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# THE DEVELOPMENT OF ENGLISH COMPANY LAW BEFORE 1900

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**Abstract**
This article outlines the development of English company law in the four centuries before 1900. The main focus is on the evolution of the corporate form and the five key legal characteristics of the corporation – separate legal personality, limited liability, transferable joint stock, delegated management, and investor ownership. The article outlines how these features developed in guilds, regulated companies, and the great mercantilist and moneyed companies. I then move on to examine the State's control of incorporation and the attempts by the founders and lawyers of unincorporated business enterprises to craft the legal characteristics of the corporation. Finally, the article analyses the forces behind the liberalisation of incorporation law in the middle of the nineteenth century.

**JEL Codes**: G10, G18, G30, K10, K20, N23

**Keywords**: Bubble Act, Company, Corporate Law, Legal Personality, Limited Liability, Transferable Shares, Unincorporated Company.

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**Industrialisation and business enterprise**

By 1900 England had the largest stock market in the world and was the leading industrial nation. Remarkably, freedom to incorporate as a limited liability company had been available only since 1855. Even more remarkable was the fact that England had undergone the Industrial Revolution without freedom of incorporation and with a legal framework which restricted the development of business organisation (Harris 2000). Indeed, most of the business enterprises which formed the backbone of the Industrial Revolution were sole traders, partnerships or unincorporated companies.[1] Therein lie two questions. Why was freedom of incorporation not a necessary precondition for industrialisation? and Did the law respond to the socioeconomic pressures of the era or did it resist them?

In this essay, we trace the evolution of company law in England before 1900. However, in order to do so, we need to identify what we mean by the company. The modern company or corporation has five basic legal characteristics – separate legal personality, limited liability, transferable joint stock, delegated management, and investor ownership (Kraakman et al. 2004, pp.1-19). Legal personality is where a firm or organisation is permitted to act as a legal person distinct from its owners and managers. This enables firms to enter contracts more efficiently, sue and be sued in the name of the firm's designated officers, own real estate and assets, and pledge real estate and assets to creditors. Hansmann and Kraakman (2000) point out the importance of the affirmative asset-partitioning role of having a separate legal personality, which means that the assets of the firm are shielded from their owners and managers as well as the personal creditors of their owners and managers. Acheson et al. (2011a) emphasise that, without a discrete legal personality, it is very difficult to separate ownership from control and for a managerial hierarchy to be formed. Unlike most of the other features of the company,

[1] In UK parlance, 'company' is used rather than 'corporation'. The explanation for this is that England had for over a century companies which were unincorporated.

separate legal personality cannot be crafted by private contracting and is ultimately the gift of the State, contrary to the views of Anderson and Tollison (1983).

Delegated management is important because it lets third parties know who has the authority to make decisions and enter binding contracts on behalf of the firm. Investor ownership is the flip side of delegated management because it permits shareholders to have control rights and cash-flow rights without having to participate directly in the management of the firm. Limited liability for shareholders means that the creditors of the company are limited to making claims solely against the company and not against the assets of the individual shareholder. Transferable joint stock refers to the ability of owners to transfer their ownership shares to other individuals. The benefit of transferable joint stock means that a business can continue completely uninterrupted even though its underlying owners may change.

As we will see in the rest of this essay, the evolution of company law in England up to 1900 was all about the struggle to enable business enterprises to have all five of the core structural characteristics outlined above. The evolution of corporate law after 1900, however, was chiefly concerned with resolving the agency problems which arose out of conflicts created by the coming together of these characteristics, i.e., shareholders vs. managers, shareholders vs. shareholders, and shareholders vs. other constituents (e.g., creditors and employees). Our focus in this essay will be on the way in which these different characteristics evolved and combined in the 500 years before 1900 and the efforts of the legal system and the political elite to stifle the development of particular characteristics during most of this era.

**In the Beginning….**

The idea of the corporation as a legal fiction distinct from the individuals who compose it has an ancient history stretching back to the Romans, and possibly even earlier (Williston 1888). In England the ability of a grouping of individuals with a common interest to act as a corporate body with legal personality stretches back to the medieval period, with guilds and boroughs being granted incorporation charters which included the right to sue and be sued, the right of perpetual existence, the right to own land, and the right to use a common seal, which verified that those entering a contract with third parties were authorised to act on behalf of the corporate body (Cooke 1950, p. 21).[2] Thus, the early development of the corporate form was for local government, and incorporation was usually, though not exclusively, granted by the Crown. Indeed, this concept of the corporate form being used for public government persisted into the seventeenth century, with the plantation of Ulster undertaken by a corporation.

By the sixteenth century, there were numerous corporations in England apart from the guilds and boroughs, e.g., universities and colleges, hospitals, charitable bodies, and ecclesiastical bodies. By this point also, the Crown had near-monopoly power over the creation of corporations and granted them through Royal charters, letters patent, or Acts of Parliament (Harris 2000, p.17). But in none of these corporations was there the concept of a joint stock or capital; they simply united individuals who had a common interest. All of the business corporations which came after these early civic and ecclesiastical corporations differed from them in that joint-stock capital was added to the separate legal personality (Williston 1888, p. 149). The common interest of the individuals who contributed the capital was profit. Thus, instead of unifying a group of individuals, business corporations were created which agglomerated a capital fund and the legal system had to adapt to deal with the consequences emerging from this innovation in corporate technology.

The vast majority of companies which were created in the sixteenth century were mercantilist corporations which, as well as being incorporated by the Crown, were usually given monopoly trading rights with various countries. Indeed, monopolistic privileges were an

[2] On the history of the common seal, see Williston (1888, pp. 117-8).

integral part of these early companies, with the State implicitly or explicitly protecting the monopoly against competition from foreign merchants (Harris 2000, p.41). They also were an attractive source of revenue for the Crown because, as a major source of the Crown's income, they allowed it easily to bypass Parliament. This was in an era when it was questioning the prerogative of the Crown and these trading monopolies were also key institutions in foreign policy through their maintenance of embassies and military and naval facilities. Woodward (1985a, p.12) rightly observes that is "shocking how non-laissez-faire are the roots of the corporation – a quintessentially laissez-faire institution".

These early mercantilist companies came in two organisational forms – the regulated company and the joint-stock corporation. The main distinction between these two forms was that the former did not necessarily have a transferable joint stock; the members of the company simply traded on their own account. With regard to limited liability, the members of the regulated companies did not possess it, and the members of joint-stock corporations did not derive this privilege from incorporation in and of itself – it existed only if expressly stated in the company charter, and was not necessarily at this time equivalent to modern conceptions (Harris 2000, pp.128-9). However, like the joint-stock corporations, the regulated companies had most aspects of a separate legal personality and they had a hierarchical managerial structure. Neither of them, however, had necessarily a concept of perpetual existence – renewing their charters, indeed, was a source of extra revenue to the Crown.

The regulated companies typically had monopolies of trade with nearby countries, e.g., the Merchant Adventurers (est. 1505); the Spanish Company (est. 1577); the Eastland Company (est. 1579); and the French Company (est. 1609), while the joint-stock mercantilist corporations usually had monopolies of long-distance trade e.g., the Muscovy Company (est. 1555); the Levant Company (est. 1581); and the East India Company (est. 1599). Subsequently, the Muscovy Company and Levant Company were reorganised as regulated companies.

The business corporation flourished in the first two decades of the seventeenth century – about 40 (mostly regulated) companies were formed and were granted monopoly trading rights across the globe, their total membership coming close to 10,000 (Harris 2000, p.45). However, for the rest of the century until the Glorious Revolution of 1688, the business corporation suffered a demise. The major cause was the abuse of the monopoly trading privileges by James I (r. 1603-1625) and Charles I (r.1625-1649).

James I, a spendthrift and heavily indebted, sold exclusive trading charters; in order to raise further income, he renegotiated, and even reneged on, existing ones. This created investment uncertainty and provoked the ire of Parliament, which in 1623 passed the Statute of Monopolies, with the aim of curtailing the ability of the Crown to sell new monopolies. However, this act was full of loopholes, which were fully exploited by Charles I when he acceded to the throne (Harris 2000, p.47). Charles I salami-sliced the domestic and international economic activity of the nation and sold it in the form of monopoly franchises. However, weak enforcement and expropriation by the Crown meant that the franchise value of charters fell quite dramatically. The status of the public company did not recover during the Interregnum (1649-1660) or the Restoration (1660-1688) and the rise of alternative sources of public finance meant that there was a much reduced incentive for the Crown or Parliament to raise finance via granting monopoly charters. The only exceptions in this period of decline were the Hudson's Bay Company (est. 1670), which had a trade monopoly over the Hudson Bay area, and the Royal African Company (est. 1672), which was granted a monopoly on the slave trade between Africa and the West Indies.[3]

[3] See Carlos and Kruse (1996) and Carlos and Nicholas (1990) on agency and other problems within these two companies.

Two milestones in the evolution of the public company were reached in the seventeenth century with the East India Company.[4] First, this company, by raising capital from nearly 1,000 investors for its 1617 voyage to the Indies, opened up investment in companies to the general public – "the company investor had arrived" (Cooke 1950, p.58). Second, in the 1650s, it raised a permanent and perpetual joint stock (Neal 1990, p.45). Up to this point, its capital had been ad hoc, with voyages and ventures being financed individually and temporary joint stocks, which enabled investors to demand all their capital back.

The Glorious Revolution of 1688 ushered in major constitutional changes, which had a major positive effect on the development of the corporation and capital markets (North and Weingast 1989). The large fiscal needs of the new State resulted in the expansion of public debt and the creation of two companies which played a major role in public finance – the Bank of England (est. 1694) and the South Sea Company (est. 1711). Half of the Bank of England's £1.2 million of capital was lent to the State and it continued to lend money to the State thereafter. It also facilitated the raising and administration of the public debt. A proportion of the South Sea Company's capital was also exchanged for national debt. Although it was initially given a monopoly of trade with parts of South America, it soon moved away from this and transformed itself into a company which focused on financing the State. The East India Company also got into the act and invested heavily in the national debt. By 1714 these three companies between them were holding 39 per cent of the national debt (Dickson 1967, p.80) The seeds of the first financial bubble had been sown.

**The Bubble Act**

The financial revolution that accompanied the Glorious Revolution resulted in 1693 in the development for the first time of a permanent government debt. Trading in these new

[4] On the East India Company, see Baskin and Miranti (1997, pp.63-82).

government debt instruments and in the shares of the three large moneyed companies (the Bank of England, South Sea Company and East India Company) and many other companies expanded substantially – the birth of the London stock market dates back to the 1690s. By 1695 there were circa 150 companies with a capital of £4.3m and in 1704 the turnover of shares in the Bank of England and East India Company totalled £1.8m or 85 per cent of their combined capital (Michie 1999, pp.15-6). The new companies in 1695 were from various sectors: banking and finance, fishing, manufacturing, mining and water supply. However, many of these companies were short-lived, and by 1717 circa 12 companies were traded on the London stock market, where trading was dominated by the three moneyed companies listed above (Harris 2000, p.58).

In the late 1710s there was increasing speculative activity on the London stock market. But the rationale for what has become known as the Bubble Act was not the quelling of this speculative activity, or the preventing of future bubbles by banning unincorporated companies from forming. Indeed, this somewhat misleading appellation was only given to the Act in the early nineteenth century. It was misleading because the Act had little to say about speculation and bubbles in company formation and because the first financial bubble was largely concentrated in the moneyed companies, particularly the South Sea Company. It was also misleading because the Act was conceived by a Parliamentary committee in February 1720 and passed on 11 June 1720, two months before the South Sea Bubble even showed signs of bursting.

The chief purpose of the Bubble Act was to limit alternative investment opportunities so that capital would be diverted towards shares in the South Sea Company. Harris (2000) provides compelling evidence that the South Sea Company was the main instigator of the legislation and that the incentives of the ruling elite were closely aligned with the South Sea Company because many of its members had invested in it. Moreover, the company was helping to refinance the substantial public debt which had accumulated in the two decades after the Glorious Revolution, and which in the relatively peaceful 1710s was paying interest at a rate of two to four per cent above the market rate. The scheme devised by the South Sea Company enabled it to operate a debt-for-equity conversion whereby subscribers could buy shares in the company using government bonds. The company then refinanced the debt at a lower interest rate and paid the government a substantial fee for the privilege of carrying out the debt-for-equity conversion. This scheme was made attractive by the continuous good news being released about the South Sea Company, which increased investor expectations regarding future profits and in turn pushed up the company's share price.

Between October 1719 and July 1720, the company's share price increased 820 per cent. The prices of the two other moneyed companies also increased – the Bank of England's went up 170 per cent and the East India Company went up 220 per cent. In addition, the speculative fervour in the stock market attracted hundreds of small 'bubble' companies which were unincorporated and had no State permission to form as companies. The estimated total capital of these companies (circa £250 million) was such that they threatened to undermine the debt-for-conversion operation being operated by the South Sea Company. The Bubble Act was passed not because these unincorporated companies were of dubious legality, but rather because they threatened to divert substantial capital away from the South Sea Company.

A secondary purpose of the Act, and one which was added to the Act late in the day as it passed through Parliamentary committees, was that it incorporated two marine insurance companies (London Assurance and Royal Exchange Assurance), giving them a monopoly of marine insurance. The chief reason for granting this monopoly was that each company offered to pay £300,000 of the King's debt.

The South Sea Bubble has been referred to as the first financial bubble and it marks a major point in the development of publicly-traded companies and the stock market. But why did it occur? Explanations for it fall into several categories. First, ever since Mackay (1856), many have blamed mania, popular delusion, the madness of the crowd and irrationality. Second, Kindelberger (2000), Neal (1990) and Giusti et al. (2013) put the blame on the large-scale debt-for-equity conversions. Third, Frehen et al. (2013) suggest that major innovations in finance, trade, maritime insurance and the corporate form fuelled investor expectations, causing the asset price reversal which has been associated with similar technological revolutions (Pástor and Veronesi 2009).

What were the long-run effects of the Bubble Act? The popular yet mistaken belief is that the Act hindered the development of the corporate form in England and set financial capitalism in England back by a century. To tell the truth, the effect of the Bubble Act was negligible at best. First, before the passage of the act, unincorporated companies were not recognised as such by the common law. The passage of the Act therefore changed nothing. Second, the Act was a dead letter – only one prosecution in the eighteenth century took place under it. Third, thanks to legal ingenuity, many unincorporated companies were established in the 1700s, notwithstanding the Act (Cooke 1950, p.84).

**The Partnership and the Unincorporated Company**

Despite the passage of the Bubble Act, within a few decades the Industrial Revolution was well and truly under way in England. How did the businesses at the core and periphery of the Industrial Revolution organise themselves? The dominant form of organisation was the partnership. In two of its rulings, the Courts of Chancery created what is known as the 'jingle rule'. In the 1683 case of *Craven v. Knight*, it was ruled that the creditors of a partnership had first call on the assets of a bankrupt partnership, and only after they had been satisfied could any surplus be made available to personal creditors. Subsequently, in 1715 in *Ex parte Crowder*, Chancery ruled that a partner's personal creditors enjoyed first call on his personal assets and that partnership creditors had a claim on personal assets only after personal creditors had been paid. Although these rules created what Hansmann et al. (2006) called weak entity and owner shielding, the English partnership form suffered from the problem of untimely dissolution and the associated opportunism and hold-up costs (Lamoreaux 1998; Acheson et al. 2011a). These costs meant that partnerships tended to be small and between individuals with close social or familial connections. As a result, they were an unsuitable organisational form for businesses with large capital needs.

Business enterprises which had large capital requirements and therefore required a relatively large number of owners and tradable ownership stakes resorted to the organisational form of the unincorporated company. This form emerged when the trust form was applied to the partnership. The enterprise's assets (including land) were held in a trust by trustees who were appointed by the partners. This meant that the partners or stockholders could sell their shares because the trustees stayed the same. To what extent did these entities have a separate legal personality, limited liability, transferable joint stock, delegated management, and investor ownership?

The deeds of settlement, which were the constitutional documents of unincorporated companies, prevented shareholders from entering binding contracts or acting in a managerial capacity. These business entities therefore had delegated management and a separation of ownership from control, with directors or managers being appointed by the owners following the regulations laid out in the deed of settlement. However, unlike third parties with corporations, third parties with unincorporated companies could not be certain whether a particular person had authority to act on behalf of all the other owners. Unincorporated companies also ran into difficulties when they came up against the common law because it ignored deeds of settlement and viewed unincorporated companies as mere partnerships. This meant that all shareholders were treated as partners and named as plaintiffs or defendants when it came to suing or being sued. There was thus a tension between what was possible in equity law in the Court of Chancery and what was possible in common law, which resulted in unincorporated companies not having a separate legal personality.

The Bubble Act was ultimately concerned with preventing the establishment of corporations with freely transferable shares. In order to keep unincorporated companies outside the ambit of the Bubble Act, deeds of settlement included clauses which required trustees to give prior approbation before shares could be transferred (Cooke 1950, p.99). In other words, although shares in unincorporated companies could be transferred, they could not be transferred freely.

Some unincorporated companies, particularly those towards the end of the eighteenth century, claimed to have limited liability and contracted to have limited liability in their deeds of settlement. Insurance companies, in particular, contracted so as to have limited liability (Supple 1970, p.118). However, much uncertainty surrounded this issue, particularly in the case of insurance companies. Although the Courts of Chancery upheld the limited liability clauses in deeds of settlement, under the common law, unincorporated companies were *de jure* and *de facto* unlimited (Macgillivray and Browne 1937, p.3). Ultimately, unincorporated insurance companies could limit their liability inter se, but not to third parties (Harris 2000, p.143), and investors even doubted the claims of insurance companies that they had limited liability (Raynes 1948, p.211). From a practical point of view, unincorporated insurance companies had such large amounts of uncalled capital (i.e., capital which could be called upon by directors and creditors) that their liability status was almost immaterial (Acheson et al. 2012).

Did the ingenuity of lawyers and the Courts of Chancery create in the unincorporated company an organisational form which was *de facto* a corporation? If this is the case, then the introduction of general incorporation in the nineteenth century was simply a matter of the law following common business practice. In addition, if it is true, then the unincorporated company is a prime example of the flexibility of the English legal system to meet the demands of a rapidly changing business and industrial environment. However, Harris (2000) suggests that this organisational form faced two major problems which meant that it was far from being the corporate form and its achievements were moderate at best.

First, the lack of a separate legal personality made litigation a very costly exercise. Indeed, after 1807, a number of unincorporated companies (mainly insurance companies) obtained Acts of Parliament to enable them to sue and be sued in the name of a company officer. By 1815, 30 such acts had been passed (Harris 2000, p.165) and the greatest growth in the number of unincorporated companies coincides with the passing of this legislation (Freeman et al. 2012, p.15).

Second, the Bubble Act cast a continual shadow over the unincorporated company, making their legality questionable. Furthermore, they could not find a legal arena that dealt quickly enough with internal disputes. Chancery was a one-man court until 1813 and, as a result, things moved very slowly and the Lord Chancellor was uninterested in internal disputes between partners and trustees (Harris 2000, p.164). In addition, Chancery fees were very high.

### The Corporation in the Eighteenth Century

With the development of corporations and transferable joint stock arose legal questions which came before the courts. Several cases came before the courts around the issues of whether shares in joint-stock companies were realty or personalty; what to do about stock in the company transferred without the consent of their owner; and what to do if the company refused a transfer (Williston 1888, pp.150-6). In terms of company bylaws, there were attempts by large shareholders to circumvent one-shareholder-one-vote voting rules, which were commonplace in early joint-stock companies, by the practice of splitting stock, i.e., temporarily transferring shares to friends to increase one's voting power. The Public Companies Act (1767) was passed to prevent this practice by requiring that members of public companies who had not held the stock for at least six months were ineligible to vote.

The practice of paying for stocks in instalments when they were first issued was commonplace among early joint-stock companies and persisted well into the nineteenth century. Disputes came before the courts regarding the non-payment of calls and whether or not an original subscriber could avoid liability by selling his stock. In *Child v. Hudson's Bay Company (1723)*, it was made clear that a shareholder must pay calls when required to do so or forfeit some of his stock for non-payment; it was not until *Huddersfield Canal Company v. Buckley (1796)*, that the assignment of a stock was established as transferring the liability for calls to the new owner.

It is not clear how far the owners of joint-stock companies were liable for the debts of their company before circa 1800. In the case of the *City of London (1680) I Ventr. 351*, it was stated that the responsibility of owners for the debts of the corporation were inconsistent with the concept of the corporate body. However, this did not necessarily let owners off the hook because a company unable to pay its debts could be legally required to make calls upon its members to enable it to pay its debts. For example, in the 1671 case of *Dr. Salmon v. The Hamborough Company*, it was ruled that the members of the company were indirectly liable for its debts because its charter gave the company power to make calls on its owners. In the 1673 case of *Naylor v. Brown*, it was ruled that the members of the company who were also creditors of the company ranked below other creditors. Apart from these cases, what limited liability actually meant in the seventeenth and eighteenth centuries remains fairly incoherent (Cooke 1950, p.77; DuBois 1938, pp.93-5; Harris 2000, p.129).

By the early 1800s, there was much more clarity about what limited liability actually meant – that (a) calls could be made on members only if call-making power had been granted to the company; (b) incorporation by Royal charter or Act of Parliament carried with it limited shareholder liability; (c) owning shares did not turn non-traders into traders, and thus expose them to draconian (i.e., debtors' prison) bankruptcy laws, which applied to traders only. In the late eighteenth century, there was correspondingly a greater desire for limited shareholder liability from those looking for corporate status – it even became a major motive in seeking incorporation (DuBois 1938, pp.95-9).

Most businesses seeking incorporation in the second half of the eighteenth century sought to do so via a private Act of Parliament rather than a Royal charter. In particular, a large number of canals was incorporated by private Acts – over 100 canals were incorporated by 1800, with nearly 80 of these formed during a promotion boom in the early 1790s (Ward 1974). These canal companies had a transformative effect in that they familiarised Parliamentarians with the corporate form (Harris 2000, p.100). In addition, canals contributed to the growth of capital markets because their shares were traded on primary and secondary markets. In a sense, they blazed the trail for the large diffusely-owned companies which would emerge in the nineteenth century.

**Freedom of Incorporation**

By 1800 entrepreneurs who wanted to form a business enterprise had three choices – (a) set up as a partnership; (b) operate as an unincorporated company; or (c) incorporate via a Royal charter or private Act of Parliament. However, there were two industries which operated outside the common law and did not have to resort to the unincorporated organisational form – shipping and the Cornwall and Devon stannary mines.

Shipping came under the jurisdiction of the High Court of Admiralty and, as a result the organisational form for shipping took a different development path. Ship ownership was divided into equal parts, and ships had sleeping partners, transferable ownership, delegated managerial authority, and partial limited liability (Harris 2000, p.190).

The Cornwall and Devon tin mines operated under the jurisdiction of the Stannary Courts, which stretched back to the Middle Ages. Stannary mines operated a cost book system, which gave them flexibility in terms of raising new capital and paying dividends on a frequent basis (Bartlett 1850). These mines operated as entities separate from their owners and had managerial hierarchies as well as tradable shares. In principle, although they had unlimited liability, there were procedures in place (mainly placing limits on a mine's ability to borrow) which resulted in owners (or adventurers) having some control over the extent of the mine's liability (Burke and Richardson 1981; Burt and Kudo 1983).

The first quarter of the nineteenth century brought various pressures on Parliament with regard to businesses and their incorporation. A combination of increasing trade, the growth of new industries, the growth of cities and towns and the rise of a new investing public that had amassed substantial savings resulted in increased company promotions. This came to a head in the 1824-25 boom, when 624 companies were floated on the London stock market (English 1827, p.30). Questions regarding the legality of these companies resulted in 438 requests to Parliament for the formation of corporations; Parliament gave 286 of these their own act of incorporation (Harris 2000, p.255). At the height of this promotional frenzy, the Bubble Act was repealed on July 5th 1825.

The subsequent crash and fallout from the collapse of the promotional boom and the collapse of the English banking system resulted in a serious financial crisis, which brought about a reform of banking incorporation law in England because, it was believed, the existing structure of English banking had been a key contributor to the banking collapse (Turner 2014, p.108). At the time the Bank of England had a monopoly; other banks were explicitly limited to being partnerships and note-issuing banks were forbidden to have more than six partners. The crisis was brought to an end when the Bank of England, under pressure from the Treasury, acted as a lender of last resort (Turner 2014, pp.144-5). As a result, the Banking Copartnerships Act (1826) was passed, which gave banks freedom to incorporate as unlimited liability companies, provided that they were located outside a 65-mile radius of London. The Bank of England Privileges Act (1833) allowed non-issuing joint-stock banks within this radius, thus ending the Bank of England's monopoly.

The repeal of the Bubble Act had the effect of increasing the legal uncertainty surrounding the unincorporated company. Unincorporated companies now came under the purview of the common law, and opposing and contradictory judgements confused matters. Some judges would declare an unincorporated company legal, but other more conservative judges, who were in the majority, would declare it illegal (Cooke 1950, p. 106; Harris 2000, p.249).

This untenable state of affairs meant that Parliament had to intervene in order to reform incorporation law. Reform came in the shape of the Joint Stock Companies Registration and Regulation Act (1844). Incorporation was obtained through registration – provisional registration was required before shares could be offered publicly and full registration was required a year thereafter, the deposit with the Registrar of Companies of a deed of settlement being signed by at least one quarter of the shareholders holding one quarter of the shares. Once registration was completed, companies enjoyed all the features of a modern corporation apart from limited liability. They could even sue and be sued in the name of designated officers and they could hold land in the company's name. Thus this Act was revolutionary in that "for the first time in at least 500 years corporations could be formed without explicit, deliberate, and specific State permission" (Harris 2000, p.284). Notably, because the Act ruled that all partnerships with more than 25 members and freely transferable shares had to register, it effectively extirpated the unincorporated company. However, companies which had been incorporated before the Act came into being did not fall under its purview. The Joint Stock Companies Registration and Regulation Act (1844) also did not apply to insurance and banking companies; banks had their own Act – the Joint Stock Bank Act (1844) – which specified that each new bank with more than six partners had to obtain a charter or letters patent in order to conduct its business. Charter duration could be no more than 20 years and banks were subject to onerous chartering stipulations. As a result, very few (if any) new banks formed under this legislation (Turner 2014, pp. 39-40).

The Joint Stock Companies Registration and Regulation Act (1844), furthermore, did not apply to companies such as railways and public utilities which required powers of compulsory land purchase and hence required parliamentary approval to go about their business. These companies were incorporated via parliamentary private incorporation bills, which meant that company constitutions and governance provisions had to be separately inserted into every bill. The 1845 Companies Clauses Consolidation Act prescribed the governance and shareholder protection rules that had to be included in future statutory incorporations. The preamble to the Act stated that it was necessary to avoid repeating the provisions in parliamentary incorporation acts to ensure greater uniformity. The Act contained a common deed of settlement which applied to all subsequent statutory incorporations.

What were the economic effects of the Joint Stock Companies Registration and Regulation Act (1844)? Within 14 months, 1,639 provisional registrations had been made, and by the time the next step in the liberalisation of company law was taken in 1856, there were 956 complete registrations and 3,942 provisional registrations (Harris 2000, p.288). However, it is unknown how many of the provisional registrations in 1844 and complete registrations in 1856 were new businesses seeking incorporation and how many were existing unincorporated companies simply coming under the provisions of the Act. In addition, the 1844 Act contributed little to the growth of public companies and the UK equity market (Acheson et al. 2009). The growth of the equity market from 1844 onwards and the opening of provincial stock exchanges in the mid-1840s was primarily driven by railways and joint-stock banks, which, as noted above, were not incorporated under this legislation.

In the period from the 1810s to the 1840s, the company form became more commonplace and the total capitalisation of the equity market grew from being less than five per cent of GDP to being more than 20 per cent of GDP (Acheson et al. 2009). This growth was largely due to the greater liberality of Parliament in granting corporate status (railways, public works, gas-light companies, etc.) and the liberalisation of banking incorporation law. Importantly, in this era, the connection between monopoly and the business corporation was broken with the ending of the East India Company's monopoly on trade with China and India, the ending of the monopoly on marine insurance in 1824, and the significant paring back of the Bank of England's monopoly as a result of the liberalisation of banking incorporation law in 1826 and 1833.

**The Arrival of Limited Liability**

The 1844 Act had given businesses formed under it every aspect of corporate status apart from limited liability. In 1855 an Act for 'Limiting the Liability of Members of Certain Joint Stock Companies' was passed by Parliament, but was quickly repealed. The act was re-enacted in 1856 as 'An Act for the Incorporation and Regulation of Joint Stock Companies, and other Associations'. These two acts enabled businesses upon registration to incorporate as limited liability companies. Banks and insurance companies were initially excluded from the limited liability acts, but limited liability was extended to banks under legislation passed in 1858, and insurance companies received this privilege by their inclusion in the 1862 Companies Act. The 1862 Companies Act was a consolidation of existing pieces of legislation and it was the progenitor of all future Companies Acts in the UK. The 1862 Act marks the final step in the centuries-long evolution of the corporate form in the UK. Every business could now avail itself of all of the features of incorporation through a simple registration process.

The effect of the liberalisation which took place in 1855 and 1856 was huge – nearly 5,000 limited liability companies had been established in England by the end of 1856 (Shannon 1933). The effect on the equity market was also substantial, but took some time to come to fruition, and it was only following a promotion boom in 1862 that the effect began to be noticed on the stock market (Acheson et al. 2009). However, the growth of the stock market in terms of issues and value in the second half of the nineteenth century (see Grossman 2002) would not have been possible without the liberalisation of incorporation law.

Interestingly, banks which had been established under the Banking Copartnerships Act (1826) could re-register under the 1862 Act. The main purpose of so doing would have been to limit shareholder liability. However, by the 1870s, there were still circa 70 English banks which were companies with unlimited shareholder liability and shares traded on stock markets (Turner 2014, p. 41). Only seven English banks took advantage of the 1862 Act. Why did banks not take advantage of the act and convert to limited liability? Ultimately, bank shareholders and depositors believed that unlimited liability made for a more stable banking system because the liability on shareholders was an effective constraint on risk shifting and excessive risk taking (Turner 2014, p. 124-5). However, the collapse in 1878 of the City of Glasgow Bank, at the time one of the largest unlimited liability banks in the UK, resulted in a change of attitude, particularly among bank shareholders (Acheson and Turner 2008). Subsequently, a Companies Act was passed in 1879 to facilitate the limitation of liability by banks. This Act created the concept of reserve liability, which meant that banks could have extended liability, but less than unlimited liability; for example, some banks had double liability (i.e., for every £100 of capital shareholders had paid in, they were liable for another £100) and others had various multiples of paid-up capital. This reserve liability could be called up only in the event of a bank's failing, unlike uncalled capital which also could be called up at the discretion of directors. All banks quickly limited their liability after the passage of the 1879 Act, but reserve liability remained a feature of British banking until the mid-1950s (Turner 2014, p.132).

The presence of unlimited liability in English banking companies until the 1880s raises an interesting question as to whether limited liability was a prerequisite for share tradability. Many scholars believe that any extension of liability beyond limited liability raises the costs of trading stock to such a degree that limited liability is a prerequisite for share tradability (Alchian and Woodward 1987; Carr and Mathewson 1988; Halpern et al. 1980; Winton 1993; Woodward 1985b). However, evidence from English banking would appear to contradict this view because the shares of unlimited liability banks were traded on public markets and trading activity and liquidity did not change when banks limited their liability (Acheson et al. 2011b). Thus, limited liability may not have been as important for the development of the public corporation as scholars believe.

The 1862 Companies Act provided little in the way of protection for shareholders (Campbell and Turner 2011). The model set of articles in Table A of the 1862 Act, which if adopted provided high levels of protection, were only default rules and 99 per cent of companies chose to ignore them (Acheson et al. 2016; Edwards and Webb, 1985). Common-law judges, largely influenced by laissez-faire theory and the practice of partnerships, did not believe that the courts should intervene in internal company matters in order to protect shareholders (Acheson et al. 2016). This brings up the question as to how companies raised capital on public markets from a diffuse range of investors. One possibility is that weak shareholder protection resulted in concentrated ownership. However, recent scholarship has revealed that the ownership of public companies in the post-1862 era was by modern-day standards diffuse (Acheson et al. 2015).[5] This is contrary to the law and finance hypothesis which suggests that the strong protection of shareholders is a prerequisite for diffuse ownership (La Porta et al. 1998, 1999). How was diffuse ownership possible in such an environment? One possibility is that companies voluntarily inserted clauses into their articles of association which offered outside shareholders a great deal of protection (Acheson et al. 2016). Another possibility is that capital markets kept companies on a short leash by requiring them to pay out most of their earnings in the form of dividends (Campbell and Turner 2011).

The liberalisation of incorporation law and the Companies Act was premised on the idea that incorporation would be sought by large enterprises with substantial capital needs. However, in the decades after liberalisation, incorporation became increasingly common for small enterprises, not with the aim of raising capital from the public, but to avoid the costs associated with untimely dissolution and facilitate the intergenerational inheritance of businesses (Harris 2013). Under the Companies Act (1862), seven was the minimum number of shareholders that a company could have, but there was nothing to prevent sole traders from setting up a company with six nominal shareholders. Indeed, the legality of this type of company came under question in the famous case of *Salomon v. Salomon* – Aron Salomon had turned his sole proprietorship enterprise into a company with 20,000 shares, with six of his family being fellow shareholders holding one share each. The concept of the private company was introduced into company law in the Companies Act 1907, which settled the issue surrounding nominal shareholders and defined a private company as one which committed in its articles not to raise capital from the public.

[5] On the issue of investor protection and corporate ownership in Victorian and Edwardian Britain, see Campbell and Turner (2011); Cheffins (2001, 2008); Cheffins et al. (2013); Foreman-Peck and Hannah (2012, 2015); Franks et al. (2009).

## Explaining the Evolution of Company Law

At the start of this essay, we posed two questions. Why was freedom of incorporation not a necessary precondition for industrialisation? Did law respond to the socioeconomic pressures of the era or did it resist them?

England experienced the Industrial Revolution without freedom of incorporation. Hansmann et al. (2006) suggest that partnership law, with weak entity and owner shielding and unincorporated companies, meant that the lack of freedom to incorporate was not a big deal. However, we saw above that the achievements of the unincorporated company were limited due largely to their questionable legality. Another possibility is that family firms, sole proprietorships and partnerships sufficed to meet the capital and organisational needs of the business enterprises at the time. Related to this argument is that English wealth was highly concentrated in the hands of the elite (Lindert 1986). In other words, incorporation was not needed to raise capital from a large number of investors because wealth was concentrated in the hands of the few. However, one has to ask counterfactually what the Industrial Revolution would have been like with freedom to incorporate, particularly from the perspective of efficient organisational design which overcomes issues of untimely dissolution.

According to Harris (2000), the responsiveness of the legal system and lawmakers in Parliament to socioeconomic forces varied over the period under consideration in this essay. In the age of discovery and empire building, the Crown and Parliament were liberal in incorporating trading companies. However, under the Stuarts, this was heavily abused. After the Glorious Revolution, there appeared to be greater liberality with respect to incorporations and the establishment of unincorporated companies. However, the South Sea Bubble and the Bubble Act resulted in a changed attitude towards incorporation and the unincorporated company. Parliament incorporated very few companies and the common law judiciary was hostile to the unincorporated company. The conservative common law had been greatly empowered thanks to the Glorious Revolution and the financial market speculation of 1720 only strengthened its opposition to the unincorporated company. Although there were attempts to undermine or bypass the common law through the Court of Chancery and the use of the trust mechanism to create unincorporated companies, this organisational form was not a successful surrogate.

The nineteenth century brought pressures upon legislators which made the liberalisation of incorporation necessary. First, the capital needs of large infrastructure projects such as railways could be met only by aggregating the funds of many investors. Consequently, Parliament became much more liberal in granting incorporation to such businesses. Second, the increasing wealth of the middle classes created a demand for alternative outlets beyond government debt and annuities for their surplus capital (Jefferys 1977). The increased political power of the middle classes in the nineteenth century at the expense of the landed elite meant that the political calculus in Parliament changed, with the result that incorporation law was liberalised by granting freedom of incorporation with limited liability.

Finally, a major debate in the law and economics literature is whether common law legal systems are superior to their civil law counterparts (La Porta et al 1999, 2008). One of the arguments as to why common law is superior is that it is inherently dynamic and pragmatic in responding to new business environments and opportunities. However, the common law judiciary in the eighteenth and nineteenth centuries was extremely conservative and did not respond in a dynamic fashion to the new business environment which had arisen. Ultimately, it required Parliamentary intervention via statutes to promote the development of the corporation (Musacchio and Turner 2013, p.535).

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