The Foundations of Shareholder Capitalism

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Susan Watson
University of Auckland and ECGI

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This paper focusses on the separate fund of capital in the company as a separate legal entity as a defining characteristic of shareholder capitalism that has been utilised by business. The paper considers the claims on that fund by shareholders and by creditors through history. The paper concludes that Courts consistently upheld that separation of that capital fund in the incorporated form even before statutory limited liability. In this paper, the value locked in the modern company is termed the Corporate Fund. The Corporate Fund is a feature of the modern company that has been 'hiding in plain sight', obscured by contemporary theoretical conceptions that marginalise the significance of the Corporate Fund, and the company as a separate legal entity that locks in that Corporate Fund. The key advance of the modern incorporated company over earlier contractual forms was that the company as an entity is itself a juridical person that has property rights.

Keywords: Corporation, separation, legal entity, capital, corporate fund, property rights

JEL Classifications: K2

Susan Watson
Dean of University of Auckland Business School and Professor of Law
University of Auckland
Sir Owen G Glenn Building - Bldg 260
12 Grafton Rd
Auckland Central, Auckland 1001, New Zaland
e-mail: s.watson@auckland.ac.nz

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Introduction

Lord Briggs in the UK Supreme Court case *BTI 2014 LLC v Sequana SA and others*[1] concluded that a modern company is a separate legal entity from its shareholders. In doing so, Lord Briggs expressly accepted that the alternative conceptualisation of the company as the abstract equivalent of its shareholders had not prevailed over time. The implications of the company being understood as an entity are manifold and of primary significance. If the company is and of itself an entity at the moment of incorporation, it cannot at the same time be a nexus of contracts between corporate constituents. The primary significance of the incorporation process itself in creating the separate entity should be recognised. It follows that the company is not entirely or even fundamentally a consequence of private ordering. Status as a separate legal entity is derived from the State through the incorporation process. Also that separation means the entity shielding provided to the company is not just strong form, but complete.

The modern company is legally a form of corporation, a category of organisation form that was historically significant and which included municipal corporations and ecclesiastical corporations. The business corporation\modern company can be differentiated from other types of corporation because it is fuelled by capital initially provided by shareholders with that capital separated in the corporation for accounting and legal purposes from investing shareholders.

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[1] *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25.

concludes that Courts consistently upheld that separation of that capital fund in the incorporated form even before statutory limited liability.

In this paper, the value locked in the modern company is termed the Corporate Fund. The Corporate Fund is a feature of the modern company that has been 'hiding in plain sight', obscured by contemporary theoretical conceptions that marginalise the significance of the Corporate Fund, and the company as a separate legal entity that locks in that Corporate Fund. The key advance of the modern incorporated company over earlier contractual forms was that the company as an entity is itself a juridical person that has property rights.

The first section of the paper sets out the Corporate Fund concept. The discussion highlights the historical progression from, first, a contractual system of contracts and expectancies, to, second, Joint Stock separated through double-entry book keeping from investing partners\shareholders, to, ultimately, permanent capital as the Corporate Fund in chartered business corporations that were separate legal entities. The section concludes by defining the Corporate Fund seeded by shareholder capital as the means for the entity to extract, aggregate, generate and transact for value.

The second section of the paper discusses liability of shareholders in early business corporations with permanent capital, concluding, first, that the business corporation was legally separate from members who were also shareholders, secondly, that shareholders could only be compelled to pay further capital to the corporation up to the limit of their subscribed capital, and, thirdly, that shareholders could not be compelled to pay sums to meet the obligations of the corporation to third-party creditor. In the next section, discussion turns to the liability of shareholders in the unincorporated contractual deed of settlement company that emerged when incorporation was restricted by the Bubble Act. The Corporate Fund was settled on a trust creating equitable separation, but challenges around suing without the mechanism of the juridical person in place, and the courts consistently treating shareholders legally as partners subject to liability to third party creditors meant the form provided less protection for investing shareholders than the incorporated business corporation.

The final section of the paper focuses on the impact of statutory limited liability on companies incorporated through general incorporation statutes, arguing that it led to a separation of the Corporate Fund in the entity to protect the interests of creditors. Precisely because they were incorporated, those companies were juridical persons meaning by the end of the 19th century the modern company had more similarities to early business corporations than it did to the contractual deed of settlement companies that preceded general incorporation.

The Corporate Fund

The modern company is based on capital; termed in this paper the Corporate Fund. Prior to the emergence of the concepts of Joint Stock and then permanent capital, business was treated as a system of 'contracts and expectancies'.[2] In a simple partnership, all partners contributed

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[2] CA Cooke, *Corporation, Trust and Company: An Essay in Legal History* (Harvard University Press 1951) 40.

equally to losses and shared equally in profits with all responsible equally for the debts of the firm.[3] Partnerships, using double-entry bookkeeping to separate the partnership fund from the partners as Joint Stock, emerged in England in Elizabethan times. Joint Stock Companies differed from simple partnerships because of the separation for accounting purposes of a partnership fund, as the stock of the business, from the partners.

Accounting separation through double-entry bookkeeping in partnerships was an important step in the process that led to the development of the modern company. The firm's books were not the accounts of the partners as individuals. Balance sheets as a recurring statement of assets and liabilities emerged around 1608 formalising the separation of partners from the business.[4] Private Joint Stock Companies were legally partnerships based on partners. They were attractive vehicles for business not because they coordinated people, but because people could hold shares in a Joint Stock Fund. For partners as stockholders, the stock of each partner became a figure moving from 'balance sheet to balance sheet representing the claim of that partner to, or the claim upon him, of the firm's balance between assets and liabilities'.[5]

Business Corporations chartered by the Crown existed in parallel with private Joint Stock Companies. Initially chartered Business Corporations operated with terminating Joint Stock Funds. Members of Business Corporations could choose to subscribe for shares in Joint Stock Funds. The concept of capital as something that should be kept intact,[6] did not emerge in Business Corporations until the seventeenth century.[7] The VOC (Dutch East India Company) acquired permanent capital in 1612 and Cromwell granted the English East India Company a charter with permanent capital in 1657.[8] Business Corporations offered a key advantage over private Joint Stock Companies. The permanent capital was separated not just for accounting purposes but also legally in the chartered Corporation as a separate legal entity from its shareholders.

The modern company, like the earlier chartered Business Corporation, is a separate legal entity from its shareholders. Ernst Freund, in 1897[9] recognised that the corporate form secures property from outsiders, and from insider defection.[10] Amongst historical commentators, Karl Marx recognised a modern company was essentially a combination of capitals separated from shareholders, rather than a combination of shareholders. Marx also recognised that the formation of companies produces an enormous expansion of the scale of production and of businesses. That expansion was impossible for individual capitals.[11] As early as 1701 Josiah

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[3] ibid 46.
[4] Cooke (n 2) 48.
[5] ibid 49.
[6] WR Scott, *The Constitution and Finance of English, Scottish and Irish Joint-Stock Companies to 1720* vol 1 (Cambridge University Press 1912) 60.
[7] RR Formoy, *The Historical Foundations of Modern Company Law* (Sweet & Maxwell 1923); see also the discussion of the emergence of the term in accountancy treatises and in the early history of the English East India Company in E Cannan, 'Early History of the Term Capital' (1921) 35 *Quarterly Journal of Economics*.
[8] Susan Watson, *The Making of the Modern Company* (Hart Publishing 2022) ch 12 'The Transition to Permanent Capital in the English East India Company' 37–50.
[9] E Freund, *The Legal Nature of Corporations* (University of Chicago Press 1897).
[10] D Gindis, 'Ernst Freund as Precursor of the Rational Study of Corporate Law' (2020) 16 *Journal of Institutional Economics* 597, 615–16.
[11] K Marx, *Das Kapital*, vol III (Verlag von Otto Meisner 1894) Ch 27 'The Role of Credit in Capitalist

Child, the Governor of the English East India Company, which had benefited from permanent capital since 1657, recognised that the East India trade could become an instrument of capital accumulation that was a 'Fund of Wealth'.[12]

Margaret Blair argues that the critical advantage of the corporate form is 'the ability to *commit* capital, once amassed, for extended periods – for decades and even centuries'.[13] Margaret Blair, and also Henry Hansmann and Reiner Kraakman,[14] provide compelling arguments for the essential role of organisational law. First, incorporation gives the enterprise 'entity' status under the law. Second, incorporation requires governance rules that legally separate business decision making from contributions of financial capital. Both those key features of organisational law are acquired at the inception of the company and can only be acquired through the incorporation process.

Hansmann and Kraakman do not explain one key feature of the modern company; its status as *persona ficta* or an artificial legal entity that itself has property rights. They recognise that economic theory does not explain why productive activity is commonly organised in nexuses of contracts, 'in which a single central actor contracts simultaneously with employees, suppliers, and customers who may number in the thousands or even millions'.[15] Why, they ask, are organisational employment relationships not constructed in the form of contractual cascades in which each employee contracts not directly with the firm, but instead with their immediate superior, so that the pattern of contracts corresponds to the authority relationships we see in a standard pyramidal organisation chart?

Rather than recognising the central importance of the *persona ficta* for organisational law, Hansmann and Kraakmaan simply proceed by assuming such structures are essential for modern market economies.[16]

In other work Hansmann and Kraakmaan consider the single organizational actor, describing the company as a nexus *for* contracts, rather than the typical law-and-economics depiction of a firm as a nexus-of-contracts.[17] In doing so they draw on the civil law concept of patrimony to define the demarcation of a pool of assets in the company. 'What has been termed a separate patrimony drawing on the civil law means that the company is viewed in law as having property rights in a demarcated pool of assets'.[18] The company is owner in law of the assets. The company's assets are distinct from the shareholders' assets with shareholders the company's

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Production'.

[12] J Child, *The Great Honour and Advantage of the East-India Trade to the Kingdom* (Thomas Speed 1697) 4–5 <https://quod.lib.umich.edu/e/eebo/A32830.0001.001/1:3?rgn=div1;view=fulltext>.

[13] MM Blair, 'Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century' (2003) *UCLA Law Review* 387, 390.

[14] H Hansmann and R Kraakman, 'The Essential Role of Organizational Law' (2000) 110 *Yale Law Journal* 387.

[15] ibid 391.

[16] ibid 393.

[17] J Armour and others, 'What is Corporate Law?' in R Kraakman and others (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, OUP 2017) 5.

[18] J Armour and MJ Whincop, 'The Proprietary Foundations of Corporate Law' (2007) 27 *Oxford Journal of Legal Studies* 429, 448. In explaining what is meant by property rights, Armour and Whincop highlight that participants' entitlements to control are protected not just against other participants but against third parties generally.

owners but not directly at least the owners of the assets of the company.[19] Entity shielding gives creditors of the company priority over creditors of the shareholders.[20] Capital lock-in also protects the assets of the company from the creditors of the shareholders.[21]

Hansmann and Kraakman have also discussed the concept of a separate fund in civil law:

> While the Anglo-American legal literature has heretofore had no name for the concepts that we term entity shielding and asset partitioning and has – surprisingly – largely neglected these concepts in general, the civil law literature is more self-conscious about the issue. In particular, the civil law has long deployed the concept of a separate fund or separate patrimony. This concept comprises a broad and somewhat vague category of arrangement commonly described – in the most general terms – as involving a group of assets set apart for a particular purpose. Creditors' rights are an important consideration in determining the presence (or consequences) of a separate fund, and the presence of a separate fund is commonly considered an aspect of the much-disputed concept of a juridical person. However, the presence of a separate fund does not necessarily indicate a distinct juridical person.[22]

Whilst recognising the existence of a separate fund, Hansmann and Kraakman attach minimal significance to the concept of corporate legal personhood. They describe 'legal personality' or 'separate legal personality' as a term bundling the three foundational characteristics of companies (entity shielding, authority to transact, procedures for legal action) that is a 'convenient heuristic formula for describing organisational forms which enjoy the benefit of each of the three forgoing "foundational" rule types…'.[23] This downplaying of corporate personhood means that their earlier insights (on the single contractual actor and on the separate patrimony or fund relate to the modern company as an artificial legal entity that is a legal person and contracting party in its own right) are not considered.

So is the company is a single, organisational actor simply because it is a legal person? That artificial legal person can contract with employees and third parties dealing with the company. The defining characteristic of that legal person could be that it locks in a Corporate Fund. The key characteristics, entity status under the law, and governance rules that legally separate business decision making from contributions of financial capital can then be seen as *consequences* of legal personhood.

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[19] R Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, (3rd edn, Oxford University Press 2017) 5, fn 12. The authors are careful to qualify their use of the term 'owner' when describing shareholders, stating: 'We use the term "owners" simply to refer to the group who have the entitlement to control the firm's assets.'

[20] See Paula Moffatt, 'The Interests of Creditors: General Body and Individual Perspectives' and Kayode Akintola, 'Creditor and Shareholder Interests'.

[21] Kraakman and others (n 18) 6.

[22] H Hansmann, R Kraakman and R Squire, 'Law and the Rise of the Firm' (2006) 119 *Harvard Law Review* 1135, fn 9.

[23] Kraakman and others (n 18) 8.

Other scholars have recognised that the modern company or corporation is a fund of value, again without exploring the implications of that insight. Berle and Means' *The Modern Corporation and Private Property* contains the following discussion:

> It should be noted that the term 'assets' as used by lawyers and others appears to have a multiple personality. At times it refers to the particular objects (and rights) which in their organised relationship make up an enterprise. A pro-rata share in such assets (for instance, one millionth of a factory building plus one millionth of a series of machines plus one millionth of a fleet of delivery trucks, etc) would have almost no meaning to a shareholder. It would be practically impossible to have new capital added through sale of securities to outsiders and yet each former stockholder maintain his asset portion. Only when the term assets is used to refer to a fund of value, – perhaps a sum of values, measured in a chosen unit (money), does pro-rata share come to have meaning. The introduction of value, however, brings with it a multitude of meanings which attach to that concept and the fund of value referred to 'assets' may, therefore, refer to quite different things. Most commonly, the value fund referred to is 'book value,' ie, the assets as arrived at by the accountant through the application of his statistical technique and frequently 'book value,' or something closely analogous, is the concept back of assets in much of legal thinking. When the question is pushed, however, it usually appears that the value fund may bear little relation to book value, being rather the value fund which the whole enterprise represents – still involving a vague concept, but one which frequently leads to results different from 'book value'.[24]

Rather than developing the concept of the 'value fund the whole enterprise represents' [25] further, Berle and Means adopted the definition of assets as a fund of value. They confine their discussion to a footnote on the basis that the actual definition would only occasionally affect their current study.

In 2022 in *Sequana*, Lord Briggs said:

> Put shortly, of the two strands in the reasoning in the *Salomon* case, namely the company as a separate entity with its own interests and responsibilities and the company as an abstract equivalent of its shareholders, it is the first which has clearly prevailed over time.26

What Hansmann and Kraakman term the 'separation' of the firm's assets is initiated when shareholders contribute capital on incorporation. That capital forms the seed of the Corporate Fund. From the moment of incorporation, the modern company has the status of a legal person and is a separate legal entity from its shareholders.

[24] AA Berle and GC Means, *The Modern Corporation and Private Property* (rev edn, Harcourt Brace & World 1968) 141, fn 1.
[25] ibid.
[26] *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [139].

The *persona ficta* concept where the company is treated by the law as an artificial legal person first entered the common law in 1612 in *the Case of Sutton's Hospital*.[27] The key differentiating feature of the *persona ficta* corporation from earlier common law corporations was that legal personhood is not based on natural persons comprising the corporation. Instead a *persona ficta* corporation owes its existence in some way to the State. For early business corporations like the English East India Company, it was through the Crown and later the State granting a charter as a concession; for modern companies, it is through following a process set out in a general incorporation statute.

The modern company therefore is a separate legal entity. The Corporate Fund, as the value fund the whole enterprise represents,[28] grows from the capital originally contributed by shareholders forming the foundation of shareholder capitalism. The Corporate Fund provides the company with the resources to contract with other parties and to operate as an entity in the world. The company can grow the value of the Corporate Fund by extracting, aggregating, generating and transacting for forms of value. Rather than a passive nexus for contracts between contracting parties, the company itself actively contracts for value and operates actively in the world as an entity deriving value.

Financial value can be separated from the company using double-entry bookkeeping, and distributed to shareholders in the form of dividends. When the company is liquidated, the persona ficta, the artificial entity that is a legal person, ceases to exist. Any financial value in the Corporate Fund 'crystallises' and is realised by creditors and then shareholders. Shareholders are residual claimants on the Corporate Fund but that claim can only be realised when the entity and legal person cease to exist.

The word 'capital' has multiple meanings, both generally and as a term connected with companies.[29] In England, the capital maintenance rules developed, but these were designed to protect creditors[30] and should not be understood to mean that the Corporate Fund of the company is the same as the amount of capital contributed by shareholders. The concept of separated value in the company, which in this chapter is called the Corporate Fund, has long been understood to be a different concept from that of capital contributed by shareholders, even though the Corporate Fund is seeded by capital contributed by founding shareholders. At only two points in the life cycle of the company are the Corporate Fund the same as shareholders' capital. At the moment of incorporation, the capital contributed by shareholders seeds the Corporate Fund. The seeding capital gives shareholders 'an interest' in the company through shares. If, at the point of liquidation, a company is solvent, then the corporate legal person ceases to exist with the Corporate Fund again becoming shareholders' capital.

The Early Business Corporation and Creditors

[27] *The Case of Sutton's Hospital* (1612) 10 Co Rep 23a, 77 ER 960, discussed in SM Watson, *The Making of the Modern Company* (Hart Publishing 2022) ch 2.
[28] ibid (n 20).
[29] LCB Gower, *Gower's Principles of Modern Company Law* (4th edn, Stevens 1979) 214.
[30] ibid 216.

This section considers the impact of incorporation of *persona ficta* companies. Three related questions are considered. First, were early business corporations with permanent capital legally separate from members who were also shareholders? Second, under what circumstances could shareholders be compelled to pay further capital to the corporation? Finally, could shareholders be compelled to pay sums to meet the obligations of the corporation to third-party creditors?

Gower considered that incorporation seems:

> at first to have been valued mainly because it avoided the risk of the company's property being seized in payment of the member's separate debts, rather than as a method of enabling the members to escape liability for the company's debts.[31]

Only 10 charters were granted to business corporations in the period between 1630 and 1680.[32]

> The idea of the corporate entity evolved so rigidly that no liability on the part of the shareholders for the company's debts was considered possible. As a result, it was held that if a company became extinct and its reserves exhausted, creditors could not maintain actions against the shareholders.[33]

The default rule therefore for all forms of corporation, including business corporations, was that members were not liable for debts of the corporation.

The issue of liability of shareholders of business corporations had arisen from time to time when corporations operating with Joint Stock Funds (which were not permanent capital) incurred debt. The Virginia Company was chartered by James I in April 1606 to colonise the eastern coast of North America. It was a chartered corporation with Joint Stock. The minutes of the Court Book of the Virginia Company record a lively debate in 1622.[34] On one side, and in line with established principles of corporations' law, it was argued that members were not liable in their private capacities. Men's private estate was separate from the property of the Corporation, with only the goods of the Corporation liable for the debts:

> And 8ouching the engagement of mens private estate hereby: therein was no danger; it beinge cleare by lawe that only the goode of the Corporation are lyable to the debte thereof, Concerninge which he [Mr Carswell] said he had taken aduise of most sufficient Lawyers: And Mr Carswell said that Mr White the Lawyer (who newly was departed out of the Court) having hearde this disputation did affirme that private mens estate could not be lyable to the debte by the Seale of the Corporation but onely the Goode of the Corporation it selfe.[35]

On the other side it was argued that members could be liable in their private capacities:

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[31] LCB Gower (n 28) 26.

[32] S Williston, 'History of the Law of Business Corporations Before 1800' (1888) 2 *Harvard Law Review* 105, 111–12, as cited in H Hansmann, R Kraakmann and R Squire, (n 18) 1378.

[33] LL Peck, *Women of Fortune: Money, Marriage, and Murder in Early Modern England* (Cambridge University Press 2018) 65, 25.

[34] SM Kingsbury (ed), *The Records of the Virginia Company of London: The Court Book, from the Manuscript in the Library of Congress*, vol 2 (Washington Printing Office 1906) 165.

[35] ibid.

> Mr Wrote still persisted in his former opinion … that he could not be pswaded but each member of the Companie (upone grant of the Seale for Securytie) was bound to make this good, out of his owne private estate, alledginge that he had likewise askede Counsel of Lawyers…[36]

The example of the Russia (Muscovy) Company was given, where 'divers Brothers' of that company were sued for its debt through a levy.[37]

The situation the Russia Company found itself in was, however, quite different to what happened in the Virginia Company. The Russia (Muscovy) Company, was founded in 1553, initially operating using a Joint Stock Fund. In 1620 it was resolved that the Russia Company would be wound up. Calls that had been made on the shares of many shareholders whose payments were in arrears. A new undertaking was formed that would operate as a Regulated Company, a different legal form. In Regulated Companies, each member traded on his own behalf subject only to the bylaws of the company itself.[38] The new Regulated Company undertaking took over the assets and liabilities of the old Russia Company for £12,000.

The new Russia Company did not raise enough capital and incurred loans at high interest rates. An Order in Council gave the company immunity from arrest for debt. In relation to further liability, on 17 December 1621, the debts of the previous company were ascertained to be £24,000. It was determined that amount should be paid by adventurers (shareholders) from the previous Company who continued to be shareholders in the new Regulated Company.[39] As a Regulated Company, members of the new Russia Company were able to trade on their own account, with debts owing not necessarily relating to any past Joint Stock Funds in the previous Company, but rather relating to the private obligations of those members. The private brothers (as the members of the new Russia Company as a Regulated Company were called) were, by order of the Council, acquitted and exempted from former debt incurred when the Russia Company traded with Joint Stock.[40]

The Virginia Company, where the debate mentioned above took place, was not and did not become a Regulated Company. The shareholders of the Virginia Company were not liable with the argument 'that private mens estate could not be lyable to the debte by the Seale of the Corporation but onely the Goode of the Corporation it selfe' prevailing.[41] In other words creditors needed to look to the Joint Stock. Shareholders were not liable in their private capacities.

[36] ibid.
[37] ibid 165–66.
[38] Formoy (n 6) 4.
[39] Scott (n 5) 57–58. Note that the levy on members did not take account of the value of debt owed by the Dutch, so ultimately it was not collected.
[40] ibid.
[41] Kingsbury (n 33) 165.

Early cases support that the debts of a corporation were not the debts of its members in their private capacities.[42] In 1680 in *City of London*,[43] the Court said that the shareholders' being made personally responsible for corporate debts was inconsistent with the nature of a body corporate. Kenyon MR expressed similar views around liability of members in 1788 in the famous case *Russell v The Men of Devon*.[44] Granted, *Russell* involved a public corporation that did not have shareholders.[45] However, four years earlier, in 1784, Lloyd Kenyon had stated in a private opinion, that in the event of incorporation, 'the Corporate Stock alone would be answerable to the engagements, and the individuals who may compose the Corporation could not be liable in their private characters'.[46]

Some commentators argue that *City of London* in 1680 meant no more than the debts of a corporation could only be paid through the corporation itself, rather than creditors' being able to sue shareholders directly.[47] The 1671 case *Salmon v The Hamborough Company*,[48] from 1671 where the principle of 'leviation' was set out, is often used to support the existence of this form of indirect liability. On appeal, the House of Lords apparently held that the members were obliged to answer to the corporation for the debts of the corporation owed to third parties dealing with it.

If the company did not pay within a certain period, the House of Lords ordered the directors to:

> make such a Leviation upon every Member of the said Company as is to be contributary to the Publick Charge, as shall be sufficient to satisfy the said Sum to be decreed to the Plaintiff in that Cause, and to collect and levy the same, and to pay it over to the Plaintiff as the Court shall direct.[49]

The case should not be viewed as authority for the indirect liability of shareholders to creditors of the corporation in the early history of the business corporation.[50] The action was against the Governors, Assistants and Fellowship of the Merchant Adventurers of England, commonly called the Hamborough Company. The Company of Merchant Adventurers was chartered by Henry VIII in the period before Joint Stock Funds were utilised in England for business ventures. In 1776, in *The Wealth of Nations*, Adam Smith wrote of how, in the middle of the

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[42] *Anon* (1441) YB 19 Hy VI 80; *City of London* (1680) 1 Vent 351, as cited in Cooke (n 1) 77, which firmly established corporate debts were not debts of the members; AB DuBois, *The English Company After the Bubble Act, 1720–1800* (Octagon Books, 1971) 98, where it seemed reasonably well settled that there was no procedure by which a creditor of a corporation could proceed against a member for the corporation's debts.
[43] *City of London* (1680) 1 Vent 351, as cited in Cooke (n 1) 77.
[44] *Russell v The Men of Devon* (1788) 100 ER 359, 672.
[45] ibid.
[46] Lord Kenyon, *Case of Opinion* (29 January 1784), Boulton & Watt Manuscripts, Birmingham Collection, Assay Office, as cited in AB DuBois, *The English Business Company after the Bubble Act, 1720–1800* (The Commonwealth Fund 1938) 965–66.
[47] Cooke (n 1) 77.
[48] *Salmon v The Hamborough Company* (1671) 22 ER 763 (HL).
[49] ibid 764.
[50] D Jenkins, 'Skinning the Pantomine Horse: Two Early Cases on Limited Liability' (1975) 34 *Cambridge Law Journal* 308, 318.

previous century, the Hamborough Company subjected trade to restraint and regulation with admission to the company by a fine (fee), not a purchase of shares:

> About the middle of the last century, the fine for admission was fifty, and at one time one hundred pounds, and the conduct of the company was said to be extremely oppressive.[51]

Significantly, therefore, the Hamborough Company did not have Joint Stock or permanent capital; it was a Regulated Company where members traded for themselves. It was because there was no Corporate Fund from which creditors might recover, and because the company refused to levy members to raise further capital to pay creditors, Dr Salmon brought the action.

Dr Salmon had petitioned against the security of the common seal of the corporation. In relation to their own liability, the members of the Hamborough Company argued in part that 'No single member of the Company ever derived any private benefit from money borrowed on the common seal.'[52] The members also argued that '[a]ll lenders to the Company should have ascertained that it had neither common stock nor any lands'.[53] Both arguments supported the separation of liability of the members in their private capacity from the corporation[54] and also that creditors would be expected to look to a Corporate Fund if one existed.

The Report of the case stated that, as the Company had no capital fund, the plaintiff wanted members to be levied.[55] To repay debt the corporation had in the past levied members but refused to do so to repay the £2,000 owing to Dr Salmon. Claiming it had nothing that could be distrained, the Company did not appear. But members who 'served in their natural Capacities, did appear and demur, for that they were not in that Capacity liable to the Plaintiff's Demands.'[56] In other words, the members argued that in their private or natural capacities, they were not liable for the debts of the corporation; it was a separate legal entity from them in their private capacities.

It follows, therefore, that the creditors would have been expected to rely on the capital of the company if the company had in fact issued shares in its Corporate Fund. As a Regulated Company, the Hamborough Company did not have Joint Stock or permanent capital against which Dr Salmon could claim.

Hamborough is one of a small number of cases that are used to support arguments that shareholders in corporations were not always protected from liability to creditors of the company. Gower says:

> [M]any charters expressly conferred a power on the company to make leviations (or calls) on the members and it was by no means clear that a company did not have this power in the absence of an express provision. This being so limited liability was illusory; the company as a person was, of course, liable to pay its debts and in order to

[51] A Smith, *The Wealth of Nations*, ed A Skinner (Penguin 1970) 308.
[52] Jenkins (n 49) 314.
[53] ibid.
[54] ibid.
[55] *Salmon v The Hamborough Company* (n 47) 763.
[56] ibid.

> raise money to do so it would make calls on its members. Moreover [citing *Hamborough*] the creditors by a process resembling subrogation, could proceed directly against the members, if the company refrained from taking the necessary action.[57]

However, as Jenkins points out, it must have been implied that a Regulated Company had the power to make leviations because it could not otherwise have financed its operations.[58] That argument does not apply to a corporation with Joint Stock or permanent capital. Leviations or calls or levies on shares in companies with Joint Stock or permanent capital were enforcement of contractual obligations relating to amounts of unpaid capital on shares subscribed for.

Hamborough, therefore, is not authority for the argument that shareholders in early business corporations with Joint Stock or permanent capital did not always enjoy protection from liability to creditors of the company. Second, and relatedly, the principles governing leviations on members of Regulated Companies were not the same as the principles governing calls on shareholders of corporations with Joint Stock Funds or permanent capital. Leviation should properly be equated in modern parlance with a levy.[59] Although the liability of members of the Regulated Company was separate from the corporation itself, members would have joined knowing they could be levied by the Company.[60] Functional limited liability did not therefore exist in Regulated Companies, creating uncertainty both for members of these corporations and for the creditors who dealt with them. Finally, the point that creditors could proceed against the members in their individual capacities if the company did not pay is not supported by the authority cited. As Jenkins points out, if *Hamborough* was authority for that point, it would have been followed in subsequent cases.[61]

Granted, whilst there is no authority supporting the proposition that shareholders of companies could be made liable to third-party creditors, there is also no authority definitively stating that they could *not* be made liable. Direct references to liability to creditors are rare.[62] It may have been assumed no liability was possible because that principle was of such long standing. Creditors of the failed corporations discussed above, the Charitable Corporation or the York Building Company, never in fact proceeded against the personal estates of shareholders.[63] In 1721, the Commissioners of the Treasury considered that a special Act of Parliament would be required to make it possible to proceed in the future against shareholders of the proposed Bank of Ireland.[64] The Carron Company stated that while the capital stock and fund of the corporation would be answerable for the debts of the corporation in the first instance, if those amounts were

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[57] LCB Gower (n 25) 26, citing *Salmon v The Hamborough Company* (n 47). See also FG Kempin Jr, 'Limited Liability in Historical Perspective' (1960) 4 *American Business Law Association Bulletin* 11, 13–14; Cooke (n 1) 77, which states '[i]t was held by the Lords that there was an obligation on the members that they would answer to the corporation for its debts to the outside world'.
[58] Jenkins (n 49) 317.
[59] ibid 316.
[60] ibid 319.
[61] *Hamborough* was not followed in eighteenth-century English cases, and when it was cited in 1852 in *Hallett v Dowdell*, all three Judges declined to follow it: *Hallett v Dowdell* (1852) 18 QB 2, 35–36, as cited in Jenkins (n 49) 320.
[62] DuBois (n 41) 94.
[63] ibid 95.
[64] ibid 94.

insufficient to satisfy creditors, the shareholders would then be answerable as if 'their successors and assigns had not been incorporated into a Body Politic and Corporate and as if this present charter had never been granted'.[65]

Could shareholders be compelled to pay sums of capital to the company itself?[66] Clearly, a shareholder in a business corporation with a Joint Stock Fund or permanent capital had to pay calls or levies on their shares when called upon to do so.[67] But were the calls up to an agreed amount, the subscribed capital; or could the calls be made whenever the company required an injection of funds, meaning that shareholders did not have limited liability to the company?

Commentators mostly concur that shareholders of corporations with permanent capital had limited liability to the corporation by the late eighteenth century. They differ about when limited liability of shareholders to the business corporation first emerged.[68] With the advent of permanent capital, evidence shows that subscribing shareholders could be required to pay instalments on their subscribed capital, but no more. In the period before it had permanent capital, shareholders were required to contribute extra amounts above their initial subscriptions to the East India Company.[69] When the capital in the East India Company was made permanent in 1657, there were to be six calls over two years. At that time the original investors could have exited after seven years, with the capital wound up but valued and subscribers entitled to the estimated equivalent of their original subscription. At that time, it was intended a new subscriber could join the company[70] with the capital to continue as the capital of the company.[71] Therefore evidence exists that it was only before the advent of permanent capital that subscribing shareholders could be required to contribute more than the original capital they subscribed for.[72]

A related question is whether governing bodies of corporations could be forced by creditors to make calls on shareholders for debts owing by the corporations. The Governor and Company for raising the Thames Water at York Buildings obtained its charter in 1690. The York Building Company was a chartered corporation with permanent capital. In 1719, speculators purchased its charter; raising £1,200,000.

[65] Inventories of Warrants, 15 July 1773, Bundle 65, 1872, Register House, Edinburgh (as cited in DuBois (n 41) 97, fn 79).
[66] DuBois (n 41) 98–99; Cooke (n 1) 77, is stronger, '[i]t was, of course, firmly established that the debts of a corporation were not the debts of its members', citing *Anon* (1441) YB 1 Hy VI, 80.
[67] *Child v Hudson's Bay Co* (1723) 2 P Wms 207, where Lord Macclesfield used the example of the common by-laws of companies to deduct calls out of the stocks of the members refusing to pay their calls as an analogy when the validity of a by-law to place restrictions on stock was questioned–the statement is therefore strictly *obiter*.
[68] Goebel Jr, *Cases and Materials* (1946) 428; cf Cooke (n 1) 76–79. Cooke bases much of his argument on *Salmon v The Hamborough Company*, but see the discussion of that case above
[69] Scott (n 5) 92-94.
[70] ibid 129.
[71] WW Hunter, *History of India: The European Struggle for Indian Supremacy in the Seventeenth Century*, ed AVW Jackson (Grolier Society 1907) 285. In fact, as the Company prospered, the appraisements became statements of assets, which enabled stockholders and the public to regulate their dealings.
[72] DuBois (n 41) 99–104.

After a chequered history of speculative and failed ventures and stock manipulation, creditors asked the Court to order the York Building Company to make a call on its shareholders. Lord Hardwicke LC laid down:

> Where the companies are obliged to make calls, this court will not decree them to make such a call, upon a bill brought by a creditor for that purpose, in favour of that particular creditor, unless under very extraordinary circumstances.[73]

The concept of an equitable fund for creditors developed, although it may have depended on particular facts being present. In 1673, in *Naylor v Brown*,[74] Naylor lent money to the Company of Woodmongers. Sir William Wild declared a trust of £620 to several members of the company. In an action brought for the return by shareholders of the property of a dissolved chartered corporation, the Court held that 'there was still an equitable fund appertaining to the company for the benefit of creditors'.

> The Court was of Opinion that the Declaration, of the Trust by Sir Wm Wild was utterly void as to the said £620, for that the Corporation did not join therein, nor give him any Authority under their common Seal, or by any corporate Act to make such a Declaration.[75]

The Chancery Court ordered that the debts be paid before debts owed to the shareholders were repaid – the doctrine of equitable subordination. The Court said:

> Distribution of that Sum amongst particular Members of the Company was injurious to such Creditors who were not Members thereof; it being more reasonable, that if Losses must fall upon the Creditors, such Losses should be born by those who were Members of the Company, who best knew their Estates and Credit, and not by Strangers who were drawn in to Trust the Company in the Credit and Countenance it had from such particular Members; and which in this Case was more remarkable, because several of the principal Members of the Company had set their Names to the Plaintiffs Bond of £500 under the common Seal, which though it did not legally bind them in their private Capacities, yet it was certainly an Inducement to the Plaintiffs to lend their Money.[76]

Interestingly, Bainbridge and Henderson link the subordination of shareholders' claims as creditors in *Naylor* to the control of shareholders over the capital in the company.[77] Jenkins considers the facts indicate 'the presence of something very like fraud'.[78] Certainly, the fact that the shareholders were best placed to have information about the operation of the company, combined with their inducing Naylor and others to lend money, probably led to their

[73] *The Case of the York-Buildings Company* (1740) 2 Atk 57; 26 ER 432 (Ch).
[74] *Naylor v Brown* (1673) Cas temp Finch 83; 23 ER 44.
[75] ibid 44.
[76] ibid 45.
[77] See the discussion in SM Bainbridge and MT Henderson, *Limited Liability: A Legal and Economic Analysis* (Edward Elgar Publishing 2016) 28.
[78] Jenkins (n 49) 311.

subordination to other creditors on dissolution in *Naylor*. DuBois considers that the concept that a corporation was a person distinct from its members probably influenced the decision.[79]

The Deed of Settlement Company and Creditors

The Deed of Settlement company was an unincorporated contractual form that emerged when incorporation was restricted. It was an advance on the earlier contractual Joint Stock Companies because the Corporate Fund was settled on a trust creating equitable separation. Ultimately though challenges around suing without the mechanism of the juridical person in place, and the courts consistently treating shareholders legally as partners subject to liability to third party creditors made the form less attractive to investing shareholders than the incorporated company.

The Bubble Act was ineffective because its drafters failed to recognise that it was a combination of separated capitals in a Joint Stock or Corporate Fund rather than acting as a corporation that investing shareholders sought. From FW Maitland:[80]

> In 1720, as all know, the South Sea Bubble swelled and burst. A panic-stricken Parliament issued a law, which, even when we now read it, seems to scream at us from the statute book. Unquestionably for a time this hindered the formation of joint stock companies. … [L]ater on when the great catastrophe was forgotten, lawyers began coldly to dissect the words of this terrible Act and to discover that after all it was not so terrible. For one thing, it threatened with punishment men who without lawful authority "presumed to act as a corporation." But how could this crime be committed? From saying that organization is corporateness English lawyers were precluded by a long history. They themselves were members of the Inns of Court. Really it did not seem clear that men could "presume to act as a corporation" unless they said in so many words that they were incorporated, or unless they usurped that sacred symbol, the common seal.

The primary intention of the parties was not to associate; it was to acquire the benefits of the business corporation form through the common law of contract and the mechanism of the trust,[81] 'without troubling King or Parliament, though perhaps we said we were doing nothing of the kind'.[82] The deed of settlement was drafted, to exclude as much as possible, those rules of partnership that differentiated the partnership from the corporation. Clauses were inserted to ensure that the rule that investing shareholders were legally partners who could bind each other was negated.[83] Shareholders were contractually removed from management.

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[79] DuBois (n 41) 94, fn 47.

[80] HAL Fisher (ed), *The Collected Papers of Frederic William Maitland*, vol 3 (Cambridge University Press, 1911) 390.

[81] Cooke (n 1) 95.

[82] FW Maitland, 'Trust and Corporation' in HAL Fisher (ed), *The Collected Papers of Frederic William Maitland*, vol 3 (Cambridge University Press 1911) 283.

[83] Although, as discussed below, in *Waugh v Carver* (1793) 126 ER 525 the Court held that the shareholders were partners at law.

What motivated the development of the form was a combination of capitals, not an association of shareholders. The novel aspect of the deed of settlement form of company that distinguished it from earlier types of contractual Joint Stock Company was the settling of the Joint Stock or Corporate Fund on a trust. Mutual covenants between the shareholders as partners and the trustees selected by them were set out in the deed of settlement. The trustees covenanted to observe all the terms of the deed and to apply the Fund settled on them for the specified purposes.[84] Chancery was more efficient than the common law courts in dealing with the concept of funds, with the equitable rights of the members as beneficiaries firmly established.[85] Andreas Televantos highlights, this 'is strong evidence that eighteenth-century lawyers were comfortable with the notion of trusts of circulating trade assets to be used in a business.'[86]

As Maitland described the concept of the trust fund:

> The Court of Chancery managed to do something more for its darling. What it did I cannot well describe in abstract terms, but perhaps I may say that it converted the "trust fund" into an incorporeal thing, capable of being "invested" in different ways. Observe that metaphor of "investment." We conceive that the "trust fund" can change its dress, but maintain its identity. To-day it appears as a piece of land; tomorrow it may be some gold coins in a purse; then it will be a sum of Consols; then it will be shares in a Railway Company, and then Peruvian Bonds. When all is going well, changes of investment may often be made; the trustees have been given power to make them. All along the "trust fund" retains its identity.[87]

The earlier *persona ficta* Business Corporations that continued to exist in parallel, also had this key characteristic. In the deed of settlement companies, the Corporate Fund was separated through a trust, rather than through the business corporation as a *persona ficta* and separate legal entity. In fact, the disadvantages inherent in not being treated as a juridical person by the common law made the deed of settlement company form ultimately less efficacious than the business corporation with challenges around suing and around the liability of shareholders to third parties were the most significant drawbacks of the form.

Some other perceived disadvantages were less significant in practice. The clear disadvantage of the rules relating to the dissolution of partnership with any change in partners was avoided through hiding the ownership structure behind the trust.[88] Thus, deed of settlement companies with multiple investing shareholders were a viable option.[89] Second, the disadvantage that the form was not overtly sanctioned by the law did not prove entirely problematic in practice. The

[84] Cooke (n 1) 88.
[85] ibid.
[86] A Televantos, *Capitalism Before Corporations: The Morality of Business Associations and the Roots of Commercial Equity and Law* (Oxford University Press 2021) 37, citing DuBois (n 38) 115–16; M Freeman, R Pearson and J Taylor, *Shareholder Democracies? Corporate Governance in Britain & Ireland before 1850* (University of Chicago Press 2012) 56.
[87] Maitland (n 81) 283.
[88] Televantos (n 85) 38.
[89] Televantos notes that 'deed of settlement companies could face difficulties in both finding and replacing trustees, especially in light of the restrictive law governing trustees' duties, remuneration, delegation powers, and unlimited liability': Televantos (n 85) 38, fn 58, citing DuBois (n 41) 222.

courts showed a willingness to allow merchants to use the form, at least until the nineteenth century. Lord Eldon, long regarded as an opponent of liberalism and hostile to the deed of settlement form, was in fact influential in the development of English commercial law in a way that accommodated the form.[90] While not overtly endorsed, by the late eighteenth century deed of settlement companies were tolerated by the courts, with the Bubble Act largely forgotten during that period.[91]

The challenges of raising capital for investment without access to the legal form of the corporation were counterbalanced by the tendency for capital markets in the period to be 'local and personal rather than national and institutional'.[92]

Restrictions on the ability of the deed of settlement company to sue and be sued as a juridical person were undeniably problematic as a deed of settlement company could not sue without all shareholders, who were partners in the common law partnership, joining in the action. Trustees were permitted to sue on behalf of deed of settlement companies during the period.[93] Chancery, however, required all shareholder-beneficiaries to join in actions against the company itself, in effect rejecting jurisdiction over the form[94] and making it difficult for managers and directors to be held to account by shareholders.[95] Exceptions existed to that principle, meaning some commentators consider that, in practice, it did not apply.[96]

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[90] See the discussion in Televantos (n 85) 9–10; see in particular 'one commentator was able declare "Indeed, there is no branch of the law in which the exceeding merit of Lord Eldon is more strongly exhibited than this [partnership law], in which with the most painful and patient attention he laboured to obviate and overcome the difficulties of the subject, and by a particular examination and careful adoption of the customs of merchants, to established such principles as would eventually bring the law and practice of the courts of equity into conformity with the necessities of an extended commerce: and we find his repeatedly lamenting the strange rules so obviously at variance with mercantile customs with which he had to contend"': ibid 9, citing I Cory, *A Practical Treatise on Accounts*, 2nd edn (W Pickering 1837) 70.

[91] Televantos (n 85) 38: 'The position began to change in the early nineteenth century, and deed of settlement companies began to attract official attention. Newspapers and journals were filled with promotions for shares in companies, many of which appeared to be dubious; use of company articles purporting to create limited liability and transferable shares had become more common; and the Bubble Act had been largely forgotten.'

[92] M Daunton, *Progress and Poverty: An Economic and Social History of Britain 1700–1850* (OUP 1995) 245.

[93] See Televantos (n 85) 38, fn 54, '*Metcalf v Bruin* (1810) 12 East 400, 405; 104 ER 156, 158 (per Lord Ellenborough CJKB, "We could not, indeed, invert the rules of law to enable persons to sue as a body or company who are not a corporation; but here the bond has been given to trustees [i.e. not in the name of the shareholder-partners], who are under no difficulty of suing upon it in their own names…"). The point is not mentioned in Campbell's shorter report of the same case, (1810) 2 Camp 422, 170 ER 1204.'; see Televantos (n 82) 23, fn 55, '*Ex p Cobham* (1784) 1 Brown Ch Cas 576, 577; 28 ER 1307; noted in Notes of Cases in Chancery and Exchequer 1780–1788, held by Georgetown Law Library within the Lord Eldon Collection, 327 ("Thurlow C said he was aware that [not allowing joint creditors to prove against the separate estate] was the constant practice but it did not seem founded on any Principle – for it was clear a joint Creditor was a Creditor on all the Partners & on each"); and *Ex p Copland* (1787) 1 Cox 420, 29 ER 1230 (BC). See also Eldon's notes on *Ex p Kensington* (1808) … : Eldon wrote that Lord Hardwicke had said that joint creditors could not prove against the separate estate, but that "Lord Thurlow thought otherwise", Eldon Notebook 1807–1809 p 3.'

[94] Televantos (n 85) 48–49.

[95] Televantos (n 85) 47–49, citing *Ellison v Bignold* (1821) 2 Jac & W 503, 37 ER 720.

[96] J Morley, 'The Common Law Corporation: The Power of the Trust in Anglo-American Business History' (2016) 116 *Columbia Law Review* 2145, 2183–91; Maitland thought this problem could be overcome: "Parliament was by this time very willing to grant: for instance, active and passive *Processfähigkeit*, the capacity of suing and being sued as unit in the name of some secretary or treasurer. And this, I may remark in passing, tended still further to enlarge our notion of what can be done by "unincorporated companies." Maitland (n 81) 53.

The courts, particularly the Chancery Court presided over by Lord Eldon, consistently treated deed of settlement companies legally as partnerships.[97] The distinction was entirely clear at law. The incorporated form, the business corporation, was a corporation on one hand; and the unincorporated form, the deed of settlement company, was a partnership on the other. The courts tolerated the desire of entrepreneurs to trade using deed of settlement companies as if they were separate legal entities,[98] without departing from a fundamental position that these enterprises were partnerships at law, not corporations.[99]

Personal liability for business debts was considered morally and ethically desirable.[100] Business corporations, where shareholders were not liable to third parties, were generally regarded as less trustworthy,[101] being 'widely associated with fraud, speculation, monopoly and inefficiency, and not generally looked upon in a favourable light.'[102] But the potential liability of shareholders of deed of settlement companies was a significant challenge for those shareholders. The most significant disadvantage ultimately therefore, was that shareholders of deed of settlement companies were not protected from liability. As Televantos puts it:

> What is perhaps most remarkable about the law of the time is how it balanced these different political, economic, and ethical considerations. The courts gave effect to traders' presumed expectation that partnerships and trusts had an existence separate from the partners and trustees, by shielding the partnership or trust assets from the private wealth and creditors of the partners or trustees. At the same time, the law made clear that partners and trustees took personal responsibility for debts they contracted in their own name – whether as partner, trustee, or personally.[103]

Even after the repeal of the Bubble Act in 1825, the courts consistently treated deed of settlement companies as legal partnerships, [104] with shareholders as partners remaining liable for the debts of the company.[105]

Maitland interestingly suggested that if the legislature had not capitulated to demands for general incorporation statutes in the mid-nineteenth century, contractual Joint Stock Companies might have continued to contract using the word limited in their names. Third party creditors might then have been precluded from claiming from shareholders, having recourse only to the Joint Stock or Corporate Fund. Shareholders would have had comprehensive limited liability to voluntary creditors.[106]

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[97] Televantos (n 85) 43, noting that "courts of the Regency era, especially Lord Eldon's Chancery, refused to treat deed of settlement companies as anything other than partnerships: the trust played only a minor role in their constitution, and did not oust most of the partnership law rules".
[98] ibid 51.
[99] ibid 173.
[100] Televantos (n 85) 29.
[101] ibid 29–30.
[102] P Ireland, 'Capitalism Without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality' (1996) 17 *Journal of Legal History* 41, 43 (citations omitted).
[103] Televantos (n 85) 173.
[104] *Burnes v Pennell* (1849) 2 HLCas 497, 520–21; 9 ER 1181, 1191.
[105] Televantos (n 85) 43. See also Ireland, P, 'Triumph of the Company Legal Form 1856–1914' in J Adams (ed), *Essays for Clive Schmitthoff* (Professional Books, 1983) 42–47; DuBois (n 41) 40.
[106] Maitland (n 81).

> And if our legislature would not by any general measure grant full corporateness, our courts were equally earnest in maintaining the unlimited liability of the Gesellschaftsmitglieder [members of the firm].
>
> But the wedge was introduced. If a man sells goods and says in so many words that he will hold no one personally liable for the price, but will look only to a certain subscribed fund, must we not hold him to his bargain? Our courts were very unwilling to believe that men had done anything so foolish; but they had to admit that personal liability could be excluded by sufficiently explicit words. The wedge was in. If the State had not given way, we should have had in England joint-stock companies, unincorporated, but contracting with limited liability. We know now-a-days that men are not deterred from making contracts by the word "limited." We have no reason to suppose that they would have been deterred if that word were expanded into four or five lines printed on the head of the company's letter-paper. It is needless to say that the directors of a company would have strong reasons for seeing that due notice of limited liability was given to everyone who had contractual dealings with the company, for, if such notice were not given, they themselves would probably be the first sufferers.107

Nevertheless '[i]n England the State capitulated gracefully in 1862'[108] making general incorporation with limited liability available to all. As discussed in the next section when shareholders of a deed of settlement company lost limited liability in *Waugh v Carver*[109] in 1793 (where it was held that a partnership existed where individuals agreed to share profits from a business venture, even if they did not intend to form a partnership) the push for general incorporation and for limited liability became inevitable.

Statutory limited liability

Statutory limited liability meant the Corporate Fund was separated in the entity to protect the interests of creditors..

Use of discrete statutes to form statutory corporations for large-scale infrastructure projects such as canals and railroads became common with the onset of the Industrial Revolution. *Hansard* says 'the rule had been to grant them only in cases where the enterprise, from its magnitude, demanded a very large capital, and where the benefit to the nation from the undertaking was evident'.[110] The liability of shareholders was usually limited to the nominal

[107] See ch 13 Rebecca Parry, Alex Kastrinou and Ellis 'Limited Liability and Personal Liability of Directors'; ch 14 Andrew Vinson 'Director Liability - Behind the Veil Together with the Scope for Accessory Liability'; and ch 15, Sofia Ellina 'Wrongful Trading: Scope and Challenges'.
[108] Maitland (n 81) 55.
[109] *Waugh v Carver* (1793) 126 ER 525.
[110] *Hansard* (HC Deb 1853, vol 129) cols 1598–99 states: 'There was power in special cases for the Queen in Council to grant charters with limited liability. The practice with respect to these charters was this: They were sent to the Committee of Privy Council for Trade. Those consisting of financial questions-for instance, colonial and banking charters-were disposed of under the responsibility of the Treasury. Charters, neither commercial nor financial, were under the responsibility of the Home Office, and the ordinary charters were disposed of under the Committee of Privy Council for Trade. With respect to those charters, the rule had been to grant them only in cases where the enterprise, from its magnitude, demanded a very large capital, and where the benefit to the nation

value of their shares.[111] In 1837, clearly adopting the *persona ficta* conception of the statutory business corporation, Alderson B said of the shareholders in a statutory company that 'the individual members of a corporation are quite as distinct from the metaphysical body called "the corporation", as any others of his Majesty's subjects are.'[112] Despite shareholders of statutory corporations being granted comprehensive statutory limited liability, logically the separation of the shareholders from the statutory corporation as a *persona ficta* should have meant that they were not liable for its debts.

In the deed of settlement company form, the Joint Stock Fund was held in a trust created for business purposes. The title to trust assets was held by the trustees. By the end of the eighteenth century, a clause was commonly inserted stating that 'each shareholder was only to be liable to the extent of his own share in the capital stock.'[113] These clauses would not necessarily have been legally effective; a point Gower says 'was probably not clearly grasped by lawyers and certainly not by investors'.[114] However, the trust agreement could also contain a clause freeing the beneficiaries from liability to third parties for debts incurred by the trustee on behalf of the trust. The clause was regarded as effective in a series of early-nineteenth-century cases involving insurance companies that put the limitation of shareholder liability clause in their insurance contracts. Chancery also recognised that shareholders, as beneficiaries, had limited liability so long as third parties were given sufficient notice of the claimed exemption from liability at the time they extended credit to the trust.[115] Maitland went as far as asserting that the deed of settlement form '(in effect) enabled men to form joint-stock companies with limited liability, until at length the legislature had to give way'.[116]

This advantage for deed of settlement companies, if it existed at all, did not persist following the outcome of *Waugh v Carver*[117] where the Court held that the sharing of profits was enough to constitute a partnership. By the time the introduction of statutory limited liability was debated in 1854, it was stated at the outset that it was assumed that every partner (as shareholders in deed of settlement companies were called) had unlimited liability and that the law had been settled since *Waugh v Carver*.[118] In the first quarter of the nineteenth century, the

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from the undertaking was evident. That rule was not of easy application, and the course of precedent had not been uniform. The present Government had only granted charters in two classes of cases-one the Australian Voyage, and the other the Submarine Telegraph. He found that charters had been obtained by the following companies:- Royal Mail Pacific Steam, Peninsular and Oriental, Indian and Australian, General Screw, Eastern Steam, South American General, African Royal Mail, and Liverpool and Australian.'

[111] JB Baskin and PJ Miranti Jr, *A History of Corporate Finance* (Cambridge University Press 1997) 139.

[112] *Bligh v Brent* (1837) 2 Y & C Ex 268, 295.

[113] This clause was commonly inserted in the deeds of settlement of insurance companies and became common at the end of the 18th century and beginning of the 19th century: Cooke (n 1) 87; see *Re European Assurance Society* (1875) 1 Ch D 307 (CA) and the cases cited therein.

[114] LCB Gower (n 28) 26.

[115] FG Kempin Jr, 'Limited Liability in Historical Perspective' (1960) 4 *American Business Law Association Bulletin* 11, 12–13; *Re Waterloo Life Assurance Co* (1864) 33 Beav 542.

[116] FW Maitland, 'The Unincorporate Body' in HAL Fisher (ed), *The Collected Papers of Frederic William Maitland*, vol 3 (Cambridge University Press, 1911) 278–79.

[117] *Waugh v Carver* (n 108) 525.

[118] See the discussion of the relatively short duration of unlimited liability in England in *Hansard* (HC 1854, 134) cols 752–60 (Mr Collier). Morley argues that shareholders of deed of settlement companies were only seen as partners from the 1820s. See J Morley, 'The Common Law Corporation: The Power of the Trust in Anglo-American Business History' (2016) 116 *Columbia Law Review* 2145, 2176. But see the discussion of authority

renewed enforcement of the Bubble Act by the courts[119] led deed of settlement companies to seek private acts of incorporation. Lord Eldon considered that the Bubble Act was drafted too badly to be useful, but an unincorporated body acting as a corporate body was an offence at common law.[120] The subsequent repeal of the Bubble Act in 1825 led to concerns from Lord Eldon and others that raising large sums of money by selling freely transferrable shares was usurping Crown and parliamentary privileges, and that another speculative bubble would ultimately burst, harming English interests. Joint Stock was linked with gambling mania and corruption, with that perception strengthened by a market crash in 1825.[121] Lord Eldon still considered raising sums by selling shares to be illegal, despite the repeal of the Bubble Act.[122]

The 1844 Joint Stock Companies Act was, therefore, introduced at a time when companies were still viewed with suspicion. The Report of the Select Committee set out various modes of deception adopted by deed of settlement companies. The Report argued for legislation that would tackle these practices.[123] The 1844 statute did not give the shareholders of the incorporated companies limited liability. Requirements such as minimum capitalisation and publicity, the two-stage registration process and enforcement difficulties meant that 76 per cent of companies were abandoned before completing the second stage of registration in the period the Act was in force between 1844 and 1856.[124]

One of the arguments in the 1850s debate leading to statutory limited liability was that statutory limited liability would put partners in private partnerships (deed of settlement companies) in the same legal position as partners in public partnerships – the term then used for incorporated statutory corporations. Robert Lowe, the architect of the facilitative Joint Stock Companies Act 1856, reprobated the state of the law, saying that it would have been better if *Waugh v Carver* had been decided the other way.[125]

The US experience provided a potential model for the inclusion of limited liability in the Companies Act 1862.[126] Legislators to varying extents had drawn on the US experience when the Limited Liability Act 1855 was drafted.[127] Also, many legislators were aware of the

by Televantos (n 85) 43–46, which refutes this assertion.

[119] *R v Dodd* (1808) 9 East 516, 103 ER 670 (KB). See the discussion in CA Cooke, *Corporation, Trust and Company: An Essay in Legal History* (Harvard University Press 1951) 97–99.

[120] *Kinder v Taylor* (1824–1826) LJR Ch 68, cited in Cooke (n 1) 99, and see the discussion ibid 99–102.

[121] Televantos (n 85) 39–42.

[122] *Kinder v Taylor* (n 119), citing Cooke (n 1) 99–102.

[123] The Gladstone Committee, *First Report of the Select Committee on Joint Stock Companies; together with the Minutes of Evidence (taken in 1841 and 1843), Appendix, and Index* (HC 1844, (119-VII)) (communicated by the Commons to the Lords: HL 1844, (65-XX)).

[124] For discussion see Televantos (n 85) 43–44.

[125] *Hansard* (HC 1856, 140) col 114. The statutory requirement that creditors be alerted to the limited liability of beneficiary shareholders is the origin of the use of the word 'limited' in English companies; there is no equivalent requirement in the United States, or in civil law jurisdictions. The reason for the divergence may be that the deed of settlement form did not exist in a significant way in the United States, and did not exist at all in civil law jurisdictions.

[126] FG Kempin Jr, 'Limited Liability in Historical Perspective' (1960) 4 *American Business Law Association Bulletin* 11, 14.

[127] *Hansard* (n 124) cols 2039–42.

competitive advantage forms of limited liability offered the commercial interests of the French[128] and the Americans.[129]

The concept that the corporation was akin to a trust holding a fund for creditors emerged early in the nineteenth century in the United States. In *Wood v Dummer*,[130] Justice Story stated:

> It appears to me very clear upon general principles, as well as the legislative intention, that the capital stock of banks is to be deemed a pledge or trust fund for the payment of the debts contracted by the bank. The public, as well as the legislature, have always supposed this to be a fund appropriated for such purpose. The individual stockholders are not liable for the debts of the bank in their private capacities. The charter relieves them from personal responsibility, and substitutes the capital stock in its stead.[131]

The trust fund doctrine was one of the legal developments that facilitated the legal separation of the Corporate Fund in the corporation from shareholders in the United States and the revival (if it had ever truly gone away) of the *persona ficta* corporation.

> Ironically the effect of the trust fund doctrine in effecting that separation led to its eventual effective demise by the early twentieth century with the separate identity of the corporation where the corporation held its property like any individual stressed by contemporary writers. The residual place of the doctrine was only in insolvency when the distinct corporate identity disappeared.[132]

By the end of the 19th century a similar process had taken place in England. The revival of the *persona ficta* corporation took place despite the mid-Century general incorporation statutes embodying liberal principles of freedom of contract and unlimited association, with companies incorporated through the registration process in the Companies Act 1862 understood by drafters of the legislation to be based on an association of shareholders as a continuation of the private partnership deed of settlement form.[133] In England the Companies Act 1862 was called the accountants friend because of the requirement to keep accounts that identified the capital of the company at every point of the life cycle of the company. That requirement was inevitable because limited liability of shareholders meant that creditors' interests were in the Corporate Fund As the century progressed the Courts increasingly viewed capital as the property of the company.[134]

The association of shareholders on which the Companies Act 1862 was based did not survive in practice. What the enactors failed to learn from history was that the motivation for

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128 In the limited partnership called *partnership en commandite*.
129 *Hansard* (n 124) col 2040.
130 *Wood v Dummer* 30 F Cas 435 (1st Cir 1824).
131 ibid.
132 H Hovenkamp, *Enterprise and American Law: 1836–1957* (Harvard University Press 1991) 55, discussing SD Thompson, *Commentaries on the Law of Private Corporations*, 2nd edn (The Bobbs-Merrill Company, 1909) 29, 33, 34.
133 Susan Watson, *The Making of the Modern Company* (Hart Publishing 2022) ch 12 'The Transition to the Modern Company in England' 171–98.
134 *Re Exchange Banking Co* (1882) LR 21 Ch D 519 (CA); *Imperial Hydropathic Hotel Co, Blackpool v Hampson* (1882) 23 Ch D 1 (CA), where Lord Jessel MR analysed the requirements of the Companies Act 1862 by referencing corporations' law and municipal corporations.

incorporation was not an association of persons, but a combination of their capitals. As CA Cooke, writing in 1951 pointed out:

> The importance of the double entry system of keeping books lies not in its arithmetic, but in its metaphysics. To create a capital fund which can be shown as in debit or in credit towards its owners was to do the same thing in terms of finance that the lawyers did in terms of law. The lawyers created, for essentially practical purposes, the legal entity of the corporation, a legal person separate and distinct from its members, linked with them by rights and duties. The business men created the financial entity of the business, a fund separate and distinct from its subscribers, linked with them by debits and credits. The most common corporate form of the twentieth century, the [modern] company, is descended from these two inventions.[135]

For that reason by the end of the 19th century, the House of Lords upheld the separate legal entity of Salomon & Co Ltd despite the clear flouting of s 6 of the Companies Act 1862 requiring an association of shareholders.[136] Through the incorporation process investing shareholders were granted not just limited liability to the company but the separation of their capital in the *persona ficta* as the Corporate Fund. Shareholders were protected from all forms of liability beyond the amount subscribed for including any externalities the company caused as it operated in the world. The corporate entity was freed to grow value for the ultimate benefit of investing shareholders.

Conclusion

Comparatively little is written about how the financial aspects of the modern company shaped its legal form. The key characteristic of Joint Stock Companies and early business corporations sought by investing shareholders was not the coordination of men, but the combining in the holding of shares in a Joint Stock or Corporate Fund: 'the joint stock fund subscribed for by the members was the very essence of their association'.[137] These combinations of capitals, the Corporate Fund, were separated from investing shareholders legally and for accounting purposes in trusts and in incorporated companies. Once early chartered business corporations were granted permanent capital, accounting and legal separation of the Corporate Fund through the adoption of the *persona ficta* form was achieved. The foundations of shareholder capitalism were in place.

The ingenuity of the creation of contractual deed of settlement form where the Corporate Fund was settled on a trust could not ultimately overcome the consistent unwillingness of the Courts to treat the form as other than a partnership at common law. General incorporation was viewed by the drafters of the statutes as incorporation of the contractual form based on shareholders. But as demonstrated in this paper throughout its history an associative relationship between

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135 Cooke (n 1) 185. Cooke does not recognise that the modern company form existed in the earlier business corporations like the English East India Company.

136 *Salomon v Salomon & Co Ltd* [1897] AC 22; Susan Watson, 'How the Company Became an Entity: A New Understanding of Corporate Law' (2015) *2 Journal of Business Law* 120.

137 CA Cooke states that 'the joint stock fund subscribed for by the members was the very essence of their association': Cooke (n 1) 142.

shareholders was not what shareholders sought. By the end of the 19th Century, the modern company, like the earlier business corporation, was separate for legal and accounting purposes from its shareholders. Those companies were juridical persons meaning by the end of the 19^{th} century the form was more similar to early business corporations than contractual deed of settlement companies

As most recently affirmed in *Sequana,* the modern company is a separate legal entity from its shareholders. The modern company is not itself a nexus of contracts although as a legal person it can contract. As a consequence of the State-facilitated incorporation process, the modern company most significantly is an entity fuelled by a Corporate Fund entirely separated from shareholders for liability purposes that is operated for the ultimate benefit of those investing shareholders.

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