CONTRACT OR CONCESSION? AN ESSAY ON THE HISTORY OF CORPORATE LAW

Paul G. Mahoney*

By the time a law student arrives at the introductory Corporations course, she has already absorbed a bit of information about corporate law. Having perhaps encountered the Dartmouth College case in Constitutional Law, she knows that a "corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it . . . ."\(^1\) She may also have learned, from Austin v. Michigan Chamber of Commerce, that "[s]tate law grants corporations special advantages—such as limited liability, perpetual life, and favorable treatment of the accumulation and distribution of assets—that enhance their ability to attract capital and to deploy their resources in ways that maximize the return on their shareholders' investments."\(^2\) The first chapter of her assigned Corporations text will likely reinforce the message that corporations are special in that legislatures provide them certain benefits in order to facilitate the raising of capital and the exploitation of economies of scale.

That account is historically inaccurate. By itself, this inaccuracy may not matter to the teacher of an introductory Corporations course. What does matter, however, is that the idea of the corporation as a creation of the state that receives special privileges (at the price of enhanced governmental scrutiny) short-circuits a potentially informative and lively discussion. To what extent might the indicia of "corporateness"—transferability of shares, legal personality, limited liability, and centralized management—be created by contract, supplemented perhaps by other common law devices such

* Professor of Law and Albert C. BeVier Research Professor, University of Virginia School of Law.
\(^1\) Trustees of Dartmouth College v. Woodward, 17 U.S. 517, 636 (1819).

873
as trusts or agency? The answers to that question provide a fascinating picture of a community of merchants generating efficient institutions despite the obvious collective action problems that beset them. The answers also stand the received wisdom on its head by showing that the state, far from facilitating organizational development, often tries to thwart it.

I. CORPORATION VERSUS CORPORATENESS

In its original sense, the word "corporation" referred to any organization that had legal personality separate from that of its individual members. Municipalities, guilds, and universities, therefore, were all "corporations" in English law. Legal personality, along with various rights of self-governance, was typically bestowed by a royal charter. In this limited sense, to say that a "corporation" is a creation of the state is almost a tautology. Almost, but not quite—some municipalities, guilds, and other associations claimed to be bodies corporate without any royal charter, and some commentators insisted that the crown could only recognize, not create, corporate status.

The more interesting question is when and why business associations began to seek corporate status through a charter. The answer that would immediately occur to a modern commentator is that "corporateness" conveyed certain advantages—most notably limited liability—that would have been difficult or impossible to achieve without governmental assistance. Businesses can be

---


4 See Gary M. Anderson & Robert D. Tollison, The Myth of the Corporation as a Creation of the State, 3 Int'l Rev. L. & Econ. 107, 108 (1996) ("[T]he modern corporation developed and spread due to its superior economic efficiency as an organizational form, in spite of, not because of, governmental interference in the free market.").

5 See C.A. Cooke, Corporation, Trust and Company: An Essay in Legal History 7 (1959) (explaining that, in a corporation, "[t]he acts of the individual are attributed to the group as a whole and the power, responsibility, and liability that clothe them are the power, responsibility, and liability of the group, and not of the individuals").

6 See W. Jethro Brown, The Personality of the Corporation and the State, 21 L. Q. Rev. 365, 370-71 (1905) (stating that "it is truer to regard [the corporation] as an entity which has compelled the law to grant it official recognition").
organized as proprietorships, relying entirely on contract for their relations with suppliers of capital and other inputs. Others are organized as partnerships, a contractual relationship among capital suppliers, but one that relies in part on a set of “off-the-rack” contractual terms that the law of partnership supplies. Some businesses, however, have more substantial needs for capital and find it expedient to attract funds from a large group. Legal personality, transferrable shares, centralized management, and limited liability are essential for that purpose. In order to facilitate the growth of such businesses for the public good, therefore, governments bestow these “corporate” benefits.  

In this standard story of the growth of the corporate form, the innovation of limited liability takes primacy. As the Economist noted early in this century:

The economic historian of the future . . . may be inclined to assign to the nameless inventor of the principle of limited liability, as applied to trading corporations, a place of honour with Watt and Stephenson, and other pioneers of the Industrial Revolution.  

Limited liability is viewed not merely as an innovation, but as an instrumental deviation from ancient doctrines of personal responsibility. An extreme but illustrative expression of this view appeared in the Encyclopaedia Britannica in the middle of the nineteenth century:

In the scheme laid down by Providence for the government of the world, there is no shifting or narrowing of responsibilities, every man being personally answerable for all his actions. But the advocates of limited responsibility proclaim in

---

7 Statutory law may also bestow legal personhood on a partnership. See UNIF. PARTNERSHIP ACT § 201 (1994) (stating that partnerships are entities distinct from their partners); id. § 201 comment (noting its break from Uniform Partnership Act’s “ambivalence” with respect to entity theory of partnership).
8 ECONOMIST, Dec. 18, 1926, at 1053.
their superior wisdom that the scheme of Providence may be advantageously modified . . . .

The corporate form and the limited liability that accompanies it, so the story goes, are favors granted by governments to entrepreneurs in order to reap the social benefits of mass production. The same concern for social welfare that prompts the grant of special benefits, however, requires that the grant be limited and conditional. According to Justice Brandeis, "whether the corporate privilege shall be granted or withheld is always a matter of state policy." To appreciate the many inaccuracies in this standard story, it helps to begin by thinking conceptually about the problems that must be solved in order to attract capital from a large number of far-flung investors/owners. As Hansmann and Kraakman have recently argued, a central problem in the law of business organizations is that of asset partitioning. Consider a business (ignoring the organizational form) with a few owners. The owners will have personal creditors and the business will have business creditors. Each class of creditors needs to know which assets are available to satisfy which debts. Can the personal creditors seize business assets such as machines and inventory if the owner's personal debts are unpaid? Can the business creditors seize an owner's house or car if the business's debts are unpaid? It is critically important to a well-functioning system of organizational law that the answers to these two questions be clear, and extremely useful that the law offer multiple organizational forms that provide a varied menu of answers to them.

To keep the two questions separate, I will refer to protection for an organization's assets against its owners' creditors as "forward partitioning." Forward partitioning is a key feature of what corporate law calls "legal personality." I will refer to protection for the owners' assets against the organization's creditors (which

corporate law misleadingly calls "limited liability") as "reverse partitioning."

Modern statutes defining business organizations such as partnerships, corporations, and limited liability companies solve partitioning problems elegantly. By taking specified procedural steps, the organization becomes a legal person entitled to own assets and sue and be sued in its own name. The equity investors, by contrast, own a claim to cash flows generated by the organization, but they do not own the organization's assets. Thus, personal creditors of the equity claimants are generally able to stand in the shoes of the claimant herself (that is, receive the cash flows) but are unable to make a claim against the organization's assets. The organization thus exhibits forward partitioning. Some organizations (such as corporations and limited liability companies) offer reverse partitioning as well—the organization's creditors can look to the organization's assets but not to the assets of the equity investors. Partnerships differ in that absent agreement to the contrary, the organization's creditors can also seek repayment from some equity investors (the general partners).

As Hansmann and Kraakman note, were these statutes suddenly swept away, it would be difficult and costly for entrepreneurs and investors to create either type of partitioning from scratch using only property, contract, and agency law.\textsuperscript{12} It does not necessarily follow, however, that those statutes were therefore historically necessary—that property, contract and agency law could not have evolved solutions to the asset partitioning problem. Indeed, as we will see, these alternative mechanisms did so once and were on the way toward doing so again before legislatures turned their attention to business organizations.

The point is in part semantic. When courts developed particular rules relating to the specialized form of contracts they called "partnerships" or "joint stock companies," we can say that they were developing "organizational law" in the same way that legislatures do today. Thus one might think that the issue is merely whether organizational law must be statutory, not whether we need organizational law.

\textsuperscript{12} Id. at 6.
I want, however, to make a slightly more aggressive claim. Asset partitioning problems are ubiquitous in any economic system that relies on property and contract as organizing principles. We do not even notice most situations in which such problems arise because the corresponding solutions are so familiar and longstanding that they have become part of the scenery. As a consequence, we attribute too much uniqueness to the particular asset partitioning problems created by large-scale organizations and too little flexibility to property and contract law in dealing with those problems. Had property and contract law been permitted to keep evolving in the field of business organizations, the set of asset partitioning rules that reside in the law of property, contract, and tort (rather than the law of partnership or corporations) might be much larger. Put differently, we think of “unlimited liability” and “legal personality” as deviations from baseline rules of property, contract, and tort—baseline rules that are somehow natural or inevitable. A little history is sufficient to show that they are neither.

II. EARLY APPROACHES TO ASSET PARTITIONING PROBLEMS

We take it for granted that when I fail to pay a debt, my creditors cannot recover from my parents, adult children, siblings, or neighbors. Similarly, when I provide capital to a friend who runs a small business and we call it a “loan” and provide for a fixed schedule of payments, that business’s other creditors cannot recover from me. Yet if we call the capital an “investment” and denominate ourselves “partners,” the business’s other creditors can recover from me.

While those rules are quite stable today, they have varied over time. Primitive societies often have rules of kinship responsibility for wrongs.\(^{13}\) In the contractual context, Holdsworth notes that rules regarding the personal liability of partners in a \textit{societas}, an early form of general partnership, were not uniform, although eventually the unlimited liability rule of the Champagne fairs

dominated.14 More interesting was the practice in some medieval towns and trade fairs that when a foreign debtor left without settling his debts, his creditors could have the goods of the debtors' countrymen seized as security for those debts.15 Similarly, the early practice of permitting creditors to seize and imprison a defaulting debtor must have been, in part, a means of putting pressure on the debtor's family and friends to make good the debt.

It is inevitable that a system of law focused on property and voluntary exchange must confront and provide default rules to resolve such basic issues as who may or may not be held responsible for a particular debt. The right answer is not obvious because borrowed money generates positive externalities; family members, business associates, and vendors of the debtor may benefit to some extent. At some point in the distant past, some set of decisionmakers chose the current rules rather than others, and they have survived long enough to constitute a baseline.16

How difficult is it to imagine that, absent legislative occupation of the field of corporate law, the baseline rules might have permitted or even facilitated the contractual creation of an entity able to own assets in its own name (assets which would then be out of the reach of the equity investors' personal creditors), with a class of investors who contributed equity capital, selected management but did not themselves manage, and did not bear personal responsibility for the entity's debts? It is not difficult at all. There is a long history of organizations that exhibit forward and/or reverse partitioning. As an English legal scholar noted early in this century:

   It is a fact which has received far too little notice from English lawyers that, whenever men act in concert for a common purpose, they tend to create a body which, from no fiction of law, but from the

14 8 W.S. Holdsworth, A HISTORY OF ENGLISH LAW 197 n.5 (1937).
16 The baseline rules recognize these positive externalities in a limited class of cases. The law of fraudulent conveyances imposes liability on persons other than the nominal debtor in cases where the external benefits are especially large and one-sided.
very nature of things, differs from the individuals of whom it is constituted.\textsuperscript{17}

Roman law recognized certain private organizations, the \textit{collegia}, as able to hold property and litigate in their own right.\textsuperscript{18} Adolph Berle argued that "[t]hey were not made by the state, and the state had nothing to do with them."\textsuperscript{19} In an act that (as we will see) anticipates the English experience, the Emperor Augustus became concerned about the political consequences of free association and therefore forbade the creation of such organizations without governmental approval.\textsuperscript{20} Berle considered this the origin of the "state concession" view of the corporation.\textsuperscript{21}

Following the fall of Rome and the eventual revival of long-distance trade in Europe in the eleventh and twelfth centuries, the law merchant governed business transactions. The law merchant is an excellent place to look for voluntary solutions to asset partitioning problems, as it was a private system of law.\textsuperscript{22} Its rules were set by merchants and enforced by merchants. It thereby offers an example of spontaneous order—that is, the resolution of collective action problems with minimal government involvement.\textsuperscript{23}

The law merchant recognized organizational forms that had some combination of forward and reverse partitioning. One such form, the \textit{commenda}, used both. A \textit{commenda} was typically set up for a specific voyage and was similar to a limited liability partnership. Because it was recognized as an entity separate from its partners, the partners' creditors could not seize business assets. Business creditors could recover only against the partnership assets.\textsuperscript{24}

\begin{footnotes}
\item[17] Brown, supra note 6, at 365 (quoting A.V. Dicey).
\item[20] Thomas, supra note 18, at 473.
\item[21] Berle, supra note 19, at 4.
\item[22] For a combination of historical and formal demonstrations of the ability of merchants to create institutions that would foster cooperation, see Paul R. Milgrom et al., The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs, 2 Econ. & Pol. 1 (1990).
\end{footnotes}
Indeed, as early as the twelfth and thirteenth centuries, investors were using the device as a way to diversify their capital among multiple ventures, bearing systematic risk but not engaging in the intense monitoring that personal liability impels.\(^{25}\)

It is easy enough to see how merchant courts could enforce a rule of “limited” liability as to contract creditors, themselves generally merchants. But what about tort creditors? Could the merchant courts absolve their fellow merchants from personal liability for tort claims (which a plaintiff could bring in the royal courts)? To ask this question is once again to mistakenly assume a modern baseline. Generally speaking, businesses commit torts through acts of employees. Under the medieval conception of tort, however, liability attached only to acts done or ratified by the defendant. As a result, employers were not liable for employees’ torts.\(^{26}\) The partners of a *commenda*, therefore, had no exposure to tort liability resulting from their employees’ acts. They were liable for their own acts, but that does not make them different from modern partners or shareholders. Today, an employee/shareholder of a corporation would be liable for an automobile accident caused by his own negligence while engaged in the corporation’s business.\(^{27}\) The liability, however, would follow from the defendant’s negligent act rather than his partial ownership of the business. In short, the position of a partner in a *commenda* was analogous to that of a shareholder in a corporation.

The *commenda* might have evolved gradually into the modern corporation, in which event the notion of the corporation as a concession of the state would be obviously ahistorical. That this did not occur was in part a consequence of the royal courts’ efforts to take jurisdiction over commercial disputes away from the merchant courts. The royal courts became increasingly aggressive until, in the early seventeenth century, Lord Coke decided that a party to a contract that called for disputes to be resolved by a merchant arbitrator could revoke the arbitration clause unilaterally at any

\(^{25}\) *Id.*

\(^{26}\) 8 HOLDSWORTH, supra note 14, at 446-47.

\(^{27}\) The business can, and often does, indemnify the employee against tort judgments incurred in the scope of his employment.
time and sue in the royal courts. The role of the merchant courts thereafter declined significantly.

The common law courts were less flexible in their approach to commercial problems than were the merchant courts. In particular, they found the idea of legal personality without specific governmental authorization to be troubling. It is that tendency to which Holdsworth attributes the failure of the commendata to take root in English common law. The judicial attitude likely stemmed in part from the Stuart kings' desire to establish firm royal authority over the municipalities, guilds, and other instruments of economic regulation. Although Coke would later lose his job for asserting the primacy of the common law over royal prerogative, he deferred to James I's views about incorporation. In a 1615 case, he stated flatly that "incorporation cannot be created without the King." This commenced two centuries of legal uncertainty about the sufficiency of contract to create a legal person.

Coke's statement, however, should be taken in its context: James I was opposed to the creation of any form of association (economic, social, or political) without his blessing. The objection was to free association generally, not to the idea that asset partitioning was a departure from the ordinary rules of English law. Indeed, admiralty law can be seen as an early form of organizational law with rules that facilitated asset partitioning. A voyage is a form of organization—a nexus of contracts among merchants, factors, lenders, and the vessel's owner, master, and crew. One method of financing a voyage was through the bottomry loan. A bottomry loan was made to the master of a ship on the security of all the goods on board. It

30 8 Holdsworth, supra note 14, at 196.
31 Sutton's Hospital, 10 Co. Rep. 1a, 26b, 77 Eng. Rep. 937, 964-65 (1615); see Berle, supra note 19, at 9 (declaring idea to be "loose in logic and wrong in history").
32 Business enterprise was, in the official view, just one more source of undesired social upheaval. See Christopher Hill, The Century of Revolution 1603-1714, at 22 (2d ed. 1980) ("[T]he official attitude towards industrial advancement was hostile, or at best indifferent. It was suspicious of social change and social mobility . . . ."); William Robert Scott, I The Constitution and Finance of English, Scottish and Irish Joint-Stock Companies to 1720, at 8-9, 20 (1951) (mentioning freedom to associate—to hold meetings—a key feature of privileges granted corporations by royal charter).
was in fact a combination of loan and insurance, payable only if the ship made it back to its original port. The other assets of the ship's owner, master, and shippers were not available for repayment, although the assets of the "organization" were, and in that sense there was reverse partitioning. There was forward partitioning as well, because a bottomry loan gives rise to a maritime lien, which takes priority over non-maritime claims. Thus, the assets of the organization (the cargo, tackle, and so on) were put out of reach of the personal creditors of the organization's investors (the vessel's owner and shippers) until the loan was repaid. What admiralty law did not do, however, was assert that the voyage was in any sense a "legal person."

Judicial resistance to the creation of the indicia of corporateness without royal permission did not stop merchants from designing organizational forms that had these indicia. By the seventeenth century, merchants were interested in forms of association that would last longer than a single voyage. They designed a contractual arrangement—the joint-stock company—under which several merchants could each provide capital for an enterprise that would not liquidate after each voyage, but continue to operate for multiple voyages and create long-term foreign trading relationships and capital assets. A joint-stock company was an agreement among a group of merchants to pool their assets under a single management and to divide ownership into pro rata shares that could be sold. The agreement also provided for centralized management in a "court" or board of directors. Some agreements stated that the owner/merchants would provide additional capital when called upon by the managers to do so.

Such agreements created two key indicia of corporateness: centralized management and free transfer of shares. Whether they sufficed to create either forward or reverse asset partitioning was a more complex question, given royal and judicial hostility to

---

33 See Gerard MalyneS, Lex Mercatoria: Or, the Ancient Law Merchant 122-23 (1685) (discussing bottomry loans).
34 See Giles-Jacob, Lex Mercatoria: Or, the Merchant's Companion Containing All the Laws and Statutes Relating to Merchandized 41 (1729) (examining Bill of Bottomry).
35 Scott, supra note 32, at 1-14.
36 Id. at 44-46.
corporateness without incorporation. For some joint-stock companies the issue was solved by formal incorporation. Many joint-stock companies petitioned the crown for a charter granting legal personality (I discuss below why some but not all joint-stock companies did this). The question, then, was to what extent unincorporated joint-stock companies would also be treated as separate persons and thereby achieve forward partitioning.

The answer remained unclear as a matter of legal doctrine until 1720 and unclear as a practical matter for a century afterward. One could argue that Coke had asserted only the tautological argument that incorporation required a royal charter, but corporateness did not. Moreover, once Coke and James I parted ways over the issue of judicial independence, the common-law judges may have had second thoughts about the depth of their support for royal authority. As ideas of economic freedom gained political support in England at the end of the seventeenth century, the crown appears to have been less inclined to assert an exclusive right to create "corporateness." The key point is that legal uncertainty did not spell the end of the joint-stock company. The advantages of separate legal personality were so great that merchants used a variety of means to achieve it. It was "a tribute to the shrewdness of eighteenth century lawyers that in most instances the advantages of formal incorporation were approximated."

The surest but most complex means of achieving de facto legal personality was through the trust device. The shares of a joint-stock company would be put into a trust, which then would declare itself the sole legal owner of the business assets, with the company then able to hold property, sue, and be sued in the name of the trustee.

---

37 See id. at 91-92 (discussing incorporation of East India Company).
38 See id. at 337 (attributing permissive attitude toward unincorporated joint-stock companies at end of seventeenth century to crown's preoccupation with military matters after Glorious Revolution).
39 See Anderson & Tollison, supra note 4, at 107 (discussing advantages afforded to merchants by separate legal personality status).
41 Id. at 217-18.
A simpler strategy was to include an agreement to arbitrate disputes into all of the business's contracts.\textsuperscript{42} Merchant arbitrators could be counted on to enforce the parties' expectations. There were, however, two drawbacks to this strategy. The first we have already encountered: courts were generally unwilling to enforce agreements to arbitrate (although they would enforce a final arbitral award).\textsuperscript{43} The second problem was that the business could not be certain that its individual owners had included a similar clause in their own personal contracts, meaning that the business would not be protected from suit against the personal creditors of its owners.

Nevertheless, the strategy was used successfully. Concern for reputation seems to have been sufficient to solve the first problem. Judging from the paucity of reported cases, businessmen must have honored their agreements to arbitrate. The second problem would have been mitigated by the practical difficulties of suing a partnership to obtain a share of the business assets. To liquidate business assets, the personal creditor would have to join all the other owners and seek partitioning of those assets. It would be far easier, one suspects, to reach an accommodation with the individual debtor under which all returns from the business would be paid over to the creditor.

The creation of reverse partitioning was a simpler matter to achieve by contract. Even a partnership can insulate its partners from liability for partnership debts by contracting for that result. Some joint-stock companies went farther and declared limited liability in their organizational documents on the theory that general notice to creditors was a substitute for creditor-by-creditor negotiation.\textsuperscript{44} Others, by contrast, expressly declared unlimited liability in their organizational documents as a way of increasing their access to credit.\textsuperscript{45}

By the end of the seventeenth century, developments in tort law were making it possible to imagine tort liability for joint-stock company shareholders. Courts were beginning to hold owners of

\textsuperscript{42} Id. at 221.
\textsuperscript{43} Id.
\textsuperscript{44} See Anderson & Tollison, supra note 4, at 114 (describing various means by which companies obtained limited liability status).
\textsuperscript{45} Id. at 115.
businesses liable for negligent acts of their employees. The change may have originated in admiralty cases in which, traditionally, a ship's owner was not liable for negligent acts of the master or crew.46 Admiralty law, however, did hold the master responsible for a mariner's negligent acts. Late seventeenth century decisions began to hold the shipowner liable as well.47

We must not make too much of the risk of tort liability. Products liability and liability for environmental damage—tort claims that can bankrupt the largest organizations—were not yet even on the horizon. Nevertheless, by 1700 the fluid state of the law of joint-stock companies and the law of torts could easily have crystallized into something like modern corporate law. It would not have been a radical act for a court to declare, in an appropriate case, that an unincorporated joint-stock company was a separate legal entity, that its charter's declaration of limited liability (if any) was effective against contract creditors, and that the developing principle of respondeat superior was sufficient to give a tort creditor a claim against the assets of a joint-stock company but not its individual owners.

The courts, however, did not get a chance to explore these ideas further. In 1720, Parliament took the law of joint-stock companies into its own hands. To understand why, we must briefly return to the incorporated joint-stock companies.

III. THE TRIUMPH OF THE CONCESSION THEORY

If joint-stock company promoters did not have to seek government charters for purposes of asset partitioning, why did they do so? The answer is twofold. First, overseas trading companies often wanted to set up trading posts or garrisons in the places to which they sailed. A charter could, and often did, make it clear that the

46 See MALYNES, supra note 33, at 121 (describing duties of ship owners).  
47 See 8 HOLDSWORTH, supra note 14, at 252-53 (discussing development in admiralty law of employers' liability for employee torts).
company had rights of governance similar to that of a municipality in those outposts.\footnote{See Giles Milton, Nathaniel's Nutmeg, or the True and Incredible Adventures of the Spice Trader Who Changed the Course of History (1999) (providing informative, entertaining account of difficulties faced by overseas trading companies).}

Merchants also sought incorporation as a formal grant of monopoly rights over their trade. Many of the early trading companies received exclusive rights to trade in a particular area (e.g., Russia, Africa, East India).\footnote{Scott, supra note 32, at 3-237.} Monopolies were not, however, unique to overseas trade. They were instead a ubiquitous feature of early modern English economic life.\footnote{Hill, supra note 32, at 21-28.} The Crown raised revenue by selling monopoly rights, and corporate charters were one of the devices used to record sales.

What frequently distinguished incorporated from unincorporated joint-stock companies, therefore, was that the former were owned by politically well-connected merchants who had paid a handsome price to secure a monopoly, while the latter lacked the money or connections to gain similar privileges. Indeed, in some instances unincorporated joint-stock companies were probably competing with chartered companies in violation of the monopoly rights legally granted the latter. Consequently, the political position of unincorporated joint-stock companies was more precarious than that of incorporated joint-stock companies. Unincorporated joint stock companies operated in a legal no-man's land: they were not illegal, but their existence was something of an affront to the Crown.

Parliament addressed this affront in 1720, ending a brief period of benign neglect of unincorporated joint-stock companies. The Bubble Act made it illegal, without a royal charter, to "presum[e] to act as a corporate Body," or "to raise a transferable Stock or Stocks."\footnote{See Dubois, supra note 40, at 41 (quoting Bubble Act).} Thus, for the first time, English law formally embraced the proposition that a business organization with separate legal personality and transferrable shares could not be a creature of contract but must be a concession from the state. This was not the recognition of a fact—it was by that time tolerably clear that separate legal personality and transferability could be created by
contract, perhaps supplemented by trust—but an exercise of regulatory authority by a government that had concluded that unincorporated joint-stock companies were unduly interfering with the sale of monopoly rights.\(^{52}\)

Despite heavy penalties (including, ironically, the right of any monopolist harmed by an illegal company to recover treble damages), the Bubble Act manifestly failed to eradicate unincorporated joint-stock companies. Joint-stock companies continued to be created and operate right up to the repeal of the Bubble Act in 1825.\(^{53}\) The explanation is straightforward: charters were expensive, the benefits of legal personality were considerable, and merchants were willing to run the risk of prosecution. These merchants, of course, also ran the risk that their own creditors would refuse to treat their businesses as separate entities. Yet, the level of cooperation was high enough, despite the impossibility of legal enforcement, to permit the survival of the organizational form.

The real impact of the Bubble Act was to cut off any possibility of further development of a common law of joint-stock companies. By the time of the Bubble Act’s repeal in 1825, judges, having had nothing to do with unincorporated joint-stock companies for a century, were determined to fit them into an existing legal category (e.g., partnership) rather than see them as a different form of contract altogether. The notion of separate legal personality without incorporation had ceased to reside in the judicial mind. Thus the Lord Chancellor, faced with a suit against a joint-stock company that had three hundred shareholders, threw up his hands at the thought of adjudicating such a dispute:

\[
\text{[O]ught the jurisdiction of the court, which can be administered usefully only between a limited number of persons, to be employed for a purpose which it cannot by possibility accomplish? Here is a bill with nearly three hundred defendants. How}
\]


can such a cause ever be brought to a hearing? . . .
In such a suit, the Plaintiff can do nothing, except put himself and others to enormous expense. 54

This way of thinking made it difficult for business creditors to sue successfully, and thus for businesses to obtain credit in reliance on legal remedies. It also made it difficult for a partner's personal creditors to cause the sale of partnership assets in order to satisfy the partner's personal debts. 55 As a practical matter, therefore, joint-stock companies and their creditors had to rely on voluntary cooperation. To the extent companies cooperated with business creditors, but refused to cooperate with personal creditors, they again would have achieved forward partitioning de facto.

The fact that formation of joint-stock companies continued in the face of these extraordinary obstacles to legal enforcement demonstrates that business lenders perceived the level of voluntary cooperation to be high. Organizational documents often provided that any dispute with the company would be submitted to arbitration. 56 Other joint-stock companies sought private bills from Parliament authorizing the company to sue and be sued in the name of an officer. 57

Parliament reacted by commissioning a report on the law of partnership (by now the concept of a joint-stock company as something legally different than a partnership was unthinkable) to propose a legislative solution. 58 The report made two key suggestions: (1) that partnerships with more than fifteen partners be authorized to sue and be sued without suing the individual partners, and (2) that a form of entity with limited liability be authorized by statute. In 1844, Parliament took up the first suggestion by enacting the first general incorporation statute. 59 It provided that joint-stock companies (meaning partnerships with transferable shares and more than twenty-five partners) were compelled to

57 Shannon, supra note 55, at 274.
59 7 & 8 Vict., ch. 110 (1844) (Eng.).
register with a government official, thereby gaining legal personality.

Having stunted the growth of a common law of joint-stock companies by a century of illegality, and faced with a Lord Chancellor who (in his Parliamentary role) opposed free transferability of shares without Parliamentary acquiescence, it made sense for Parliament to clear the matter up through a general incorporation statute. Had Parliament not stepped into the fray in 1720, however, it seems plausible that courts would have continued to develop a common law of joint-stock companies that would have treated them as a separate legal person and permitted free transfer of shares, along with the right to vote for management. General incorporation, in other words, was Parliament’s solution to a problem largely of Parliament’s creation.

The last step in the development of modern corporate law was the rediscovery of limited liability. It is tempting to imagine Parliament responding to the pleas of industrial pioneers by protecting them from the claims of their business creditors. The real picture, however, is more complicated and more interesting.

It would have been a simple matter for Parliament to adopt limited liability in 1844, at the same time as the first general incorporation statute. The Report of the Law of Partnership (drafted by a lawyer) called for limited liability. Moreover, it is reasonable to think that the House of Commons, whose membership drew heavily from the merchant ranks, would have been responsive to requests from entrepreneurs for a limited liability provision. Interestingly, however, the merchants did not clamor for limited liability.

The debate over limited liability has received considerable attention, so it need only be summarized here. In the 1840s, merchants for the most part opposed limited liability. Many argued that owner liability was necessary for creditworthiness or to prevent excessive speculation. The more pertinent view, however, was that the rule did not matter much, as creditors and debtors could

---

contract for the desired result in any event (tort liability, still a trivial issue, was never discussed). Parliament stuck with the status quo.

In the 1850s, however, pressure for limited liability came from an unanticipated direction. Robert Slaney, a member of the House of Commons known as a champion of the poor, pushed successfully for the appointment of a parliamentary committee on investments for the middle and working classes.\textsuperscript{61} The committee heard testimony that the growing number of small savers found little outlet for their savings beyond government bonds; land was illiquid because of the complexity of titles and the expense of conveyance and unlimited liability made investment in joint-stock companies too risky for those who had only modest wealth.\textsuperscript{62}

A more subtle point was made, not surprisingly, by John Stuart Mill, who was called to testify before the Committee.\textsuperscript{63} Mill anticipated the modern law-and-economics analysis of limited liability by pointing out that unlimited liability impaired the liquidity of shares by making the value of a share depend on the wealth of the holder. In particular, he noted that entrepreneurs of modest means could not easily incorporate a business and attract capital from wealthy investors because the latter reasonably feared that they would be the only ones sued if the business became insolvent:

> A limitation of the responsibility, so far as relates to the working classes themselves, might not be essential [because if they began a small business they would invest nearly all of their wealth in it];

\textsuperscript{61} See Halpern et al., supra note 60, at 118 ("[P]roponents of limited liability hypothesized that its availability would facilitate investments of savings by the middle and working classes otherwise discouraged from investing ... under an unlimited liability regime.").

\textsuperscript{62} See Report from the Select Committee on Investments for the Savings of the Middle and Working Classes, 1 British Parliamentary Papers 1849-1850, at 533, 544 (containing testimony of John Malcolm Ludlow).

To a modern observer, the point may seem backwards. A person of modest means has less to lose and therefore should be more, rather than less, concerned about unlimited liability. It may be, however, that given the vast social distinction between the poor and the middle class and the thinness of the social safety net in early nineteenth century England, the consequences of losing modest savings seemed very dire indeed.

\textsuperscript{63} See id. at 617-30 (containing testimony of John Stuart Mill).
but still I think that an alteration of the law in regard to the responsibility of partners would be of great importance to those associations, not for the sake of the responsibility of the [entrepreneurs], but in order to induce persons of capital to advance it to them for those purposes. I think that the great value of a limitation of responsibility, as relates to the working classes, would be not so much to facilitate the investment of their savings, not so much to enable the poor to lend to those who are rich, as to enable the rich to lend to those who are poor.\textsuperscript{64}

The Committee ultimately decided not to recommend changing the default rule to limited liability, but proposed merely that Parliament reduce the cost of seeking a private bill to obtain limited liability. Parliament, however, soon faced popular criticism for failing to remove an obstacle to the further advancement of the working class.\textsuperscript{65} Consequently, in 1855 Parliament acted against the advice of the government and its own committee by enacting the Limited Liability Act, which allowed a company to claim limited liability in its registration documents so long as it met certain requirements, such as ending the name of the company with “Limited.”\textsuperscript{66}

**IV. CONCLUSION**

As I have demonstrated, the way in which “corporateness”—legal personality, transferability of shares, centralized management, and limited liability—entered English business practice and ultimately English law was quite different than we would imagine after reading the pronouncements of United States courts on the subject. The benefits of treating a business as something separate from its owners are so obvious and overwhelming that it has never required

\textsuperscript{64} *Id.* at 618.
\textsuperscript{65} HUNT, *supra* note 60, at 132-34.
\textsuperscript{66} Limited Liability Act, 18 & 19 Vict., ch. 133 (1855) (Eng.).
substantial governmental assistance to achieve. By the same token, however, governments have at many times wished to interfere with the creation of large organizations and therefore treated contractual attempts to create asset partitioning as a challenge to their authority.

For most of the seventeenth and eighteenth centuries, the separate personality of business organizations survived in practice despite judicial and legislative attempts to undermine it. The "concession" theory of the corporation in the English-speaking world owes its lineage to two aggressive assertions of the sole right of government to create legal persons: Coke’s decision in 1615 and the Bubble Act in 1720. The first occurred at the high-water mark of English economic interventionism. The second was a last gasp of the monopolizing, regulating, interventionist impulse early in the century that would eventually witness the triumph of laissez-faire ideas.

Limited liability, on the other hand, never mattered much in a world without products liability, class actions, and other twentieth century legal innovations. It entered English law not as a favor to entrepreneurs, but as a minor episode in a general mid-nineteenth century movement to improve the lot of the English working classes.

Justices Brandeis and Marshall, then, were both wrong to claim that regulatory scrutiny of businesses organized as corporations is a quid pro quo for governmental favors those businesses receive by incorporating. They are, instead, part and parcel of the governmental unease with unfettered enterprise that led to the fiction that government “creates” or “licenses” the corporation.