HOW THE CORPORATION CONQUERED JOHN BULL

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INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP AND BUSINESS ORGANIZATION 1720-1844. By *Ron Harris*. Cambridge: Cambridge University Press. 2000. Pp. xvi, 331. Cloth, $60.

This is a study of the evolution of the forms of business organization during the industrial revolution. Historians never fully agree about anything at all, and often with good reason, but there is really no doubt that the period covered by this book is one that saw major changes in agricultural and industrial production, and in commercial practice and organization. It is convenient to refer broadly to the changes which took place in terms of a revolution, industrial, agricultural, or less commonly, commercial in nature.

Long before the starting date for this study, which is the date of the Bubble Act of 1720, there had existed firms of one kind or another, which had engaged in production, commerce, and consumption. The oldest form taken by the firm is the family. There existed in medieval and early modern England numerous other important legally recognized associations or collectivities, such as households, guilds, colleges, universities, Inns of Court and Inns of Chancery, convents, cities, boroughs and charitable foundations, such as hospitals. The typical form of association employed for business purposes was the partnership. But in the course of the sixteenth and seventeenth centuries, the institution of the corporation, which was conceived to possess a personality distinct from that of its members, and which had evolved outside the commercial world, came to be employed for business purposes.

In the same period the Court of Chancery invented the conception of the trust, an institution to some degree modeled on the earlier medieval institution of the use. In origin quite unconnected with the commercial world, the trust could, potentially, be adapted for use in the commercial field, though this development was not to take place until the eighteenth century.

The main emphasis of Ron Harris's *Industrializing English Law: Entrepreneurship and Business Organization 1720-1844*[1] is on the

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forms of commercial group organization, some incorporated, some not, which were available to the business community after 1720, in particular during the industrial revolution. Harris provides a full chapter devoted to the pre-1720 business corporation, which was mainly associated with overseas trade and monopoly. Two distinct forms of business corporation evolved — the regulated corporation and the joint stock corporation. In the case of the regulated corporation, unlike the joint stock corporation, members of the company traded with their individual stock, and the company provided the infrastructure necessary to make the venture successful. It was possible for incorporation to depend upon prescription, but business corporations mainly came into existence by way of grant or concession from the state, operating either through a Crown charter or the issue of letters patent under the prerogative, or through an Act of Parliament to which the Crown assented. There existed no right to incorporation; incorporation came about as a consequence of negotiations between entrepreneurs and the Crown, and was a privilege. Most business activity was conducted by individual entrepreneurs or by entrepreneurs operating in partnership, not through business corporations.

At the end of the day, the winner was, of course, the joint stock corporation with limited liability. It supplanted the partnership as the typical form of business organization, differing from the partnership, in earlier times the dominant form, by possessing independent legal personality, transferable assets, limited liability, and an internal hierarchical management structure. Associated with the rise of the joint stock corporation was the evolution of organized markets in which stock could be traded, along with government bonds. A school of thought attributes the triumph of such corporations over the partnership to their superior efficiency. As Harris points out (p. 22 n.19), this conception of efficiency is somewhat differently analyzed by lawyers, by economists, and by law and economics scholars, but all those who rely on the concept of efficiency as the basic tool of explanation present the modern corporate form as being "of phenomenal importance for the rise of modern industrial capitalism" (p. 23). It is thought to possess as dramatic an importance in Western history as "the discovery of America or the invention of the steam engine" (p. 23). So if you want to know how the West grew rich, and think it has something to do with the institutions of the law, study the invention of the modern corporate form of business organization.

Those devoted to universalizing the explanatory power of efficiency tend to present the historical process as driven by a sort of inevitability; other forms of business organization, which lose out in the process, resemble giraffes with medium-length necks, doomed, if they ever existed at all, not to make even cameo appearances on the Discovery Channel or amongst the wildebeest on the Serengeti Plains. Harris is an economic historian, and historians are by disposition un-

easy with historical inevitability. He also sets out to give an account of triumph of the joint stock corporation by combining insights derived from general historical writings, from the writings of economists and economic historians, and from legal historians. He has no inclination to write winners' history, but rather to explain a complicated process of evolution over time. He suspects that a belief in the driving force of efficiency, which for some odd reason triumphs only in the nineteenth century, though presumably it was around since the beginnings of time, does little by itself to illuminate a complicated story. At the same time he has no wish to neglect the importance of the concept, and is by no means uninterested, as many historians have been, in general theoretical explanations of historical change.

So his book opens with a valuable analysis of the literature that addresses the relationship, if there is one, between legal and economic development. Harris argues that, in the main, this literature adopts, to a greater or less degree, one of two contrasting paradigms or, in Max Weber's terms, relates explanation to two contrasting ideal types. According to one paradigm, the law and the legal system are viewed as relatively autonomous. Legal change, when it occurs, is managed by an elite group of professional lawyers, and in particular by the tiny coterie of judges. It is driven by the internal logic of the law, and is relatively unaffected by economic and social forces external to the law. An example of a body of law which, at least in its detailed ramifications, might seem obviously to fit this paradigm would be the bizarre "Rule in Shelley's Case."[2] According to this paradigm:

> [T]he Bubble Act, the common law, and legal hostility to the share market played significant parts in hindering the development of the joint-stock company for more than a century. After the passage of the Bubble Act, unincorporated joint stock companies were declared illegal by judges and their formation was harshly punished. Incorporation by the State was an expensive and complicated matter, granted only in exceptional cases. The legal framework was unresponsive to economic needs and delayed the progress of joint stock companies in England until well into the nineteenth century. (p. 4; footnotes omitted)

The ramifications of conceiving of the law in this way are various: for example, the legal elite is portrayed as isolated from commercial society, and ill-informed as to its needs and of the practice of the business community. Economic development is presented as coming about in spite of the law, or even, on occasions, outside the law entirely. There are indeed familiar examples of business practices that have evolved

2. Though, as I have argued elsewhere, that is only part of the story. *See* A.W.B. SIMPSON, LEADING CASES IN THE COMMON LAW 13-44 (1995) [hereinafter LEADING CASES IN THE COMMON LAW].

outside the common law; an example would be the early futures markets.[3]

According to an opposing paradigm, the law and the legal system are not viewed as autonomous, but rather as being reactive to external pressures and needs. When legal evolution was required by the business community, it swiftly occurred: "The law responded functionally to the economy and placed no restraints on growth during the industrial revolution" (pp. 5-6).

The law, according to this view, is not autonomous, but rather functional. The basic plausibility in this approach is obvious enough. After all, it was in England that the industrial revolution took place; by the mid-nineteenth century Britain had become the workshop of the world, and the first modern superpower. If an autonomous legal system, as postulated by the first paradigm, operated as a drag on development, how could such dramatic development have ever occurred?

A third possibility that Harris mentions but does not develop much at a theoretical level involves a compromise position (p. 7). According to this, the formal law is presented as indeed being autonomous, but the business community and their lawyers manipulated it, or even bypassed it entirely, so as to serve their needs. Law, according to this paradigm, is at the same time both autonomous and functional, but functional only because it is infinitely malleable. More radically, it could even be argued that according to this paradigm the forms of law, or at least of large areas of law, are simply irrelevant to economic development. Whatever the state of the law, the needs of the business community, or any other powerful social group, will be served. This way of looking at the matter is not unlike the claim, advanced by some writers wedded to the conception of economic efficiency, that efficient legal rules and institutions will drive out inefficient ones. The difference is that the claim is not so much that rules and institutions will change, but that they will be, in effect, distorted.

Harris's own position starts from the position that neither the autonomous paradigm, nor the functional paradigm can, by itself, satisfactorily explain the developments in the law of business organization in his period. The empirical evidence is incompatible with an analysis which fails to appreciate that law is both autonomous and functional or, to put it another way, that the autonomous character of law is in continuous tension with its functional character. So his aim is "to demonstrate the advantages of abandoning the poles and moving towards the center" (p. 8). Hence his interpretation "does not offer a simple and coherent thesis, as this cannot be supported by the complex nature of the interaction" (pp. 8-9).

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3. *See, e.g.*, A.W.B. Simpson, *The Origins of Futures Trading in the Liverpool Cotton Market*, *in* ESSAYS FOR PATRICK ATIYAH 179 (Peter Cane & Jane Stapleton eds., 1991).

In addition, Harris emphasizes, as do most empirical historians, the importance of "in economists' jargon path dependency, exogenous shocks, and contingency. Many historians have, in fact, been aware of such factors for quite a while, though without theorizing about them or giving them fancy labels" (p. 11). A book whose starting point is the Bubble Act of 1720 is bound to pay attention to exogenous shocks, for the passage of this Act took place at the time of the collapse of the share market known as the South Sea Bubble, and all serious historians attach some significance to contingency and happenstance. The conception of path dependency is employed throughout the study in the contention that where legal institutions end up is often conditioned by the position from which they began, or, as the point is put in one passage by "the historical burden" (p. 40). In reading Harris's introductory theoretical discussion I could not but be reminded of those brief passages in which Oliver Wendell Holmes set out, in epigrammatic form, his limited but seminal ideas on the nature of law and legal development, ideas which he was, sadly, unable to either develop or use himself. In his claim that the life of the law has not been logic, but experience,[4] he put his faith in the functional paradigm. But in the following passage he argued that: "The substance of the law at any given time pretty nearly corresponds, as far as it goes, with what it then understood to be convenient; but its form, and the degree to which it is able to work out desired results, depends very much upon its past."[5]

Harris, in his account of the evolution of business organization, emphasizes the importance of a factor not to be found in Holmes, which is the process which produces legal change. For a theme which runs through this book is that the legal situation of groups of entrepreneurs was, in this period, the product of conflict and negotiation between rival interest groups, mediated through a political process rather than a process of adjudication. In a sense, therefore, what is involved in this study is not so much the relationship between law and legal change and economic development, but between the political process and legal development.

In order to make his account of the developments after 1720 intelligible, Harris gives a brief account of group organizations as they existed in the late medieval and early modern period. In the sixteenth century, the corporation, which was not originally associated with the world of commerce, was adapted for commercial use, and Harris provides a full chapter devoted to the pre-1720 business corporation, which was mainly associated with the establishment of monopolies devoted to overseas trade. Incorporation could come about only through

4. OLIVER WENDELL HOLMES, THE COMMON LAW 5 (Mark DeWolfe Howe ed., Harvard Univ. Press 1963) (1881).

5. *Id.* at 6.

a Royal grant under the prerogative powers of the Crown, or through a legislative ad hoc Act of Parliament; there was no general legislation permitting groups of entrepreneurs to achieve incorporation so long as they satisfied conditions specified by general law and went through some formal process of registration. By the early eighteenth century, there existed a relatively small number of joint stock business corporations, such as the Hudson Bay Company, the South Sea Company, and the Bank of England, which had been formally incorporated. There had also evolved an active share market, dealing in the stock both of incorporated business companies, and of companies that had not been formally incorporated. A scheme was promoted whereby the South Sea Company was to take over the national debt, with government bonds converted into stock in the South Sea Company. The scheme ended in disaster with a catastrophic collapse of the market. The Bubble Act of 1720 made it a criminal offence for any undertaking to purport to act as a corporate body in raising or transferring stock unless it had been authorized by Royal Charter or Act of Parliament,[6] and was at one time generally explained as a reaction to the collapse of the South Sea Bubble. Harris, however, thinks this is incorrect. The Bubble Act was, in fact, promoted by the South Sea Company itself before the crash. But the context in which the Act was passed associated it with a suspicious and hostile attitude to operations by unincorporated companies, whose promotion was associated with fraud and the encouragement of wild and hazardous schemes, an attitude that long persisted, and that was combined with hostility to those who dealt in shares of such companies. But for a long time, the provisions in the Act which adopted a punitive attitude to unincorporated joint stock companies with transferable stock were a dead letter, and the criminal provision in the Act was only once invoked in this period.

In the period following the Bubble Act there was an important change in practice. The Crown adopted a restrictive policy toward the grant of new charters of incorporation. This left entrepreneurs with two alternative strategies. One was to employ forms of business association that did not involved incorporation. The other was to promote Acts of Parliament, known as Local and Personal Acts, under which they could enjoy the advantages of incorporation. This mechanism for incorporation depended for its validity upon the sovereign powers of Parliament, which could enact not only general legislation, but also particular legislation relating to a single person, as in the case of divorce Acts, or relating to a particular scheme of industrial or agricultural development.

So far as the first possibility is concerned, Harris gives a detailed account of the forms of unincorporated association which were on of-

6. The Bubble Act, 1720, 6 Geo., c. 18 (Eng.).

fer: in addition to family ownership and partnerships there were possibilities in the trust, employed in schemes of road improvement, for example, in the turnpike trusts, and outside the world of the common law there existed the system of ship ownership under the Court of Admiralty, and the system of cost book accounting operated by mining companies governed by the stannary law of the hard rock mining world, which was predominantly located in Cornwall. Given some ingenuity, entrepreneurs could operate as unincorporated companies, relying upon schemes that made use of normal contract law, of partnership law, and the trust.

In Part II of his book, Harris explores the relationship between economic and commercial development in particular fields and the forms of organization employed. Why was it that in the eighteenth century, after the invention of the joint stock corporation, forms of unincorporated business organization continued to be employed in some sectors of the economy, for example in insurance and in highway improvement, but not in others, such as in some other sectors of the transport industry, in particular the building of canals and the improvement of navigable rivers? Why the divergence? Why indeed did it take so long for the joint stock corporation, once invented, to achieve a dominant position? Was it that it was not in reality of superior efficiency? Or was it that the conditions in which it did possess superior efficiency simply did not exist in the eighteenth century? Or was it that there existed costs or other entry barriers associated with incorporation which were sufficiently serious to persuade entrepreneurs that it was preferable for them to operate through unincorporated forms?

Harris argues that the joint stock corporation as a form of organization had significant advantages over unincorporated forms, and that, at least in some sectors of the economy, the conditions in which it was superior existed in the period under consideration. But with the declining use of the Royal prerogative power to grant corporate status by charter, entrepreneurs had to rely upon private Acts of Parliament and this had the consequence of subjecting incorporation to political control. It was not the costs of promoting an Act that served as the impediment, for these were relatively modest, but rather the fact that the procedures involved gave an opportunity for rival interest groups to combine in an attempt to block the scheme. Thus, for example, existing insurance corporations, operating within a nationwide market, had an incentive to prevent a new group of entrepreneurs joining the club by securing a private act, and were able, by exploiting the political character of the parliamentary procedures, to make it extremely difficult for such an act to be obtained. But since no nationwide corporation engaging in river improvement existed, a group of entrepreneurs who promoted a new scheme for a particular river was not likely to encounter the same sort of opposition from vested interests. This

explains the divergence between the forms of organization typically used in these two sectors of the economy. There were numerous private acts for river improvement, but few in the world of insurance.

Harris does not rely solely on this explanation for divergences in the use of the corporate form. There were other explanatory factors involved; where production was organized in relatively small units operating in particular localities, the continuous interrelation between actors might encourage personal trust, thus making the advantages of the corporate form less important. In the course of the eighteenth and early nineteenth centuries, Parliament did not establish any clearly settled or general principles to guide itself in granting or refusing to grant incorporation by private act: "[N]o clear policy or general criteria existed for incorporation during much of the eighteenth and early nineteenth century [sic]. Incorporation was granted or refused on the basis of the level of opposition of conflicting vested interests" (p. 136).

But if there was no body of settled criteria, there were trends, and there was an important development, which was the outcome of political processes rather than of autonomous legal evolution. This was the progressive curtailment of the association between incorporation and monopoly — a target for the political economists. By 1833, when the Bank of England's monopoly in the issuing of notes was curtailed, this association had largely disappeared, so that a characteristic generally shared by approved schemes of incorporation was that they were not schemes involving the grant of legal monopoly powers. The joint stock corporation had become a mechanism for facilitating competition in a free market; in origin it had been a mechanism for the establishment of trading monopolies. Its economic function had been transformed.

Harris's general explanation is convincingly argued, but gives rise to a puzzle — why did the use of incorporation by charter under the prerogative decline in the eighteenth century? The process is an aspect of the steady rise in the conventional power of Parliament at the expense of the Crown, and the explanation for this essentially constitutional development largely lies outside the scope of this book. From a positive point of view, Harris's analysis of the evidence is part of a literature that emphasizes the central importance of the private bill as an instrument of economic development during the agricultural and industrial revolution.[7] There is a considerable body of writing on the history and functioning of private bill procedure; we still lack a general study.

In the early nineteenth century, the Bubble Act, whose somewhat obscure provisions had long lain dormant, was revived, and by now it was the received wisdom that the Bubble Act had been a reaction to

7. *See* LEADING CASES IN THE COMMON LAW, *supra* note 2, at 218-20. Important recent books of relevance are J. GETZLER, A HISTORY OF WATER RIGHTS AT COMMON LAW (2000), and R. W. KOSTAL, LAW AND ENGLISH RAILWAY CAPITALISM 1825-1875 (1994).

the ill deeds of promoters of fraudulent schemes, operating unlawfully perhaps even at common law. So the legality of unincorporated business companies became an issue in the courts. Harris attributes this revival to the rapid expansion in the number of unincorporated companies promoted in the late eighteenth century, and to the lack of stability in the market for shares that characterized the period. It became clear that the provisions of the Bubble Act were alive and well, and that at least some unincorporated companies were illegal. There was a speculative boom from 1824-1825, and in 1825 the Court of King's Bench held, in the case of *Josephs v. Peber*,[8] that the Equitable Loan Bank Company, which had opened its books for the sale of shares without waiting for incorporation under a private act, was illegal, so that a contract for the purchase of its shares was void. In *Kinder v. Taylor*,[9] (also 1825) the Lord Chancellor, Lord Eldon, expressed the view that the unincorporated Del Monte Company might well be illegal not only under the Bubble Act, but also at common law. During this period, the judges and the legal system they controlled swam against the commercial tide in the name of paternalism. The law, presented as an autonomous body of doctrine protective both of the royal prerogative and the unwary investor, appeared unresponsive to well-established business practice and to economic and commercial needs. Parliament responded by repealing the Bubble Act in 1825. The member of Parliament who introduced the first Bill for the repeal of the Act, Peter Moore, stated in the Commons:

> At present the law in respect to these companies was very obscure and ill-understood . . . . The necessity of settling a question of so much importance was placed beyond question, by the amount of capital which was daily investing in these speculations, and which [it] would be safe in estimating at upwards of 160 millions.[10]

Moore, as Harris shows, was himself much involved as an entrepreneur in the speculations of the period, and had a vested interest in the repeal of the Act, which was in any event brought about by a Bill promoted by the Attorney General John Copley[11] on behalf of the government of the day. Copley thought that the correct strategy was to relieve Parliament of the burden of controlling grants of incorporation through private bill procedure, and to revive the practice of relying on Crown Charters. Applications for charters would be monitored, under the supervision of the Law Officers. Under such a system incorporation retained the character of a privilege; entrepreneurs were not to enjoy a right to incorporation.

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8. 3 B. & C. 639 (1825).

9. L.J. O.S. Vol. III, Cases in Chancery 68.

10. P. 262 (citations omitted) (quoting 12 HANSFORD'S PARLIAMENTARY DEBATES 1279).

11. Later Lord Lyndhurst.

One of the characteristics of the modern joint stock corporation is the enjoyment of limited liability. In the case of partnerships, the limited partnership was only accepted in 1907;[12] the common law, unlike the legal systems of continental Europe did not recognize such an institution. There were, however, ways of providing for sleeping partners — one being to conceptualize them as lenders to the active partners, entitled to a share in the profits only in the form of interest on the loan, which might generate problems over the usury laws that limited interest rates. Another was to keep their identity a secret except to the active partners (pp. 29-31). The result was that the limited partnership did not play a significant role in business, though in the nature of things it may be difficult to know how much of a role it did play. The history of the association between incorporation and limited liability is both obscure and controversial, and Harris argues that the partial explanation for this "lies in the confused and inconsistent definition of limited liability by both contemporaries and historians" (p. 128).

Three different kinds of debt might be involved — debts of shareholders to the corporation, those of shareholders to third parties, and those of the corporation to third parties — and a number of different issues could arise and be separately answered. For example:

> Could shareholders, as such, be arrested for debts . . . and could they, alternatively or in addition, be liable to bankruptcy laws as far as debts were concerned? . . . Were shareholders liable for corporate debt only upon dissolution, or as soon as the unpaid debts were claimed? . . . Were shareholders liable only up to the sum of their paid-up capital? Could calls also be made for the unpaid balance of the shares they held in order to cover debts? (pp. 128-29)

In the course of the eighteenth century some of these issues were answered, so that for example ownership of shares in a business corporation did not turn a shareholder into a trader liable to bankruptcy proceedings. Occasionally, some aspect of limited liability was attached to a corporation under the terms of a private act, though Harris is not able to say how common this was. No doubt the matter deserves further investigation. But the general impression conveyed by the sources is that limitation of liability may not have seemed so important to early eighteenth century entrepreneurs as one might expect. One factor that operates today — the fear of extensive liability in tort law — hardly operated at all in this period. By the end of the eighteenth century, however, entrepreneurs, whether seeking incorporation by Royal charter or by Act of Parliament, regarded limited liability in one form or another as essential to success (p. 130). Harris does not really explain why this change came about, though he does note the cruel char-

12. By The Limited Partnership Act.

acter of contemporary law relating to debtors and bankrupts. By the early nineteenth century it came to be settled that limited liability attached automatically to corporations created by Royal charter, and it became common where incorporation was by private act to include a clause providing for it, though again Harris does not provide much in the way of detail as to the form of such clauses or their frequency. The whole subject needs further investigation, both to establish a narrative and to examine the significance of limited liability for economic development, since it seems that its recognition was not a prerequisite to the industrial revolution.

At the end of the period covered by this book, Parliamentary control over incorporation through private bill procedure was to be supplanted by the system of registration. Under this system, Parliament laid down the conditions under which any group of entrepreneurs could establish a business corporation not by negotiation with the Crown, and not through an essentially political process through private bill procedure, but by registration. Through registration they became subject to a scheme of regulation intended to provide members of the public with information which, it was supposed, would enable them to distinguish reliable companies from unreliable ones. In the concluding chapter of his book, Harris traces the steps by which this new approach to company formation came to be embodied in the Companies Act of 1844. It can be seen as part of a wider development, whereby a system under which the Parliamentary process was used to authorize or refuse authorization to particular entrepreneurial schemes, whether they were schemes for enclosures, for building docks, for constructing canals, or whatever, through a form of conflict resolution — each scheme being handled in isolation, was replaced by a system where Parliament settled on some general scheme of regulation that all entrepreneurs had access to and could be changed by subsequent general legislation based on experience. This change was part of a process that significantly altered the function of Parliament from a body primarily concerned with privately promoted legislation to one concerned with general legislation promoted by political parties.

Harris's study of the history of the forms of business association is an important one, written by an author with a mastery of a large body of literature, and always related to empirical evidence though continuously informed by a concern with theoretical issues. It is clearly written, and it is something of an achievement to have covered so wide a subject in a book of modest length. Like all good books it does not impose closure, but raises and suggests further lines of enquiry. It is a fine book that deserves a wide readership.