the land grant details see: Henry Varnum Poor, *Poor's Manual of Railroads* (H.V. & H.W. Poor, 1869), 319-24. It was offered for sale in pamphlets such as: "The Illinois Central Rail-Road Company offers for sale Over 2,000,000 Acres selected Farming and Wood Lands, in tracts of forty acres and upwards, to suit purchasers, on long credit, and at low interest, situated on each side of their rail-road, extending all the way from the extreme north to the south of the State of Illinois" (New York, 1856).

be used in the construction of a railroad from Chicago to Mobile. The State of Illinois used the land granted by the Federal Government, about 2,300,000 acres (about 9,300 square kilometers), in order to further convey it to the Illinois Central Railroad Company, for the construction of a line that would cross the state of Illinois from north to south. The company further extended the line southwards. By 1880 it went down all the way to Mobile Alabama and New Orleans Louisiana on the Gulf of Mexico. By 1900 it operated about 8000 KM of lines, connecting among other cities Memphis, Louisville, St. Louis and various other places along the Mississippi Valley and beyond.[67] It was sometimes called the Main Line of Mid-America. This map shows its extent as of 1892:

[67] *Poor's Manual of Railroads*, vol. 92 (London: J.W. Parker and Son, 1901), 17-18.

Map 1.6 - The Illinois Central Railroad Company line in 1892

Source: Rand Mcnally And Company, and Illinois Central Railroad Company. Map of Illinois Central R.R. [Chicago, 1892] Map. https://www.loc.gov/item/98688682/.

Its initial financial scheme was simple, and in retrospect naïve. The 13 incorporators intended to invest together only $200,000 in company shares and raise the rest of the needed capital by selling bonds in Europe that would be guaranteed based on the mortgage on the land grant received from the government. A free lunch.[68] A former Treasury Secretary was sent to Britain and Holland to promote the bonds, but the trip ended in total failure. The potential European underwriters, Barings and Rothchild's banks, were not convinced by the appraisal of the land value and sensed that land in Illinois of 1852 before the completion of the railway line was not a good guarantee for their money.

The Americans had to beef up the capital structure, by issuing more shares in the US as well as bonds bearing 7% and convertible to shares. The next trip to Britain was more successful. This time the English investment syndicate headed by Charles Devaux & Company bought $5,000,000 of Illinois Central bonds. They were attracted by the American investment, the option to buy shares, and the ability to pay for the bonds in installments spread over two years while to line was being constructed. As construction progressed and land value rose up, more British investors joined. By 1856, 80,000 shares of Illinois Central stock ($100 par value) and $12,000,000 of bonds were held by European investors, mostly British. The British shareholders held more than 50% of the Illinois Central shares. This was exceptional. In most other companies British invested mostly in bonds. In face of fluctuations in the company's state and concerns over management and reporting, a British Protective Committee was formed in London. No lesser figure than William Gladstone, past President of the Board of Trade, Chancellor of the Exchequer, and soon-to-become Prime Minister, headed it. The committee sent to Illinois representatives, including Richard Cobden, to monitor affairs.[69] The company's American Board did not

[68] Dale L. Flesher, Gary J. Previts, and William D. Samson, "Early American Corporate Reporting and European Capital Markets: The Case of the Illinois Central Railroad 1851-1861," *The Accounting Historians Journal* 33, no. 1 (2006): 8-10.
[69] Ibid., 12-14.

like the British intervention, neither the London assemblies nor the delegations. Eventually, accounting and managerial reporting was expanded and routinized to ease the concerns of the British equity investors. These included a balance sheet, reporting on revenues and expenses, budget, and status of land.[70] We can view this as an example for a path in which higher disclosure standards were set voluntarily by and for foreign investors in specific companies and these were later set as mandatory requirements for all companies.

Alabama Great Southern Railway

An exceptional case was the British equity investment in Alabama and the South as a whole. This is a rare example of the US using a model that was very common in Latin America and other overseas territories of companies registered in Britain and constructing and operating railroads in the US. Only a handful of those companies operated in our period. The salient exception to this rule is the Alabama Great Southern Railway, which was reorganized midlife, operated, and expanded as a company registered in Britain.[71]

In 1852, the Alabama Legislature granted a charter to "an act to incorporate the Wills Valley Railroad Company". In 1853, the Alabama Legislature granted a charter to the "North East and South West Alabama Railroad Company". In 1869, Daniel M. Stanton and John C. Stanton, New England brothers, bought up the stocks and bonds of the two companies, and later they incorporated the Alabama and Chattanooga Railroad Company

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[70] Ibid., 15-16.

[71] Leland H. Jenks, "Capital Movement and Transportation: Britain and American Railway Development," *The Journal of Economic History* 11, no. 4 (1951): 379.

(Alabama and Chattanooga).[72] The Stanton brothers with two New York houses, Soutter & Company and Henry Clews & Company persuaded Alabama to issue state bonds to fund the completion of the line.[73] Ultimately, in 1871 when it became apparent that the Alabama and Chattanooga did not have funds to meet any of its obligations, the State of Alabama began proceedings in bankruptcy against the railroad and the railroad passed into the hands of receivers on behalf of its bondholders.[74]

The section between Chattanooga and Meridian, Mississippi was soon returned to operating condition. It was sold to George Ingraham, president of the New Orleans and Northeastern Railroad Company in 1873, but fell again into bankruptcy in 1876 and was sold at auction in January 1877 to a group of English investors led by Frédéric Émile d'Erlanger (1832-1911).

In 1876, with the default of the Alabama and Chattanooga, a sale was forced by the Corporation of Foreign Bondholders (CFB). The bondholders purchased the railroad in exchange for a fraction of the debt due, and the bonds were converted to shares. The CFB appointed trustees to whom the possession of the railroad was surrendered in February 1876. All of this was done under the auspices of US courts.[75]

Emile Erlanger & Co. was originally a French finance and investment company, established by German-born, Parisian banker Baron Frédéric Émile d'Erlanger. By 1877 it

[72] D. R. and Hidy M. E. and Eleutherian Mills-Hagley Foundation Adler, *British Investment in American Railways, 1834-1898* (1970), 126.
[73] Ibid., 127.
[74] James Harold Clark, "History of the North East and South West Alabama Railroad to 1872," (The University of Alabama, 1949), 74.
[75] Paolo Mauro and Yishay Yafeh, "The Corporation of Foreign Bondholders," IMF Working Papers 03 (2003).

had significant banking activity in London. It had strong family and business connections in Southern US during the Civil War as well as in the Reconstruction. The company was involved in previous rounds of marketing Alabama and Chattanooga bonds on the Continent. In 1877, Emile Erlanger & Company seized the opportunity of the financial distress of the company and purchased the railroad for little less than $1,500,000.[76] The company was reorganized as the Alabama Great Southern Railroad Company, under Alabama's general incorporation law. Immediately upon the organization of the Alabama Great Southern Railroad Company, its entire capital stock was transferred to a British company, having the same name, the Alabama Great Southern Railway Company, Limited registered in London for that purpose earlier that year.[77]

Emile Erlanger and Co. have addressed a circular to the British bondholders informing them that Erlanger's agent has purchased the line after the foreclosure, and that they intend to establish the Alabama-Great Southern Railway Company Limited. The bondholders of the failed American railroad company were offered to exchange their bonds for shares of the new British company till September 1877.[78] The new company's Share Capital consisted of £1,722,600, with £156,600 "A" Shares, bearing a preferential dividend of 6%, £1,566,000 "B" Shares fully paid-up, and 1,750,000 dollars (£350,000) in First Mortgage Bonds. The shares were offered to the primarily British bondholders of the insolvent old company and its subsidiaries.[79]

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[76] W. Cline, *Alabama Railroads* (1997), 93.
[77] F. Harrison, *A History of the Legal Development of the Railroad System of Southern Railway Company* (1901), 1027" ;.Notices," *The Economist*, June 29 1878.
[78] "Notices and Reports," *The Economist*, August 11 1877.
[79] "Money-Market and City Intelligence," 7.

In order to stir confidence in the British investors they stated that “The Alabama Great Southern Railroad, formerly known as the Alabama and Chattanooga Railroad Company, has recently been reorganized under a foreclosure and sale. To secure the permanent control and management of the railway in English hands, a company has been registered, under the Companies Acts of 1862 and 1837, called the "Alabama Great Southern Railway Company, Limited."[80] The newspaper ad goes on the explain that the companies will be controlled by an English board of directors and that the railroad will be worked under their exclusive control, through the medium of highly competent and responsible agents.[81] It was mentioned that “Copies of the bond and mortgage and of the decrees of the United States Court relating to the sale can be inspected at the Offices of Messrs. Ashurst, Morris, Crisp, and Co.” This indicated that a leading British solicitor's firm with an extensive practice and experience was deeply involved in the reorganization.

In 1878 shares of the new British registered Company were advertised extensively in Britain. Unlike other American Railroads, such as the Pennsylvania Railroad whose bonds were offered only in the Economist and Financial Times, here the share offering was nationwide. Between June 24th and July 3rd, 1878, no less than 25 individual advertisements were made in newspapers such as the Daily Telegraph, Morning Post, Standard, Western Daily, York Herald as well as the Times and the Economist.[82] According to these advertisements subscriptions for the conversion were done in a London office. This was a British lead reorganization of a major American railroad company which resulted in a control of the majority shares of the company by British shareholders.

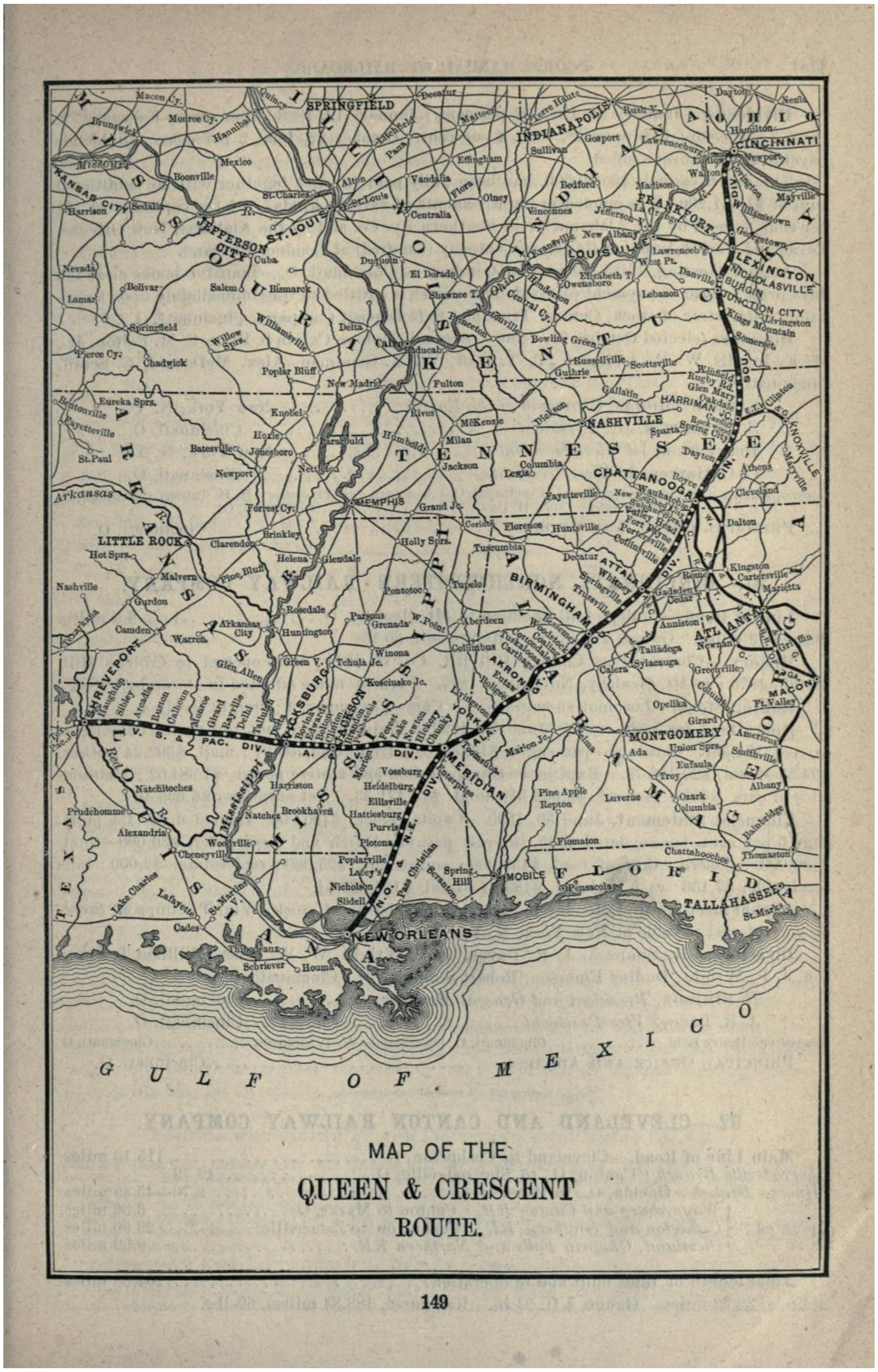
[80] "Alabama Great Southern Railroad Company," *The Economist*, June 29 1878, 788.
[81] Ibid.
[82] Based on search in Gale…

In 1881, Emile Erlanger & Co. acquired controlling interests in the New Orleans and Northeastern Railroad Company, the Vicksburg, Shreveport and Pacific Railroad Company and the Vicksburg and Meridian Railroad Company, and vested these interests in new British corporation known as The Alabama, New Orleans, Texas and Pacific Junction Company, Limited. The company was also incorporated in London.[83] All of the company's directors were directors of the Alabama Great Southern Railway Company, Limited.[84]

Soon afterwards the Company acquired a controlling stake in the Cincinnati, New Orleans and Texas Pacific Railway Company, the lessee of the Cincinnati Southern Railway. In 1883 the full 1853 KM line from Cincinnati to New Orleans was in operation, and the six constituent companies consolidated under the control of the Alabama Great Southern Company and the trade name of ***The Queen and Crescent Route***.[85]

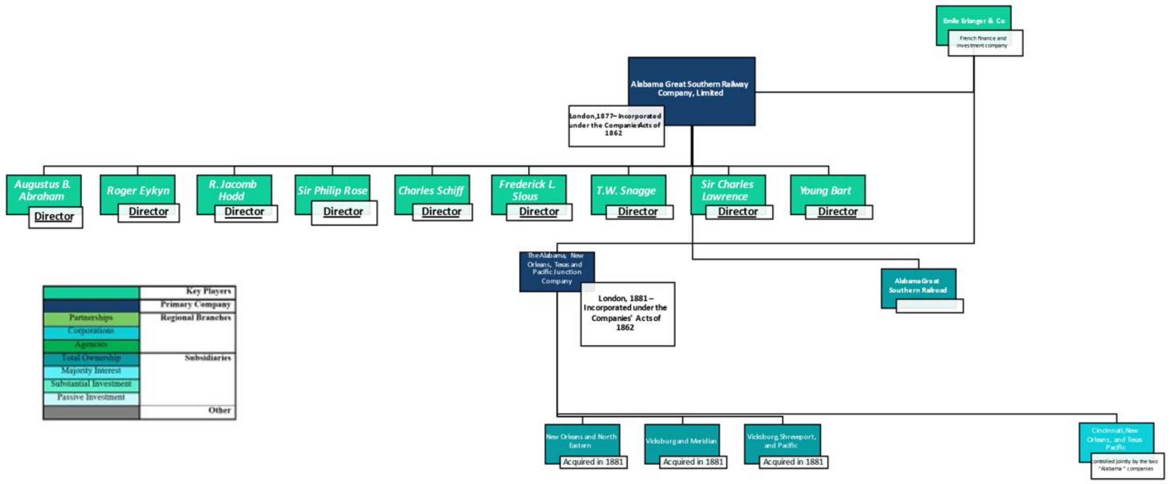
Map 1.7 - The Queen and Crescent Route line in 1891

[83] Harrison, *A History of the Legal Development of the Railroad System of Southern Railway Company*, 977.
[84]"Notices."
[85] *A History of the Legal Development of the Railroad System of Southern Railway Company*, 1036.



Source: (Poor's Manual of Railroads, 1891, p. 149)

Chart 1.3 – Alabama Great Southern Railway Company, Limited: 1877-1890



This arrangement continued until 1890.[86] After this a series of reorganizations and mergers took place and eventually in 1895 the Alabama Great Southern Railroad Company was taken over completely by the Southern Railway Co. Samuel Spencer, a Georgia native, led this reorganization with the backing of J. Pierpont Morgan.[87] The Board of the Alabama Great Southern Railroad Company was reorganized and substantially the same officers have since administered and operated the Alabama Great Southern and the Southern Railways lines proper.[88]

Why did the Alabama Great Southern incorporate in London rather than in Alabama? What can we learn from this exception about the general norm of British investment in American incorporated companies. One explanation for the insistence on incorporating in England was that unlike in the North-eastern or Mid-Western States, foreign investors did not trust Southern company legislation and the judiciary in the post Reconstruction period, and thus

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[86] Ibid., 977; "An English-American Railway System," *The Economist*, May 29 1886.
[87] J. P. and Bridges D. H. and Price D. S. Lamb, *Railroads of Meridian* (2012).
[88] HARRISON, *A HISTORY OF THE LEGAL DEVELOPMENT OF THE RAILROAD SYSTEM OF SOUTHERN RAILWAY COMPANY*, 1038.

avoided Alabama incorporation. Another is that Emile Erlanger & Co. being a French firm with German origins valued incorporation in England more than English investors. Neither of these is an all-encompassing explanation. The residual explanation is that this is an idiosyncratic case or a contingency. Anyway, the main lesson from this exception is that British investors in the US were aware of the possibility of incorporating the companies they invest in in London, as they did in the Southern US with the Queen and Crescent Route companies and as they did in Latin America but with full awareness chose not to do this elsewhere in the US.

Cross-Atlantic Institutional Bridges

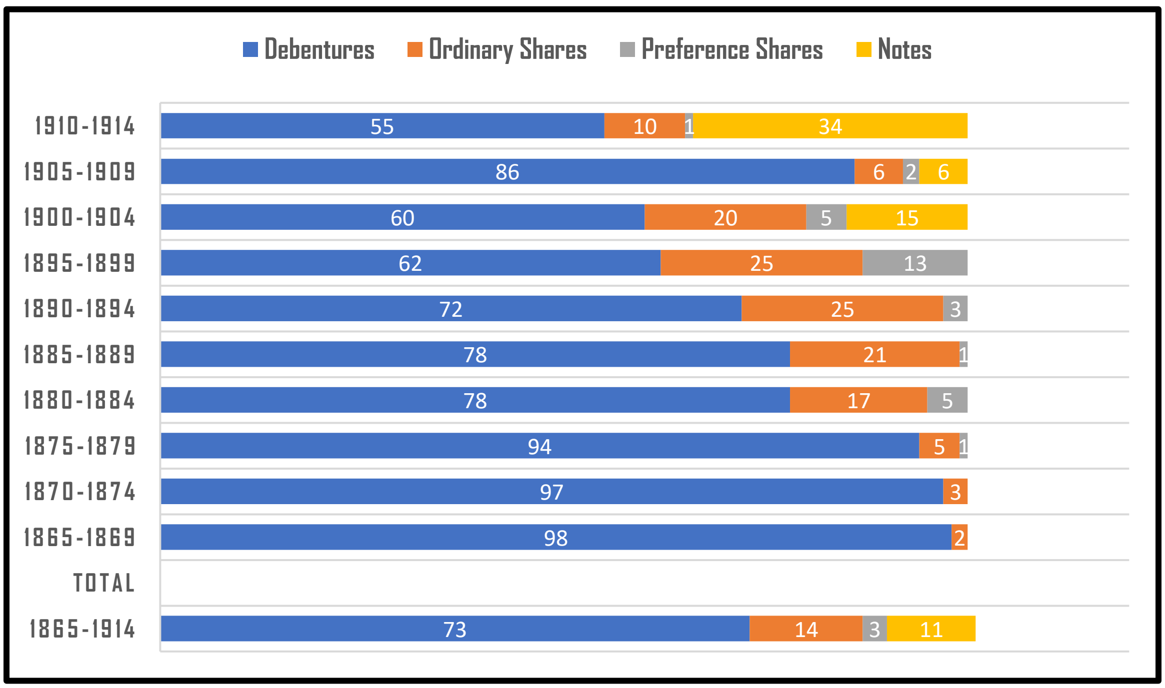
British investment in the US was done primarily through bonds rather than shares. American railway bonds were attractive to British investors who were not risk averse. While returns on British railway bonds carried 4% returns in the 1870s, and 3.50% throughout much of the following period until the outbreak of WWI, (being 0.50% to 0.75% above British Government Consols) US rail bonds yielded 6.50% in the 1870s, 5.20% in the 1880s, 4.25% in the early 1890s and 3.75% after 1900.[89] For British investors American bond returns were higher than domestic ones, up until WWI. American bonds paid higher interest rates than those of India, which was part of the Empire, but lower than those of Argentina, whose rule of law and investor protection were perceived weaker. This gap generated between 1874 and 1894 demand for US railway debentures in the UK markets. Between 1895 and 1913 the yield of U.S. railway bonds fell by 1.92%, and the

[89]Veenendaal, "European Investment in American Railways," 167-68;. ; Edelstein, *Overseas Investment in the Age of High Imperialism*, 36.

gap with British bonds narrowed as the risk on US investment fell rapidly, and the US market matured.[90]

Stone analyzed, among the rest, British investments in railways, and in particular American railways between 1865 to 1914.[91] Below are **Stone's** data on British railway investments in the USA:

Figure 1.7 – American railways investments division between 1865-1914



Source: (Stone, 1999)

In the first decade after the Civil War period more than 97% of the capital invested in railways was in the form of debentures, in the last decade before WWI it was 55%, for the

[90] Edelstein, *Overseas Investment in the Age of High Imperialism*, 95-101.
[91] Stone, *The Gobal Export of Capital from Great Britain*, 396.

period as a whole, 73% were in debentures. For the same period only 14% were in ordinary shares.

Wilkins offers three explanations for the distinct preference for debentures over shares: debentures assured a fixed return, debentures were considered less risky than stock holding, and debentures could often be purchased at a below-par price.[92] This section explains in which senses bonds were less risky.

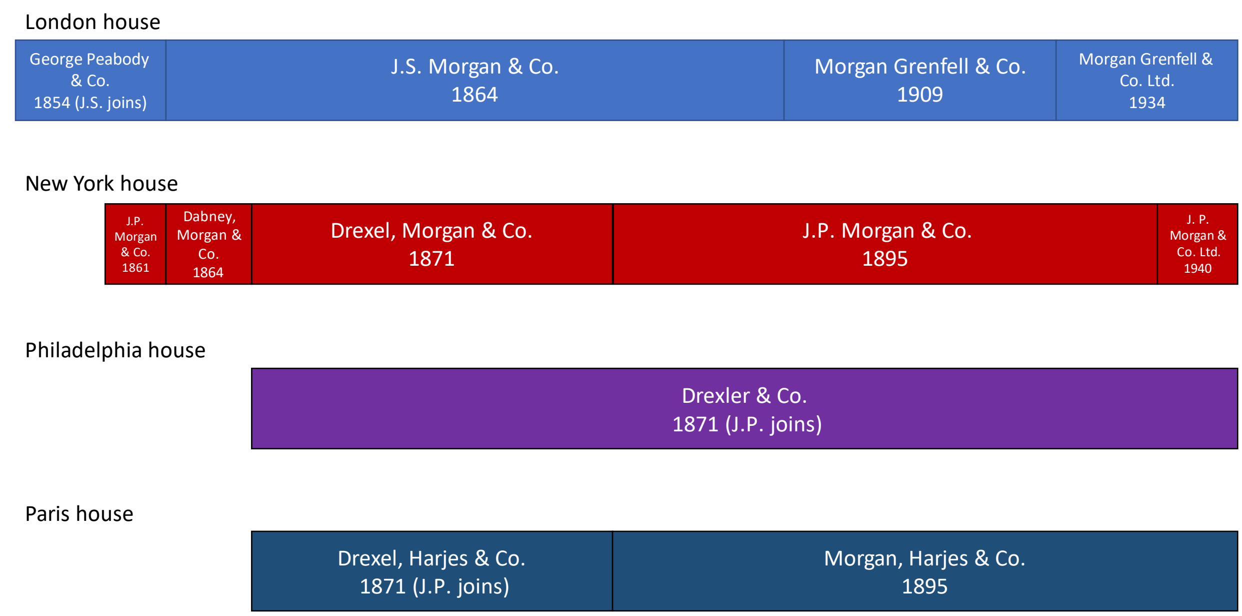
However, as we have seen, some American railroad companies had significant British shareholding. “Without attempting to state maxima, I can say that foreign investors, mostly British, came during the period to own more than half the shares of Central Pacific, Chicago, Milwaukee & St. Paul, Louisville & Nashville, Wabash, and Norfolk & Western, two thirds of Denver & Rio Grande, two fifths of Pennsylvania, one third of Union Pacific, nearly all of Ohio & Mississippi and New York, Ontario & Western, besides the long-standing heavy interests in Erie and Reading and Illinois Central and a very short run stake in Sante Fe.”[93]

As we have seen, issues in London of railroad bonds for £2,000,000 and more became common for financing the expansion of projects such as the consolidation of the Pennsylvania, Illinois or Alabama rails. By the late 1870s’, seven international banking and investment houses were active in selling American railways’ securities: Three of the seven had American headquarters and London houses: Brown Brothers; Morton, Bliss & Co.; and J. & W. Seligman & Co. Four were European based with American associates: J. S. Morgan & Co., London (associated with Drexel, Morgan & Co., New York. After 1895

[92] Wilkins, *The History of Foreign Investment in the United States to 1914*, 191.
[93] Jenks, "Capital Movement and Transportation: Britain and American Railway Development," 377.

– J.P. Morgan & Co.); Baring Brothers, London (Kidder, Peabody in Boston); the Rothschilds, (represented in New York by August Belmont & Co.); and Lazard Speyer-Ellissen, Frankfurt (interconnected with Speyer & Co., New York, and Speyer Brothers, London).[94] Emile Erlanger & Co. and Khun Loeb & Co. were other banks that originated in Europe and gradually shifted the center of gravity of their financial activities to the US. Morgan specialized in railway transaction. Of the 1,827 deals in which J.P. Morgan was involved 919, roughly 50% were railroad deals.[95]

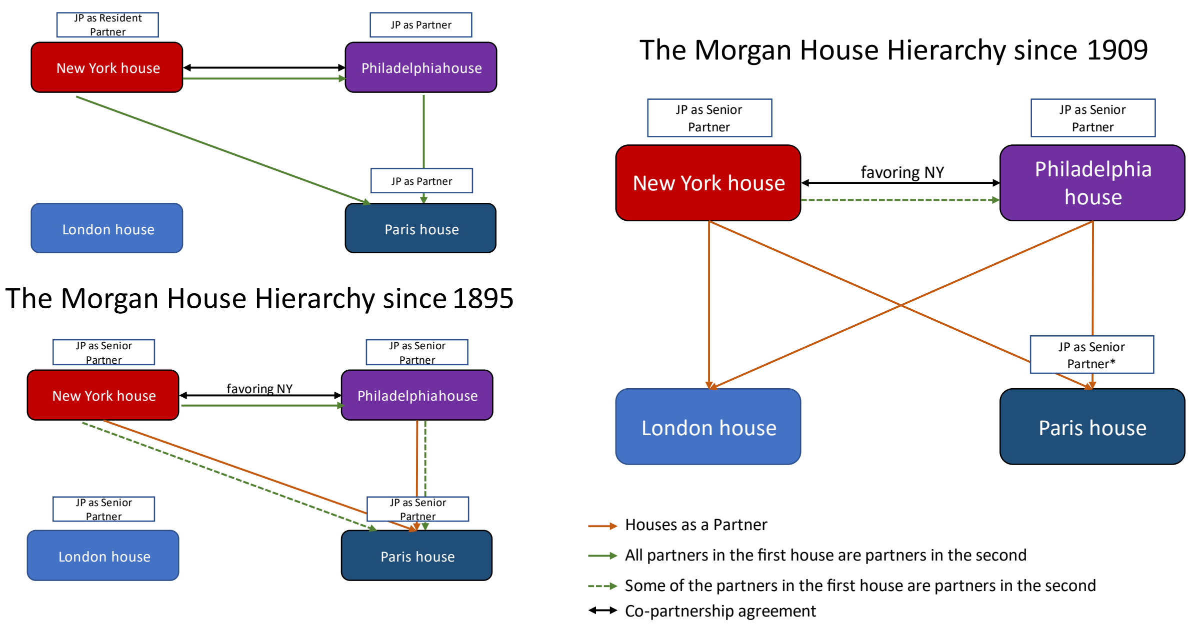
Figure 1.8 – The Morgan house timeline between 1854-1940



Source: (Cameron, 1991); (Carosso, 1987); (Pak, 2013)

[94] Wilkins, *The History of Foreign Investment in the United States to 1914*, 203-04.
[95] Susie J. Pak, *Gentlemen Bankers* (Harvard University Press, 2013), 16.

Figure 1.9 – The Morgan house hierarchy until 1890



Source: (Cameron, 1991); (Carosso, 1987); (Pak, 2013)

All the abovementioned investment bankers had connections both in Europe and the US. The Morgans were most ideally located for the task. J.S. Morgan was in London and well connected to its business and political elites. The above charts capture the organizational structure of “The House of Morgan”. The Morgans were a network of four concurrent and interconnected partnerships, situated in London, Paris, New York, and Philadelphia. It can also be seen that the legal and personal relationships between the four partnerships have changed so that the center of control and business activity gradually shifted from London where it was in the last two decades of the 19th century to New York after the turn of the 20th century.[96]

Between 1879 and1880 Morgan's marketed in London and other European stock markets 350,000 of the Vanderbilt shares in the New York Central railway. This opened a period of continuous, though fluctuating purchase of railway shares that lasted through the 1890's. The shares of 20 or 30 railway systems were introduced in the LSE by jobbers who brought them over from New York or continental Europe, an attractive object of speculative interest. In 1887, almost half of the new securities listed in New York were also listed in London.[97] A special section of the London Stock Exchange for American rails became an established feature, with a dedicated price list. A dozen brokerage firms specializing in the secondary market for American railroad bonds. Daily, weekly, annual and ad-hoc reports on American Railroads were very common in the Economist and the Financial Times.

The inroad for British investment was not only at the initial public offering stage in which the entrepreneurs raised capital from the public but also once the initial capital raised turned out not to be sufficient for completing the project. The first possibility was issuing bonds, the second possibility was issuing preferred stock, and the third option was reorganization. Periodic recessions in the US, such as those of 1873 and 1893 precipitated defaults in a large proportion of the American bonds, and forced railroad companies into insolvency. It impacted the ability of US Rails to raise additional long-term loans in the London market.[98] The way out was reorganization. The above investment bankers that underwrote the bonds,

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[96]Carosso, *The Morgans : Private National Bankers, 1854-1913*; Ron Chernow, *The House of Morgan* (London: Simon & Schuster, 1990).; Pak, *Gentlemen Bankers*; Joseph Sawe, "How the House of Morgan Cooperated to Develop the Large-Cap Us Multinational Corporation, 1895-1913," (2015).
[97] Jenks, "Capital Movement and Transportation: Britain and American Railway Development," 377-78.
[98] Ibid., 375-77.

marketed them, sold them to their friends in private placements, and even bought them for their own account. They had a vested interest in protecting bondholders as much as possible and by this also protected their own reputation for future business.

If J. P. Morgan and its peers expected to continue selling bonds to foreign investors, they needed to show that the US markets were safe and dependable. As many of the bondholders were British, the investment bankers had to be particularly active in London. However, the companies and their assets were in the US, so in order to protect British investors the Morgans and their likes had to be involved in the insolvency procedures of failed American companies and in their financial reorganization. While JS Morgan was talking to British investors his son JP Morgan stepped into American courtrooms and hired lawyers in New York. Indeed, a recent biography of the J. P. Morgan partnership argues that Pierpont Morgan's success in doing precisely this—in particular, protecting London investors in the 1880s—played a crucial role in the bank's rise to dominance on Wall Street.[99]

When railroad companies were in financial distress and did not meet their interest payment obligations bondholders in London organized spontaneously in order to negotiate collectively with the company's management. When formalized they were titled Protective Committees.

The Corporation of Foreign Bondholders (CFB) was founded in London in 1868 and incorporated under a License from the Board of Trade in 1873. Its rationale was to coordinate between bondholders' committees. This was particularly relevant with respect to sovereign debt. A few committees representing each different class of bondholders formed a Country Committee to negotiate with its government. It was occasionally also

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[99] David A. Skeel, "Debt's Dominion," 84.; Chernow, *The House of Morgan*, 29-45.

relevant with railroad company's bondholders. The CFB was often criticized as being dominated by banks. It is not surprising that banks wanted to coopt the Corporation. Financial reorganization became a major source of revenues for Morgan and its like. They did not want to let the bondholders coordinate through the CFB bypassing them. The CFB was reconstituted in 1898 by a Special Act of Parliament. The Council of the CFB now consisted of 21 members, only six of whom were appointed by the British Bankers Association, six by the London Chamber of Commerce, and nine directly from among eligible "certificate holders" of bonds. However, in 1903 there were 20 separate Bondholders' Committees affiliated with the CFB, consisting of 215 members: of these, only 32 members were also members of the CFB, and only 17 had been appointed directly by the bondholders.[100]

Investment bankers seized the opportunity and offered their superior service to bondholders in the form of financial reorganization of the company. The technical tool for doing this was equity receivership because reorganization was not yet available in the Federal Bankruptcy Act of 1867 (the first that applied to corporations). The receivership was conducted by the investment bank together with a bankruptcy law firm such as Cravath, Swaine & Moore (representing Kuhn, Loeb) or Francis Stetson (representing Morgan). The number of receiverships reach peaks after economic crises, the first peak in the late 1870s with over 90 receiverships per year, over 12,000 miles of rail and over 16% of total railroads in receivership. A second peak was in the mid-1890s with 191 receiverships, 191,000 miles and 19% of all rails in receivership.[101] The financial reorganization often

[100] Mauro and Yafeh, "The Corporation of Foreign Bondholders," 15.
[101] Skeel, "Debt's Dominion," Chapter 2, 63-88.

involved the conversion of American-held debt into equity and the calling of British investors to invest in new company bonds.

The US type of corporate reorganization, which was fundamentally an important investor protection device, was based on railway companies incorporated in US states, Equity courts, receiverships, transatlantic investment banks, voting trusts, the New York legal profession, and the American legal system at large, elements that were inapplicable for the protection in Latin America or elsewhere outside the US.

Comparison

The concerns about expropriation were, as shown above, the gravest in railways among all sectors analyzed in this book. The best scenario was that the foreign host government was able to convey credible commitment based on its domestic constitutional and political system. The US approached this status, though it still was inclined towards domestic debtors over foreign creditors, within the boundaries set by its constitution and judiciary. In India, it was the taxation of the local population coupled with guaranteed minimum returns by the colonial government, and regulation in advance of the possibility of nationalization, that created the safety net for British investors in railways. This safety net was backed by a credible commitment of the government of India that resorted to the credibility of commitments made the British government and Westminster Parliament.

When credible commitment was not sufficient, as in Argentina and Peru and other parts of the so-called informal empire, various investor protection methods were used for mitigating these concerns. In Latin America public finance and corporate finance intermingled, in the sense that the Brits invested in government bonds and in railway shares and converted one to the other as needed. They include on one end of the continuum military coercion in the form of gunboat policy and political and diplomatic threats and on the other end reputational mechanisms. In order to lobby effectively either the British government or foreign government, or to boycott effectively the foreign economy, investors coordinated informally using investment groups and social clubs, or more formally using chambers of commerce, investment banks and trusts and the Corporation of Foreign Bondholders.

The inclusion of the US in this chapter allows us to gain more nuanced insights with respect to the interplay between corporate finance and investor protection. In the US corporate finance, structures and devices played a major role in the protection of investors not only against insolvency but also against expropriation. British investors often joined in only in the second or third round of investment, after Americans already invested in assets that could serve as a security and when these were joined to land grants so that these showed initial signs of having value. British invested mostly in debt finance. They invested in bonds, issued on the London Stock Exchange backed by household name investment banks. These bonds were secured in mortgages and payable in pound sterling to reduce risks. Investment in equity was the exception and was often done by British only in reorganization. They were willing to move in only under the auspice of investment banks such as Morgan. The Morgan partnerships had good reputation both in London and in New York, Philadelphia, and Boston. The Morgans relied only on receivership that gave them control, and was protected by shrewd lawyers and independent courts. The British were not willing to invest in every reorganization, but only in ones that catered specifically to them American railway corporations were organized from an early stage, in terms of their finance and governance and the corporate law that applied to them, to suit the expectations of British investors.

The following Table 1.7 summarizes a comparison of several important investor protection and corporate organization between the four countries examined in this chapter.

Table 1.7 - Comparison of characteristics of railway companies in different countries

	Argentina	**Peru**	
Ownership	Private - British	Until 1890 - government; Afterwards - private British	S
Registration	London	After 1890 - London	
Bonds / Shares	Shares	Until 1890 - bonds; Afterwards - shares	pe
Financing Body	British banks; government guarantees		
Stock Exchange	London		
Prominent Legislation / Agreement	Mitre Laws	Grace Contract	
Land Grants	Rarely		
Miscellaneous	Guaranteed interest per constructed mile.		M w

			m (b

Of all the sectors analyzed in this book, railways were the sector in which the entrepreneurs and investors in the City of London could not distance themselves from the state. They needed a right of way. They expected land grants. They wanted state guaranteed returns. But at the same time, they did not want state regulation or taxation and did not want either the host state or the British Empire would push them into constructing lines that had political and military importance but not sufficient profit prospects.

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